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## What You Need to Know About the Fed Rate Hike

Posted on May 12, 2006 at 10:52 AM

[J. Wayne Burritt](#)

The Federal Reserve Board -- or commonly know as the "Fed" -- boosted interest rates for the 16th consecutive time on Wednesday. The quarter point increase now pushes the federal funds rate to 5%. Important to watch? Yes, for a bunch of reasons.

First, while the 5% federal funds figure itself doesn't mean much itself -- unless you're a bank doing business with another bank -- it's still super-important. That's because most other benchmark rates -- like the prime rate -- are directly effected by it. In fact, immediately following the fed rate hike, commerical banks boosted their prime rate to 8%. That's no accident.

Second, since a boatload of credit facilities -- like equity lines of credit, credit cards, and variable rate loans -- are based on the prime rate, when it goes up, the price of borrowed money -- a big source of capital for just about everybody, from corporations to small businesses to individuals -- goes up.

Third, watch fed rate hikes because of their effect on the marketplace. By raising rates 16 consecutive times the fed is making a spectacular effort to keep economic growth and inflation under control. As a result, prices -- either the ones I charge or the ones I pay -- haven't been skyrocketing. That's negative and positive: The negative is I don't have much room to prices for my products -- and that puts the squeeze on margins. After all, we all want those fat margins, don't we? The positive is my competitors and my vendors won't be able to raise prices either. And that means my products should remain competitive while my costs remain stable.

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Fourth, take a look at what's between the lines on the fed rate hike. There's no way they're going to come out and just say: "This is the last rate hike for a year. So, just sit back and relax." Why? Because the fed never wants to be tied down. Instead, they give hints and signals. In Wednesday's hike, for example, they said future increases may be needed to tame inflation. But they also said moderating economic growth could mean a pause in increases. Confused? Well, that's fed-speak.

Bottom-line: Keep a close watch on future fed rate hikes. They can mean big bucks in the long-run.

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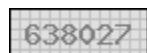
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