

How the Fed Affects Interest Rates

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Point of Interest: The Federal Reserve System

The Fed, aka Federal Reserve System, looks closely at market and economic trends to reach a decision regarding the Prime Rate, and this affects everything from mortgages to CD interest rates.

While some people might ignore news about the Fed because it "must be something that only affects bankers," when it meets to raise, lower, or stay the national interest rate, the Fed is actually incredibly important to and affects anyone who uses a savings account, credit card, car loan, mortgage or any other rate-based financial instrument. That means even you.

What is The Fed?

"The Fed" is a nickname for the Federal Reserve System (FRS). The FRS is a collection of 12 regional banks across the country that serve as the central bank for the United States. Each of these regional banks serves a specific geographical region and is further broken down into smaller branch offices. The FRS is overseen by the Federal Reserve Board of Governors, who are appointed by the President of the United States and confirmed by the Senate.

Created by Congress in 1913, the Fed has a long list of responsibilities, including the supervision and regulation of other U.S. banks and financial institutions, overseeing the conduct of the country's monetary policy, the promotion of financial system stability and consumer protection. In simpler terms, the Fed can be thought of as a bank for banks that also serves some individual customer needs.

Why does The Fed raise or lower interest rates?

One of the ways the Fed carries out its long list of duties is by controlling the recommended target fed funds rate, which is the interest rate charged by one bank lending money to another bank. Just as you sometimes need loans to meet your business or personal financial goals, so do banks.

Eight times a year, the Federal Open Market Committee will meet to discuss the current status of the economy and how it can best foster economic growth without sparking inflation. One of the most powerful means this committee has of controlling these two factors is through the Fed interest rate. After each of these meetings, the committee has three options — raise the target rate, lower the target rate, or keep it unchanged. The rate is announced after each meeting and is now given in a recommended range instead of as a single number as it was before 2008.

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The raising and lowering of the Fed interest rate can have a profound effect on the growth of the economy through determining the Prime Rate, affecting the interest rate that a bank, lender or financial institution will extend to a prime client, such as a borrower with a perfect credit score.

"When the Fed increases the interest rate, [it is] 'tightening' the money supply and making loans more expensive, which means less money in the economy," says Leibel Sternbach, founder and financial advisor at [Yields4U](#). "And when they lower interest rates they are 'adding' money into the economy by making it easier for banks to lend money."

It's a delicate balance that requires the experts of the Federal Open Market Committee to look at past, current and future market conditions and factors. Over the past year, the committee has lowered the rate on three separate occasions

How do Fed rates affect me?

If it becomes more expensive for banks to access money (rate increase), then they are going to need to charge borrowers more money to turn a profit. This means that those looking to get a new car loan, mortgage, credit card or use any other borrowing tool will probably see a rate increase as the money is now "more expensive."

On the flip side, banks use your funds to facilitate these loans to other banks. If they can make more money from these intrabank loans from a rate increase, they may offer individuals higher incentives to give them access to their money. This means those with savings accounts, CDs, and other interest-bearing accounts may see a bump in rates and what they can earn.

The Fed rate impact is the opposite when rates are lowered. Money is now less expensive for banks to borrow, which means they can lend it to you for a cheaper price. Using your money is now less profitable for the bank, so the reward they offer for access is often lowered.

While the above statements are true, many other factors at work could affect the rates you see at your local bank. Some of these factors are on the national level, while many will deal with your personal financial situation and creditworthiness.

Do changing Fed interest rates affect existing accounts? It depends. If you have a fixed-rate loan, you are locked in at the interest rate agreed upon when you took out your loan. Those with variable-rate loans, though, may see a change in loan rates based on the Fed's decision. The same is true for those with interest-bearing accounts like [savings accounts](#) and CDs. If these accounts have fixed rates, you will not see changes. If they are variable, though, you can expect to see the interest earned change as the Fed's interest rates change.

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Jason Wesley is a seasoned copywriter with a passion for writing about banking, tech, personal growth, and personal finance. As a business owner, relationship strategist, and officer in the U.S. military, Jason enjoys sharing his unique knowledge base and skill set with the rest of the world.



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