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Speaker 1

Welcome my name's Andrew Baron, and this is “Well, It Depends!” The podcast where I present pros and cons of different financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I ask the question, what do higher interest rates mean for me? But before we begin a short disclaimer. This is being recorded on March 28th, 2023.

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Please note the information provided in this podcast is strictly for educational purposes only and is not to be considered investment, tax or legal advice. It is important to discuss your situation with the professional for making any financial decisions as the strategies discussed may not be suitable for you specifically. What do higher interest rates mean for me? “Well… It Depends!”

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The Federal Reserve recently voted to increase its target for the federal funds rate to a range of 4.75% to 5%, which is the highest it's been since September 2007, just before the financial crisis. This recent increase over the past year signifies a departure from the historically low interest rates of the last decade. Higher interest rates can mean better returns for consumers who purchase fixed income products such as savings accounts, bonds and CD’s, as these typically pay based on the interest rate at the time they are purchased.

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This can be especially beneficial for retirees or any individuals who rely on fixed income investments to generate income. As it can provide them a higher level income without the need to take on additional investment risk. Additionally, fixed income can provide a source of stability during times of economic uncertainty or market volatility. Higher interest rates can make borrowing more expensive, which is a con because it can increase the cost of borrowing money for consumers with high levels of debt.

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For example, if someone has a variable mortgage, car loan or credit card debt, the interest rate on those loans will very likely increase as interest rates rise. This means that the borrower will have to pay more in interest over the life of the loan, which can add up to a significant amount of money. This can be especially burdensome for consumers who are already struggling to make their monthly payments.

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Higher interest rates can also hurt current bondholders and make it more difficult for new issuers of bonds. When interest rates rise, the value of existing bonds decreases because investors can earn a higher yield by investing in newly issued bonds that offer higher interest rates. This means that if a bond holder wants to sell their bonds before they mature, they may have to sell them at a loss.

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Additionally, higher interest rates make it more difficult for corporations and governments to issue new bonds based on affordability. This is because new higher interest rates make it more expensive for the issuer, since they have to pay a higher yield to attract investors, making it overall more expensive to borrow money through bond issues. As a result, companies may be less likely to invest in new projects and expand their operations, which can lead to economic slowdown.

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Overall, higher interest rates can be a con because it can increase the cost of borrowing and make it more difficult to manage debt. To recap, higher interest rates can mean better returns for consumers who deposit money in fixed income, such as savings accounts, CD’s and bonds. On the downside, higher interest rates can make borrowing more expensive, which can be a burden for consumers with high levels of debt.

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Consumers may have to pay more in interest charges which constrain their budgets. Higher interest rates can also lead to an economic slowdown if consumers and businesses reduce their spending. So, to answer the question what do higher interest rates mean for me? “Well… It Depends!”

Speaker 1: Andrew Baron, CFP®, EA