Fed slashes key rate

by: LAURIE WINSLOW World Staff Writer
1/31/2008 12:00 AM

The interest rate cut, the second in about a week, has some homeowners thinking about refinancing.

The short wait is over, and to no one's real surprise, the Federal Reserve has slashed a key interest rate for the second time in just over a week.

As before, the news could be good for some people, including those who want to refinance their homes at a lower rate.

Fixed-income investors who depend on interest from certificates of deposit could be less pleased to see CD rates drop even lower in the near term.

On Wednesday, the federal funds rate — the target rate for overnight lending between banks — fell by a half point to 3 percent.

That reduction came just days after the Fed made a surprise cut Jan. 22 and lowered the rate by three-quarters of a percentage point to 3.5 percent from 4.25 percent.

After the Fed's latest cut Wednesday, most commercial banks lowered their prime lending rates — what they charge their best customers — to 6 percent, the lowest level in three years.

Some say more cuts are likely and that the federal funds rate could drop as low as it did during the last recession earlier this decade, when it reached 1 percent. But Ernie Goss, a professor at Creighton University in Omaha, Neb., said he doesn't see that happening because this economic slowdown is different from the last one.

"We have more inflation now than we had then, so the Fed is not going to reduce rates as much this time, even with an economic downturn," Goss said during a phone interview.

He doesn't foresee the Fed cutting the federal funds rate below 2 percent in the future, and he doubts that it will drop even that low, he said.

On Wednesday morning, Christie Tull, a vice president at Summit Bank, was on "heavy watch" for a possible surge of loan refinancing. People are waiting for the interest rates to drop to 5 percent or lower, she said.

"I have several people waiting in the wings that are looking to refinance," Tull said.

As for when people should consider refinancing, Tull suggests that they refinance if it will lower their current interest rate by 1 percent or more.

"You typically can recoup those closing costs and see a benefit in the interest rate cut.

You also want to be staying in the house for five years," she said. "If you anticipate moving in two years, I wouldn't suggest refinancing."

As of Wednesday morning, a 30-year, fixed-rate home loan was going for 5.87 percent, with no origination fee or points, Tull said. A week ago it was at 4.875 percent for about a day before bumping back up.

A 15-year home loan was at 5.375 percent, with no origination fee or points.

Individuals will have to decide whether they want to wait for interest rates to drop even lower in the future. A home loan at 6 percent is a good rate, and people really can't complain about a 5 percent, 30-year rate, even if it were to drop lower 30 to 60 days from now, Tull said.

"It's a gamble if those rates are going to go back up or not," she said.

Loan instruments differ, and consumers have to weigh the cost of refinancing against the reduction in interest, said Fred Russell, principal of Fredric E. Russell Investment Management Co. in Tulsa.

"They have to see how much they would save on lower interest rates, and they have to guess but try to be realistic about how long they will keep that mortgage," he added.

The lowering of the federal funds target also will affect rates on certificates of deposit, although the timing is a little less clear, said Jim Huntzinger, executive vice president and chief investment officer of BOK Financial Corp.

CD rates could change quickly within days, or certainly within a week or two, Huntzinger said.

"The CD rates already reflect the interest rate environment, in general, and whether the Fed lowers rates or not, most CD investors will testify to the fact that rates are a lot lower today than they were six months ago," he said.

Like other investment professionals, Huntzinger recommends "laddering" CDs. With this method, an investor spreads money among CDs that mature at different intervals to take advantage of different interest rates.

"Staggering the maturities of your certificates of deposit is important so that you don't have everything coming due at the same time. . . . If you have multiple maturities spread out over a number of years, as opposed to months, you can mitigate your risk of having too many CDs come due at one time in a low-rate environment," Huntzinger said.

The Fed's action Wednesday may or may not affect credit card rates. That depends on the credit card issuers and individuals, said Creighton's Goss.

Many people have credit cards, such as department store cards, that are fixed at, say, 18 percent or 21 percent.

"Cardholders should not assume that their credit card rates are dropping just because the Fed is aggressively lowering interest rates. The issuers have the freedom to adjust their own rates," Bill Hardekopf, CEO of LowCards.

com, said in an e-mailed comment. "The rates for some of the more popular cards have actually increased.

"It is very important to make sure you are getting the benefit of these rate decreases. If not, it is time to shop around for a credit card with a lower rate."

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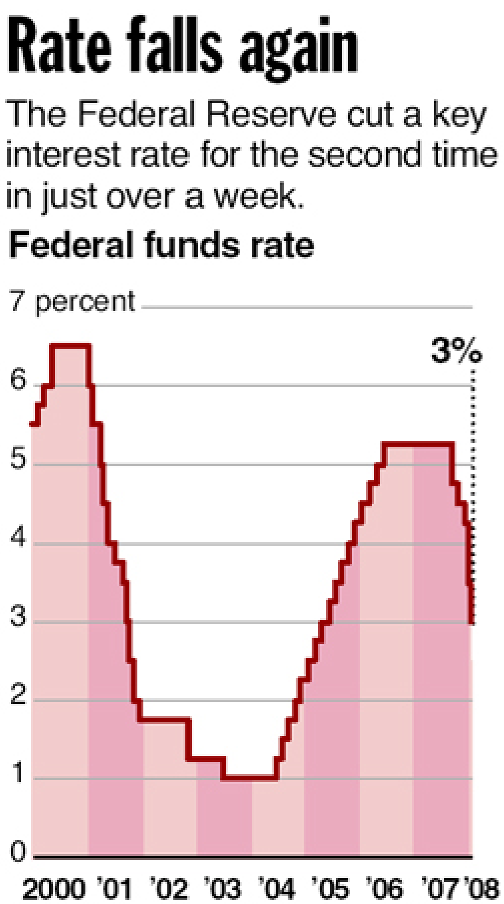

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