MoneyLend.net Consumer Insight

Interest rates will go up next year. Is it time to panic?

The Federal Reserve Board noted in a July 29 press release that economic activity has been expanding in recent months, growth in household spending has been moderate, and the housing sector is showing signs of improvement. The release also noted improvements in the labor market with declining unemployment.

It sounds like good news, and it may be, depending on whether you want to borrow money or invest it. Savers have been frustrated since the housing market collapse in 2007, with present interest rates on bank CDs being so low as to make burying cash in the backyard look like a viable alternative. A nudge upward in interest rates would be very good news indeed, if you have savings in the bank. But those looking to borrow may be feeling some anxiety.

The Federal Open Market Committee, which determines interest rates, still reaffirms that the present 0 to 0.25 percent interest rate on federal funds is still appropriate, but for the first time in years, the Fed is starting to consider moving interest upward. The Committee said that it would be appropriate to raise the target range with some additional improvement in the labor market, and when they are confident that inflation moves into the two percent range.

What does it mean for borrowers?

The Federal Reserve's "Report on the Economic Well-Being of U.S. Households in 2014" report, issued in May 2015, provides some insight into what borrowers have been experiencing during this time of unusually low interest rates. Money is cheap – if you can get it. Banks of course, tend to want to lend cheap money to only the most qualified individuals, so those with marginal credit will get increasingly pushed aside or moved into the "high risk" subprime category during loan fire sales. According to the report, 37 percent of respondents applied for credit during the 12 months prior to the report, up from 31 percent in the previous year's survey. Twenty-four percent of respondents who applied for credit were denied at least once, and many more didn't receive a denial, but were offered less credit than they desired. Overall, 32 percent who applied were either denied outright, or offered less credit than they applied for.

An unintended consequence of the historically low interest rates is a rise in high-interest alternatives such as payday loans, along with other alternatives such as peer-to-peer lending or even crowdfunding. The report notes that respondents who are denied or offered less credit are more likely to turn to these increasingly available alternative sources. Thirty-eight percent of those individuals did use alternative financial services, as compared to just 15 percent of the overall population.

Hurry up and borrow?

With a rise in interest a distinct possibility, the question to borrowers now is, "Should I rush to the bank now while rates are still at historic lows?"

Not necessarily. Rates will increase – but it will happen gradually. Most bankers predict that rates will rise, but very slowly, and will continue to remain below historic averages for some time to come. For borrowers with good credit, attractive rates will continue to be available through traditional lending vehicles. For those with poor credit who are pushed into high-risk vehicles, the Fed rates are going to be less of a factor. A 33 percent payday loan isn't going to go up or down much based on what the Fed does – those last-resort loans set those high rates simply because they are the last resort. In fact, with interest rates gradually moving upwards, banks may be more willing to deal with those having marginal credit.

Winners and losers

As with all things financial, there are winners and losers. Finance is seldom a zero-sum game. The winners include savers, who simply want a safe place to park money and earn interest. However, if you have an adjustable loan, look out. These haven't been as popular in recent years since rates have been so low, but those who are locked into ARMs will probably see a bump in their monthly payments. The banks themselves will win big, since the spread between the cost of money and the rates they charge will widen.

The move will hurt some borrowers and help others. The first ones to jump on the higher interest bandwagon will be credit card companies, and those great promotions and introductory offers will start to disappear. If you're going to apply for a credit card with special introductory offers, do it now while they are still abundant. Also, any variable-rate debt – whether it's a credit card or loan from a finance company – should be paid down as much as possible over the next several months, as holders of variable-rate loans will feel a bigger hit in the pocketbook next year.

Subprime borrowers will find more opportunities. During the credit crisis, even prime borrowers faced a more difficult time finding money, and subprime borrowers either could not find any loans at all, or were faced with predatory rates. Those with marginal or poor credit, who are looking for loans, will benefit from the Fed's impending actions.

Home mortgage rates will also inch upwards – hopefully not triggering another housing crisis. If you're planning on getting a mortgage, now would be a good time to lock in a low rate.