What Does Fed's Interest Rate Hike Mean?

On December 16, 2015 the Federal Reserve Board did something they hadn't done since June of 2006... They "raised interest rates"... This article explains how the Fed's action may effect interest rates on mortgage loans.

The dynamics of Federal Reserve action is often taught in a MacroEconomics college course and in many graduate level business courses. That level of study is far beyond the scope of this article and I refer you to the Federal Reserve website located at www.FederalReserve.gov for more information. However, I will attempt to describe the high level "side effects" of the Fed's action...

The Federal Reserve Board is the overseer of monetary policy for the United States and the regulator of many financial policies. They have many tools available to help stimulate a sagging economoy or, conversely, to stifle and overly explosive growth of the economy. The Fed, as they are known, is constantly measuring economic indicators for signs of a down turn in economic growth or signs of up turns in economic growth. Too much movement in either direction is generally considered bad for the economy for a variety of interlocking reasons.

One of the many tools used by the Federal Reserve is the Federal Funds rate. The Federal Funds rate is the rate of interest charged by depository institutions to other depository institutions overnight. Manipulation of this rate effects interest rates on credit cards, personal lines of credit and Home Equity Lines of credit (those whose rate is based on the "Prime Lending Rate"). Raising the Fed Funds rate increases the cost to borrow "short term" money and tends to slow economic growth. Lowering the Fed Funds rate decreases the cost to borrow "short term" money and tends to increase economic growth.

Rates on 15 Year and 30 Year fixed rate mortgages are not directly impacted by manipulation of the Fed Funds rate. In fact, despite the Fed raising the Fed Funds rate by 0.25% in December, long term interest rates have declined… There are many factors that have contributed to this, but I simply point out that when the Fed "raises rates", it doesn't always equate to rising long term mortgage rates.

On December 16, 2015, the Fed raised the Fed Funds rate by 0.25% from 0.25% to 0.5%… This caused the "Prime Lending Rate" to rise from 3.25% to 3.5%... In that same announcement, the Fed projected at least four additional Fed Funds rate increases in 2016. That means we could be looking at a substantial rise in "short term" lending rates this year in an attempt to slow economic growth and control inflation.

If you currently have a Home Equity Line of Credit (HELOC) whose rate is based on the Prime Lending Rate, your monthly interest rate increased by 0.25% overnight as a result of the Fed's decision on December 16, 2015. That means for every $10K balance on your line of credit, your monthly interest payment increased by approximately $2.08 per month. While this seems insignificant, when we consider that in the next year, we could have 4 more rises in the Prime Lending Rate, the monthly interest payment may rise by over $10.00 per month for every $10K balance on your HELOC… If you

have a HELOC with a balance of $70K, your monthly interest payment (after 4 more rises) could increase by over $70.00 per month ($840.00 per year).

If you find yourself in that situation, you may want to research your options to roll your HELOC balance into your 1st mortgage through a refinance… With 15 Year and 30 Year fixed rate mortgages near their all-time lows, we suggest you contact your Certified Mortgage Professional (CMP) to research your options. A CMP will have the experience and patience to explain how a refinance may benefit you…

To find a Certified Mortgage Professional, we suggest you go to the NH Mortgage Bankers CMP website at http://www.cmpnh.org.

This information has been provided by the Mortgage Bankers and Brokers Association of New Hampshire (MBBA-NH) in conjunction with the New Hampshire Union Leader. Any questions about the content should be directed to the MBBA-NH at 6 Garvins Falls Road, Suite 106, Concord, NH 03301, e-mail at info@mbba-nh.org, website mbba-nh.org. Article supplied by: Rick Herrick, Sr. Loan Officer, Certified Mortgage Professional (CMP) NMLS #48452 from Embrace Home Loans (NMLS #2184), Current President Mortgage Bankers & Brokers Association of NH.