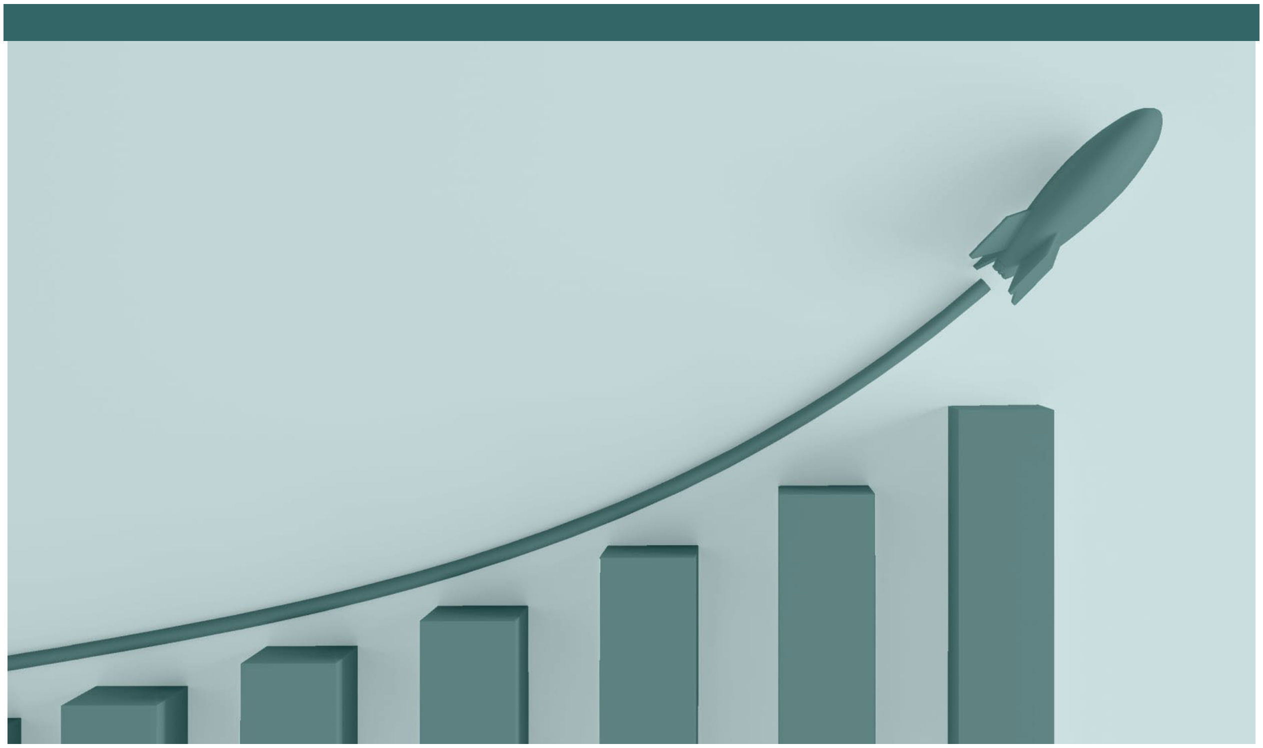
What the Fed’s Inflation Fight Means for Investors, Home Buyers and Savers

How higher interest rates are rippling through the economy



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

Updated Nov. 1, 2023 1:35 pm ET

By Tanza Loudenback

For nearly two years, the Federal Reserve has been aggressively fighting inflation. And whether you’re a borrower, saver or investor, that fight continues to have an impact on your money.

At **recent meetings**, the central bank decided to hold the federal-funds rate steady at a target range of between 5.25% and 5.50%. Before this year, rates hadn’t been so high since June 2006.

While the Fed doesn’t directly set consumer interest rates, its moves tend to ripple through the economy. Since March 2022, when the Fed began its aggressive campaign to tame inflation by making borrowing more expensive, there have been 11 rate increases.

In 2022, the question was whether the Fed would be able to raise interest rates without throwing the economy into a **recession**. “The Fed has been somewhat successful in engineering a ‘soft landing,’” says Jill Fopiano, chief executive of O’Brien Wealth Partners in Boston, adding that while **inflation** has dropped from its June 2022 peak, it’s still above the Fed’s long-term target of 2%.

