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MONEY

What the Fed’s Rate Hike Means for Savings Rates, Mortgages and More

How to take advantage as higher interest rates ripple through the economy

The Fed has been raising interest rates to fight inflation. iStockphoto/ Buy Side from WSJ Photo Illustration

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By Tanza Loudenback

The Federal Reserve just took another big step toward fighting inflation. And whether you’re a borrower, saver or investor, the move could have a big impact on your money.

At its meeting on Wednesday, the central bank announced a **0.75 percentage-point hike** to the federal-funds rate. It’s the sixth rate increase so far this year. It brings the target for the benchmark to a range of between 3.75% and 4%. Officials also signaled more increases could come later this year.

While the Fed doesn't directly influence consumer interest rates, **its moves tend to ripple through the economy**. By making borrowing more expensive, policy makers hope to dampen consumer spending, eventually bringing inflation—which remained **above 8% in September**—under control.

Of course, the trick will be to accomplish this without throwing the economy into recession. "The question is whether or not the interest rate hikes are gonna be successful in creating what's called the **soft landing**," says Jill Fopiano, chief executive of O'Brien Wealth Partners in Boston.

Meanwhile higher interest rates could spell trouble in your 401(k), and if you are shopping for a mortgage or carrying credit card debt you will likely pay more. On the other hand, if you have a savings account or CD, that dynamic should work in your favor, meaning newly generous payouts. Here's what the latest interest rate hike means for your money if:

You have high-yield savings account or CD

What to expect: More generous rates

Rates on some savings accounts have ramped up. While the national average annual percentage yield, or APY, on savings accounts is just 0.21%, according to the Federal Deposit Insurance Corporation, you can find **markedly higher rates** at startup banks or credit unions, Fopiano says.

Online banks including Ally and SoFi are paying 2.5% or higher on deposits in September, with low or no minimum balance requirements.

Rates on certificates of deposit, or CDs, from online banks are in the 2% to 3% range. CDs pay more because you give up access to your money for a year or more. Usually the longer the term, the more interest you earn.

But the spread between one-year and five-year CDs isn't impressive right now, says Richard Barrington, financial analyst for Credit Sesame, a company that provides free credit monitoring and debt payoff recommendations.

"There's reason to believe that rates have further to rise," he says. The best move if you're craving more interest than a traditional savings account can give is to buy a short-term CD and then re-evaluate rate offers in a year or two. "You don't want to lock yourself in for too long because you'd be locking yourself into a subpar rate."

You're a stock market investor

What to expect: More turbulence ahead

"This has obviously been a rough year for investors," says Barrington. Rising interest rates have hurt stocks—the S&P 500 **fell by 17%** from January to September—bonds, and even cryptocurrency, he says,

contributing to U.S. households losing a collective **$6 trillion** in wealth in the second quarter.

Higher interest rates make it more expensive for companies to borrow—just like they do for consumers. That makes it more expensive to hire and invest in new products, crimping growth prospects and hurting stock values. Then, of course, there's also the possibility that the Fed's dramatic moves will simply spook investors.

Despite **jitters investors may feel**, experts say stock investors should tune out rate hikes. Your time horizon as a stock market investor should be **at least three years**, and preferably much longer, giving you plenty of time to ride out a rate hike, and even a full-blown recession.

"As a general rule, I would say you don't want to make drastic decisions due to market conditions because they don't remain constant," says Fopiano. "Staying invested will be your most likely way to build wealth going forward."

If you do want to make a move, think about buying rather than selling, says Barrington. With markets down this year, there are plenty of great stocks trading at discounts. "I think the main thing is just don't expect quick results, because as long as interest rates are rising, it creates a headwind for investments," he says.

Take a beat to go over your retirement investment plan too, adds Barrington. **Inflation assumptions** that guide how much you should be saving to cover your future retirement expenses may now be too low in light of the rapidly rising cost of living.

You're buying a home—or have a floating-rate mortgage

What to expect: Get ready to pay more

The Fed doesn't directly set mortgage rates when it adjusts the federal-funds rate, but the two **usually move in the same direction** in response to shifts in the economy.

With the central bank aggressively fighting inflation, rates on the most common type of mortgage, the 30-year fixed-rate loan, have doubled in the last year to **more than 7%**. That means today's buyers are facing much larger homeownership costs—and **may need to work harder** to get a rate that fits their budget. The monthly mortgage payment on the median-priced home rose 48%, to $2,452, from a year ago, according to real estate platform Redfin.

Not only has the increase in mortgage rates **slowed new home buying** activity, but it has "stifled almost all refinancing activity," Barrington says.

"There are several reasons to refinance a mortgage and it's something that can give you some financial flexibility, but those reasons don't make a lot of sense if refinancing involves sharply raising your interest

rate," he says.

Borrowers with variable-rate loans, such as a home equity line of credit or adjustable-rate mortgage, could be in for a shock. Unlike fixed loans, where the interest rates remain the same for possibly decades, most ARMs have a fixed interest rate for the first five or seven years before adjusting annually. HELOCs have variable interest rates from the get-go, much like credit cards.

In a rising-rate environment, monthly payments can increase drastically on variable-rate loans (though there are annual and lifetime rate caps). "It's really important to understand when and at what levels your variable-rate mortgage starts to float," Fopiano says. Prepare to pay more, or work out a strategy to refinance to a fixed-rate option if it'll save you money in the long run.

You have credit card debt

What to expect: A potentially difficult situation, especially if you credit history is imperfect

As inflation continues to drive up the cost of everyday items, more people are using credit cards as a stopgap, Barrington says. Meanwhile, credit cards are charging **record-high interest rates** between 18% and 25%.

WalletHub **estimates** that the Fed's series of rate hikes this year will cost borrowers almost $21 billion more than if interest rates stayed near zero.

The immediate financial squeeze for borrowers is one issue, but Barrington says many are seeing their credit scores take a hit because they're using more of their available credit and missing payments. A Credit Sesame survey revealed that 1 in 6 Americans experienced a credit score decrease between May 2021 and May 2022. Situations like this can turn into a never-ending struggle: The lower your credit score, the higher your interest rate, the more expensive the debt becomes.

"To the extent people are suffering credit damage," Barrington says, "that's going to exacerbate the problem because they're going to pay rates that are at the higher ends of the range."

If you don't have the cash to pay off your debt in full, consider a balance transfer card with a low or zero interest rate offer, says Fopiano. Just make sure you know exactly when the "teaser" period ends, she adds, and make a plan to pay off your balance before the rate jumps back up.

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