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How the Fed's Timing Will Impact Market Returns and Credit Card Rates

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The timing of when the Federal Reserve will raise interest rates again will impact consumers with outstanding credit card and student loans. May's weak employment report means the odds that the Fed will raise rates at this month's meeting are extremely low.

"The disappointing May jobs report takes the idea of a June rate hike off the table," said Greg McBride, chief financial analyst for Bankrate, the North Palm Beach, Fla. based financial content company.

A lackluster economy will not likely encourage rate hikes soon although the central bankers have hinted at future increases later this year.

The postponement in raising rates gives consumers another opportunity to take advantage of paying down their current debt with zero or low interest rate balance transfer offers, purchase homes with mortgage rates under 4% or refinance their current adjustable rate mortgage.

When Increases Will Occur

The likelihood that the Fed could raise rates at either the July or December meetings depends on how much the economy improves, since Fed Chair Janet Yellen "very data driven," said Robert Johnson, president of The American College of Financial Services in Bryn Mawr, Pa.

"I believe November is off the table as it is a week before the U.S. presidential election," he said. "I doubt any action would be taken in September in the run up to the election.

The Fed considers a three-prong test for increasing interest rates: examining indicators of a rebound in the economy, additional strengthening in employment and inflation occurring near 2%, Johnson said.

The Fed lacks compelling economic reasons to raise interest rates currently, said David Twibell, president of Englewood, Colo.-based Custom Portfolio Group.

"The economy continues to plod along at the same anemic pace that has characterized the entire recovery," he said. "The real reason to raise rates is to counteract the massive imbalances created over the past eight years of 0% rates," he said.

Credit Card Rates

The interest rates on credit cards and home equity loans are pegged to the prime rate and follow any moves made by the Fed, said McBride. Consumers seeking to lower their monthly credit card payments by transferring the balances to a lower interest rate should not wait.

"The 0% offers will get less generous over time and there will be fewer of them," he said. "Grabbing them now locks in a window of time get the debt paid off without the headwinds of interest charges. Giving yourself that window of opportunity to get your debt paid off is pretty attractive."

Average credit card rates are substantial at 13.40% for a fixed rate cards and a 0.25% rate increase would boost payments by $0.25 per every $100.

"The impact is not very noticeable at the individual consumer level, but does marginally increase their interest costs," said Jerry Braakman, chief investment officer of First American Trust, a Santa Ana, Calif.-based financial planning firm with $1.1 billion assets under management.

Consumers who want to utilize low interest rates to refinance larger purchases such as a major home repair or medical bill should lock in rates now, said Jon Ulin, a managing principal of Ulin & Co. Wealth Management in Boca Raton, Fla.

"Don't procrastinate," he said. "While money can't buy you love or happiness, keeping your debt servicing payments as low as possible may lower your household stress and increase your cash flow over time."

Savings and Stock Market Will Not See Gains

Savers who have funds in an online account or CD will not see rates rise much even after the Fed hikes them.

"Investors will not see rates on savings or checking accounts increasing quickly or dramatically," said Johnson.

The stock market will likely react negatively to a rate increase, mirroring the rapid decline in returns in January and February after the Fed raised rates in December. When interest rates start to rise, the S&P 500 returned only 5.9% in the period from 1966 through 2013, he said.

When rates decline, the benchmark index rose by 15.2% annually. During a rising interest rate environment, investors should shift their allocations toward consumer staples such as consumer goods, food, energy and utilities and away from discretionary sectors such as apparel, autos, retail and construction, Johnson said.

The impact to the market will be positive "as long as the rate hikes are viewed as indicating a strong economy," said Patricia Buckley, a managing director of economics for Deloitte, a New York-based consulting firm.

Impact on Student Loans and Auto Loans

Graduates with existing fixed rate student loans will not be impacted with rising interest rates. Depending on when the Fed decides to increase rates, new student loan borrowers may not be affected in the short-term since the rates for student loans are set on July 1 each year. Any hikes will not affect car owners with auto loans, because the impact will be nominal.

"If you spend 30 seconds worrying about it, you've wasted 30 seconds," said McBride. "There is zero impact on affordability. A quarter percentage point for someone with a $25,000 loan is $3 a month, so you not have to downsize from a SUV to a compact car."

Why Rate Hikes Are Beneficial
Interest rate increases can produce a mixed outcome for consumers since rate hikes can "slow economic activity over the long term, which is not beneficial to consumers as reduced employment growth reduces disposable income," said Braakman.

"The Fed's action is driven by the expectation that the economy is improving enough to withstand higher rates," he said. "If the Fed is wrong, this can have adverse impacts on economic growth. Higher rates generally improve the strength of the U.S. dollar, reducing inflation and helping conserve consumer buying power."

The economy can not sustain interest rates hovering near zero for long periods, said David Twibell, president of Englewood, Colo.-based Custom Portfolio Group. "It is long past time to start weaning the economy off them," he said." ZIRP was designed to be an emergency measure to protect the financial system during an unprecedented crisis."

The Fed's inaction and "timidity" has produced the "defining economic policy of the past decade, creating economic distortions and choking off investment returns for retirees and risk averse savers along the way," Twibell said.

"The economy and stock market will be better off over the long haul with a strong Fed whose focus is more on the future health of the economy rather on the short-term fluctuations of the equity markets," he said.

As rates eventually increase, it will lower the average American's real income, said Chris Barnes, a senior vice president of research at Market Strategies International, a Livonia, Mich.-based market research company.

"Savers on a fixed income will fare best," he said. "Consumers have been less predictable in terms of spending, partly, because the savings rate has remained at an elevated level."