The Federal Reserve Raises Interest Rates as Inflation Soars

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As food, gasoline and and utilities continue to rise, the Federal Reserve recently boosted interest rates by 0.75 percentage points to ostensibly tame soaring inflation by making it more difficult to borrow and buy things like homes and cars. More than 8 million American renters, which amounts to 15% of renters, are late on paying their rent after getting deferrals due to COVID in 2020. Mortgage rates have already surged in response to the Fed's rate increases this year. The average 30-year mortgage stood at 5.23% on June 9, according to Freddie Mac. That's up from 2.96% a year earlier. Higher interest rates have raised payments on medium-priced homes by over $600 a month. Average credit card interest rates have topped 20%. The Federal Reserve is the cause of the problems and intends to raise rates again by .75 points again in July.

Earlier this year, the Federal Reserve turned to its most potent weapon — raising interest rates — to combat soaring inflation. But with consumer prices having only accelerated since then, the central bank boosted rates by 0.75 percentage point on Wednesday — its largest hike since 1994 — to try to tame the nation's fiercest bout with inflation in 40 years.

The rate hike follows the announcements of a 0.25 percentage point hike in March and a 0.5 percentage point move in May — with the latter marking the sharpest increase since 2000.

The Fed had earlier been expected to boost rates by a more modest 0.5 percentage point, but the bank opted for a larger hike after the Consumer Price Index, a broad basket of goods and services used to track inflation, surged 8.6% in May, from an 8.3% annual rate in April. Gasoline prices have continued to hit new highs almost daily amid depleted domestic production and Russia's war in Ukraine, while food and housing costs are also surging.

The idea behind the Fed's rate hike is to make it costlier to borrow money, which in theory should tamp demand for purchases that require borrowing, like home buying or buying items with credit cards. With the latest rate increase, consumers and businesses should brace themselves for a hit to their wallet, experts say.

"The cost of borrowing is becoming more expensive, particularly for those with variable rate products," said Mark Hamrick, senior economic analyst at Bankrate. "Fortunately, on the other side of the rate equation, returns on savings will likely be improving, particularly for those who investigate more generous high-yield savings options."

By year-end, the federal funds rate — the rate that determines borrowing between banks — could be almost twice as high as its pre-pandemic level of about 2%, according to forecasts.

"It was just a few weeks ago that investors were forecasting the funds rate to be ~2.58% at the end of this year, but that number is now more than 100 [basis points] higher at 3.7%," analyst Adam Crisafulli of Vital Knowledge told clients in a research note. "And the 'terminal' funds rate (the level at which the Fed will stop hiking this cycle) is now seen north of 4%."

Here's what the Fed jacking up interest rates could mean for your wallet.

What will the rate hike cost you?

Every 0.25 percentage point increase in the Fed's benchmark interest rate translates to an extra $25 a year in interest on $10,000 in debt. So Wednesday's 0.75 percentage point increase means an extra $75 of interest for every $10,000 in debt.

Economists expect the Fed will continue to raise rates throughout the year as it battles inflation. Some analysts now forecast the central bank will announce another 0.75 percentage point increase in July, followed by two 0.5 percentage point hikes in September and November.

By early 2023, the federal funds rate could be 3.75% to 4%, according to TD Macro. That implies a rate increase of at least 2.75 percentage points higher than the current federal funds rate of 1%. For consumers, that means they could pay an additional $275 in interest for every $10,000 in debt.

How could it impact the stock market?

The stock market has slumped this year amid various headwinds, including the impact of high inflation and the Fed's monetary tightening. But a bigger-than-expected interest rate increase on Wednesday "could be welcomed by stocks," Crisafulli said before the rate hike was announced.

“It would represent a powerful signal by [Fed Chair Jerome Powell], help the Fed recapture control of the policy narrative and clamp down on the massive change in tightening forecasts,” he noted.

The S&P 500 rose 15 points, or 0.4%, to 3,750 on Wednesday.

Credit cards, home equity lines of credit

Credit card debt will become more expensive, with higher APRs hitting borrowers within one or two billing cycles after the Fed’s announcement, according to LendingTree credit expert Matt Schulz. For instance, after the Fed’s March hike, interest rates for credit cards increased for three-quarters of the 200 cards that Schulz reviews every month.

Consumers with balances may want to consider a 0% balance transfer credit card or a low-interest personal loan, Schulz said. Consumers can also ask their credit card companies for a lower rate, which research has shown is frequently successful.

Credit with adjustable rates may also see an impact, including home equity lines of credit and adjustable-rate mortgages, which are based on the prime rate.

What’s the impact on mortgage rates?

Mortgage rates have already surged in response to the Fed’s rate increases this year. The average 30-year mortgage stood at 5.23% on June 9, according to Freddie Mac. That’s up from 2.96% a year earlier.

That is adding thousands to the annual cost of buying a property. For instance, a purchaser buying a $250,000 home with a 30-year fixed loan would pay about $3,600 more per year compared with what they would have paid a year earlier.

The Fed’s newest rate hike might already be baked into current mortgage rates, said Jacob Channel, senior economic analyst for LendingTree, in an email.

“The Fed’s rate hike may not mean that mortgage rates are going to significantly increase,” he noted.

The housing market reflects one part of the economy where the Fed’s rate increases are slowing demand. Channel added: “These high rates have significantly dampened borrower desire to refinance current loans, and they’re also showing signs of reducing demand for purchase mortgages as well.”

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