The Federal Reserve & Your Wealth Plan: How Does This Impact You?

The Federal Reserve raised the Federal Funds rate .75% on June 15, 2022 and is expected to make numerous, additional rate increases this year. The previous increases made on both March 15th and May 4th were highly anticipated by financial experts, covered extensively across various news outlets, and may signal a future impact for your wealth plan. Defining the Federal Funds rate and examining its policy history may provide the opportunity to best understand what future rate increases may mean for you and your wealth plan.

What is the Federal Funds rate and its policy history?

The Federal Funds rate is the target interest rate set by the Federal Open Market Committee (FOMC). The FOMC is the designated policymaking arm of the Federal Reserve. The Federal Funds rate is the rate commercial banks borrow at and lend excess reserves within the banking system on an overnight basis. Banks generally must maintain a minimum balance at the Federal Reserve and may lend to one another to meet Federal Reserve requirements. The Federal Funds rate is the interest rate applied to these transactions.

Historically, the Federal Funds rate has fluctuated depending upon economic indicators such as unemployment and inflation. The rate reached its highest level of 21% in June 1981 and has been reduced to as low of a range as 0%-0.25%, most recently due to the Coronavirus pandemic. Although the FOMC rate increases are usually in .25% increments, larger increases are possible. The last increase greater than .25% was a .50% increase in May 2000.

Because the Federal Funds rate is a determinant in what interest rate banks borrow capital, it may influence various bank solutions consumers may utilize for business and personal growth. The following is how future Federal Funds rate increases may affect bank strategies commonly utilized in your wealth plan.

- **Deposits** – Typical cash strategies include deposits made into interest bearing checking, money market, and savings offered by banking institutions. Interest rates for these strategies will directionally follow the Federal Funds rate. Traditional cash strategies are important for a strong wealth plan as they provide immediate liquidity for cash flow, the creation and maintenance of an emergency fund, and access for lifestyle purchases (such as the payment of credit cards, purchase of a vacation home or vehicle, and other obligations). Cash strategies should be balanced with other investment options to maintain pace with inflation and target lifestyle goals and objectives. Remember, cash yields have historically never kept up with inflation. In turn, the value of a cash strategy is primarily the liquidity it provides since the strategy itself will slowly lose purchasing power over time.

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- **Mortgages** – Mortgage rates are set based upon the yield of the ten-year Treasury note not the Federal Funds rate. Mortgage rates have begun to trend higher due to the fact that ten-year Treasury note yields have also recently increased. Treasury rates are not tied to the Federal Funds rate but are influenced by a variety of factors including how investors expect the Federal Reserve to react to inflation. Continued monitoring of the housing market regarding inventory, desired property location, and the ten-year Treasury note value will provide a better predictor of future mortgage rates then the Federal Funds rate.

- **Credit Cards** – Depending upon credit card terms, future increases to the Federal Funds rate may impact a credit card's annual percentage rate (APR). As part of your wealth plan, it is prudent to review any credit card obligations and if rates increase, determine if debt reduction or restructure is sensible.

- **Student Loans** – Like mortgages, the interest rate for federal student loans is set according to the 10-year Treasury note. Federal student loan interest rates are set every May and are in place for the current academic year. Private education loans may be affected by changes to the Federal Funds rate depending upon their terms and structure.

- **Variable Loans** – Like private student loans, variable lending agreements, such as a Securities Based Line of Credit (SBLs) and a Home Equity Line of Credit (HELOCs), may be affected by an increase to the Federal Funds rate. A review of terms and a discussion with your Wealth Advisor may be judicious in determining next steps regarding credit planning.

Conclusion

Future FOMC action will have a varying effect on the strategies mentioned above. Bank savings vehicles have different term and distribution permissibility based upon time horizon and access needs, and various lending needs have different purposes which complement the building of your financial picture. Continued monitoring of your wealth plan as the FOMC acts will provide the best information to maximize the savings and credit strategies most important to you.

A frequent, proactive review and updating of your strategic wealth plan can help navigate future rate increases. Your Regions Wealth Advisor looks forward to discussing these and other ideas to maximize your wealth strategic plan.

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