A Hike in Federal Interest Rates Has Downstream Consumer Impacts

Over the last few years, the Federal Reserve (Fed) has steadily increased the federal funds rate, usually by 25 basis points. These increases ultimately lead to higher interest rates on a variety of financial products, from student loans to home mortgages. With the Fed poised to raise interest rates another two or three times this year, consumers are starting to see the impacts of higher rates materialize.

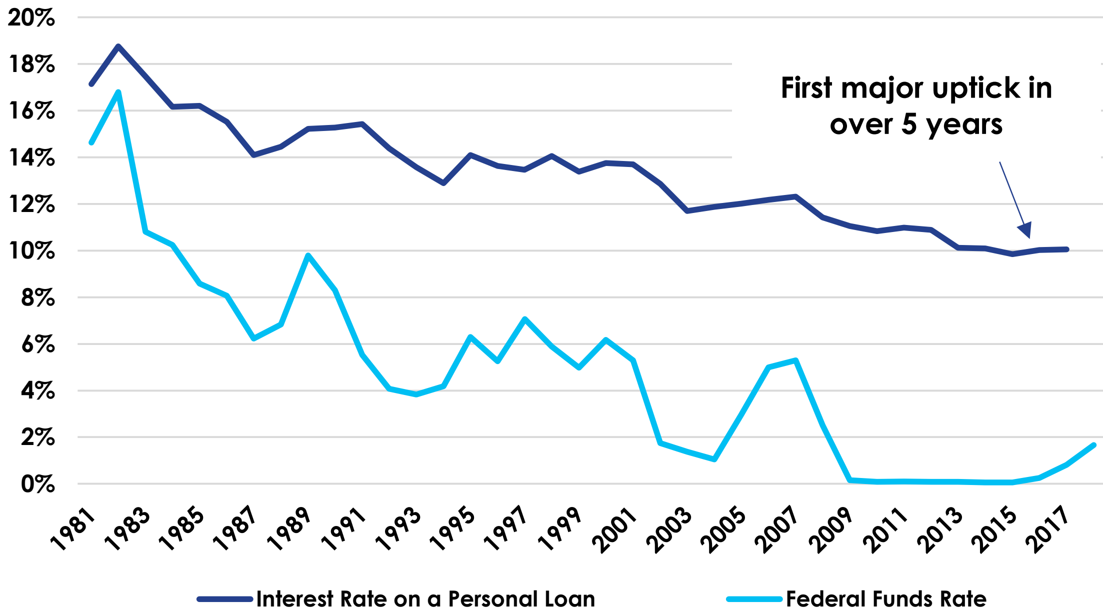
The federal funds rate is the central interest rate in U.S. financial markets, playing an important role in our economy and markets. It also influences rates downstream, including the rate banks charge their customers for financial products such as personal loans and home mortgages, among others. When the Fed changes rates, consumers usually feel a ripple effect in the financial products they regularly use.

Two years after the Fed began raising rates, the impact and cost to consumers is starting to materialize. For example, a mortgage holder with a five-year adjustable rate, which is modified on an annual basis, could end up paying an additional $1,250 a year in interest due to the 0.25 percentage point increase in the rate back in March. Two additional 0.25 percentage point increases, as projected, could cost that same mortgage holder an additional $3,750 a year in interest alone. Consumers taking out new loans will feel the hike as well. Those seeking auto loans, adjustable-rate mortgages, and other loans may also see higher interest rates as a result.

At the same time, there is no guarantee that the higher interest rates will translate to significantly higher rates in bank accounts. Savers may see small increases in how much a bank is willing to pay them to park their money in a regular savings account. Since bottoming out at 0.06 percent in the third quarter of 2013, interest rates on savings accounts barely budged, leaving few options for safe and consistent returns. Other saving vehicles, such as CDs, have followed the same trend as well, ticking up to 0.38 percent for a 12-month CD but failing to keep up with rate hikes.

However many rate hikes the Fed moves forward with, one thing is for sure: consumers will start seeing the impact on financial products sooner rather than later.

Rising Rates Could Increase Cost for Consumers



Source: Board of Governors of the Federal Reserve System.
Note: Data is not seasonally adjusted, end of period quarterly data. Personal loan rate is for loans less than $100,000 at commercial banks.