Key Questions

May 9, 2022

What Does the Fed's Rate Hike Mean for You?

Michelle Moore, Portfolio Analyst / Fixed Income Trader, KeyBank Investment Center

The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Expect your expenses to continue to increase across the board, but with strategic financial management, there can be positive results from the higher interest rates, which are expected to rise even more.

Last week, as he began his pre-scheduled press conference, Jerome Powell, chair of the Federal Reserve (the Fed), addressed the American public directly:

> **"Inflation is much too high. And we understand the hardship it is causing, and we're moving expeditiously to bring it back down. We have both the tools we need and the resolve that it will take to restore price stability."**

In other words, inflation is uncomfortably high. It is hurting both consumers and businesses, and the Fed is determined to bring it under control. In an attempt to do so, the Fed raised interest rates by 0.50%. Though rates still remain low on an absolute basis, the increase of 50 basis points was the largest in more than 20 years.

So what does this mean for you?

Impact on Borrowing Costs

Most notably, the Fed's increase means a rise in the rate that credit institutions charge consumers, adding to the squeeze that they are already feeling at the gas pump, grocery store or just in daily life. Higher borrowing costs will make financing cars and houses more expensive and will increase the expense of buying with credit cards. All this likely will slow the demand for goods and services, and slow the economy. If the Fed raises interest rates too much and the economy slows, a recession could result. For more insights on this concept, please read our recent Key Questions article: "What Could Fed Chair Powell Learn From a WWII Hero?"[1]

Economic Implications

In short, the Fed's rate hike will affect the economy in a variety of ways, including lending and borrowing costs, consumer spending, business profits, the stock market (which is slumping) and even the national debt, as the government's borrowing costs rise. And based on continued comments from the Fed, interest rates appear poised to move even higher. On the positive side, however, the initial rate bumps can prepare you for a trend toward higher rates, and you can take action early to adjust. Reducing debt, especially variable interest rate debt, is usually a sound strategy in this environment.

Key Takeaways

Consumers with adjustable-rate mortgages and home equity lines of credit should take a closer look at their financing options and consider moving to fixed-rate alternatives. Getting ahead of rising interest rates can save borrowers thousands of dollars.

Changes in credit card rates will follow the Fed's moves closely, so consumers can expect to pay more on any revolving debt. For people carrying debt, consider a zero percent balance transfer. This will protect you from the rate hikes that are expected over the next several months. It's also a way to get debt paid off for good without facing the hit of higher interest charges.

On the other hand, for savers and investors, higher rates are a good thing, because earnings should increase on savings vehicles and short-term, fixed income securities. This was an insight pointed out by my colleague Tim McDonough in his recent Key Questions article: "Should Bond Investors Be Buying Into a Bond Bear Market?"[2]

In sum, navigating the next several months as the Fed tries to tamp down inflationary pressures will require close attention and deft management by consumers and investors.

Unless you can pay cash, it may make sense to hold off on major purchases such as a home or a car. In this rising-rate environment, think twice before tapping into personal lines of credit and adding to your credit card debt. It also may be prudent to lock in fixed rates on variable-interest debt and revolving credit, if possible. If you can pay down or eliminate revolving debt or credit, even better!

But the economy is strong and as long as it remains so, rising rates could present positive opportunities, especially for investors. Now is a good time to consult your financial advisor to weigh these strategies and determine how they impact you.

For more information, please contact your advisor.

About the Author

Michelle Moore is a KPB Portfolio Analyst / Fixed Income Trader on the Taxable Trading Team within the KeyBank Investment Center. Michelle focuses on corporate bonds and brokered CDs. She has been trading for over 20 years and has worked on all sides of the desk from Equity Trading to Tax-Free bonds. Prior to becoming a trader, Michelle was an Office Administrator in a local branch office for a large brokerage firm.

1 https://www.key.com/kpb/our-insights/articles/what-could-fed-learn.jsp
2 https://www.key.com/kpb/our-insights/articles/buying-into-bond-bear-market.jsp

210714-1142677-1232741135