Who is the Fed and Why Should You Care?

If you've ever paid attention to news stories about the economy, you've probably heard about "The Fed." But, do you know what the Fed is and how it impacts you? Learning a bit more about how the central bank of the United States works and how it affects your finances can help you make long-term plans for big financial decisions. Understanding the Fed can help give you an idea of what the economy is currently like, what's going to happen, and how it affects your business, your job, and/or your investments. Here are a few basic facts about the Fed you should be aware of:

It is not a government agency.
The Fed is owned by private banks and operates independently of the U.S. government, though its Board of Governors are appointed by the President. It has a franchise to manage the country's economy as long as the Fed continues to fulfill its three mandates: maximize employment, stabilize prices and moderate long-term interest rates.

It sets important interest rates.
The main way the Fed impacts the economy is by setting the Federal Funds Interest Rate, which is the basis for every other interest rate out there. In general, when the Fed lowers interest rates, the goal is to stimulate the economy. Conversely, they usually raise rates when they want to slow down the economy. The Fed manages these rates through the Federal Open Market Committee (FOMC), which meets eight times each year. After each meeting, the FOMC issues a press release about the general U.S. economy and whether or not the Fed will raise interest rates.

The Fed Funds rate does impact consumers.
Even though consumers do not directly borrow money from the Fed, the financial institutions that provide their car loans and mortgages do. Since the Fed Funds rate is the basis for other rates (by being the cost of what your bank has to pay in order to get money) raising and lowering it affects the rates you, the consumer, can get from your bank. So, if you're in the market to buy a house and you hear that the Fed may be raising interest rates soon, you know to act quickly in order to secure a lower interest rate for your mortgage.

What's going to happen next?
While no one knows exactly when the Fed will raise interest rates, it will happen eventually. While rates are still at record lows (near zero), it is a good time to borrow money or refinance your mortgage. By comparison, in the early '80s the Federal Funds Rate was nearly 20 percent. Today, that would be like buying a house with a credit card. When rates do rise, mortgages and car loans will become more expensive. However, you'll also earn more interest on your savings account and any interest-bearing investments will have higher yields.

By keeping these basic concepts in mind, consumers can create a better financial plan for themselves. Be sure to speak with your local banker if you want to learn more about the Fed.

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