

Federal Reserve Interest Rate Increase



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The Federal Reserve raised interest rates by 0.75%. As a result, the prime rate is moving to 4.75%. This is the largest interest rate increase since 1994. When the Federal Reserve adjusts the interest rate it specifically refers to the federal funds target rate which is the rate commercial banks borrow and lend their extra reserves to one another. The federal funds rate is an important benchmark for interest rates in the US economy and has a large influence on global interest rates.

The Federal Reserve raises interest rates in an effort to oppose inflation. Inflation is caused by increased consumer demand for products. Raising interest rates will make products more expensive curbing consumer demand and slowing the economy.

When interest rates increase it makes it more expensive to borrow money. This means variable interest rates on loans (including new loans from your retirement plan), bonds, mortgages, and credit cards will increase resulting in higher monthly minimum payments. This change does not affect fixed rate debts set before the increase.

The rise in interest rates can also lead to increased earnings on saving accounts, money market accounts and certificate of deposits (CDs). Because it will be more expensive for banks to borrow money, the banks themselves are now in competition to increase their deposits from consumers.

As a consumer there are few things you can do during this period to make your money work harder.

1. Increase your savings. Research and take full advantage of interest bearing accounts with higher rates of return.
2. Reduce your debt. Pay-off variable rate debts as soon as possible or transfer balances to fixed interest rate.
3. Focus on long term investments. Don't panic at the volatile changes of interest rates. Continue deposits into your IRA or employer sponsored plan.

The Federal Reserve changes to interest rates can invoke fears, however knowing what these changes are and how they effect our economy will help you make better decisions for your money.



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