"From their forward guidance, it seems that the Fed may hike one more time in 2023, and that they will be in no great hurry to cut rates in 2024," Fopiano says.

Meanwhile, higher interest rates could be causing 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, thanks to generous payouts.

Here's what the latest interest rate increase means for your money if:

You have a 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 0.45%, according to the Federal Deposit Insurance Corp., you can find **markedly higher rates** at startup banks or credit unions, Fopiano says.

Some banks, especially those that operate primarily online, are **paying 5% or more on savings** account deposits, with low or no minimum balance requirements.

Rates on certificates of deposit, or CDs, from online banks are in the 5% to 6% range. CDs pay more because you give up access to your money for at least a few months and sometimes as long as five years.

"Normally, long-term rates would be higher than short-term rates to compensate depositors for committing their money for a longer time," says Richard Barrington, financial analyst for Credit Sesame, a company that provides free credit monitoring and debt payoff recommendations. However, that's not the case right now.

"CD yields generally still don't reflect the inflation rate, and long-term CD rates are a particular problem," 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 when the term expires. "One year seems to be the sweet spot right now," Barrington says. "No matter what maturity you choose, be sure to shop around for CD rates."

You're a stock market investor

What to expect: More turbulence ahead

As of Oct. 31, the S&P 500 was up **about 8.5%** year to date, meaning you've probably seen a bump in your 401(k) balance. But stock gains haven't been widespread or consistent enough to indicate a full recovery since the market peaked in early 2022. The latest rally was led by **a few**

very large tech stocks, Barrington says. It’s a sign investors should take a step back and look at the bigger picture.

“If you’ve had a few hot stocks in your portfolio, that’s great,” he says, “but now might be a good time to pare back some of those positions and rebalance into more reasonably-priced sectors. The more a portfolio’s performance is dominated by a few hot stocks, the less effectively diversified it becomes.”

That said, no portfolio is immune to the effects of rising inflation and rates. Higher interest rates make it more expensive for companies to borrow—just as they do for consumers. That makes it more expensive to hire and invest in new products, crimping growth prospects and hurting stock values. Then, there’s also the possibility that the Fed’s moves will simply spook investors.

Despite **jitters investors may feel**, experts say stock investors should tune out rate moves. 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.”

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 cost of living increases.

“Many people have wondered if the current level of inflation is going to be the new normal,” he says. “Until something changes to drive inflation lower, consumers would be wise to get used to it.”

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

What to expect: Higher monthly payments

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

With the central bank aggressively fighting inflation, the average rate on a **30-year fixed-rate mortgage**—the most common type of home loan—has risen sharply to **nearly 8%**. While that’s more than double the average rate of two years ago, Barrington says it’s within striking distance of historical norms.

Still, today’s buyers are facing rising homeownership costs—and may need to consider alternative strategies, **such as a shorter loan term**, to get a rate that fits their budget. The monthly mortgage payment on a median-priced home is about **10% higher** than a year ago, or $2,736, according to real-estate brokerage Redfin.

“Since neither mortgage rates nor home prices are a particular bargain right now, the best advice for would-be buyers is to take some extra time to **build up a bigger down payment** and work on your credit score,” Barrington says.

Homeowners with variable-rate loans, such as a **home equity line of credit** or **adjustable-rate mortgage**, could also 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 will save you money in the long run.

You have credit card debt

What to expect:

Tougher lending requirements

As inflation continues to drive up the cost of everyday items, more people are using credit cards as a stopgap, Barrington says. Meanwhile, banks are charging **record-high interest rates**. For accounts accruing interest, the average is nearly 23%, according to LendingTree.

The immediate financial squeeze of high interest payments for borrowers is one issue, but Barrington says many have seen their credit scores take a hit because they are using more of their **available credit** and missing payments. Rates of delinquency—when an account is 60 days or more past due—**are on the rise**, especially among young borrowers.

In response to those behaviors and overall economic uncertainty, many banks are **reporting tighter lending standards** for credit cards, making it harder for people with “mediocre-to-poor credit scores” to access affordable borrowing, Barrington says.

Situations such as this can turn into a never-ending struggle: The lower your credit score, the higher your interest rate, the more expensive the debt becomes. 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.