Snack-Sized Econ: Interest Rates

March 14, 2024

Experts at the Kansas City Fed break down economic concepts that impact our everyday lives. The first installment explains everything you need to know about interest rates.

About Snack-Sized Econ

Snack-Sized Econ is a series brought to you by education experts and economists at the Kansas City Fed. This video series aims to break down economic concepts that impact our everyday lives. Interest rates are the subject of the first series. Watch the videos below to learn the basics of interest rates, how the Federal Reserve influences them and how they impact consumers.

Intro to Interest Rates

Let's break down interest rates. They represent the time value of money.

If you don't have one dollar, you can pay interest to borrow it. You can get one dollar today and pay it back over time, plus interest.

It can benefit you too.

You can save a dollar and earn a return. A return is money you saved plus interest earned on that money while it was in a bank account.

When it comes to interest rates, lending and borrowing money are similar. Lenders get interest from money loaned. Borrowers pay interest on money borrowed.

Common interest rates you may know include:

- Mortgage or auto rates: the interest a buyer pays to borrow money for a home or car
- Savings rates: interest earned by keeping money at a financial institution or in savings
- Credit card rates: interest paid to borrow money to buy something now and pay for it later
- U.S. Treasury rate: The interest paid by the U.S. government

Finally, there's the Federal Funds Rate. That's the interest rate banks pay each other to borrow money overnight. We'll dive into that in the next video.

Remember, interest rates are something that grows into more money in the future. This can benefit you if you save or lend and work against you if borrowed.

Interest Rates and the Fed

Banks and credit unions need to have cash on hand for customers like you and me. Sometimes, they need to borrow that money. A place they borrow from is the Federal Reserve Bank, sometimes called The Fed or the Bank for banks.

Like we talked about in the first video, the entity borrowing money pays interest to have that money now. It's the same for banks that borrow from the Fed. The Fed's interest rate for banks to borrow or lend money is called the Federal Funds rated, or the Fed Funds rate.

This rate is based on economic conditions, primarily the supply and demand for money within the market.

If there is lots of money available and few borrowers, interest rates will be low, many times to encourage spending in the economy.

If there isn't a lot of money in the economy and there are many borrowers, interest rates tend to be high, often times to slow down spending.

While the Fed Funds rate does not directly dictate interest rates that lenders and borrowers experience, it does set a benchmark for other interest rates, like mortgage rates or auto loans or other interest we experience in our daily lives.

In the next video, we'll look into how interest rates impact consumers like you.

Interest Rates and You

Interest rates affect our saving, borrowing, and lending choices. Understanding how interest rates affect us can help us make informed decisions towards our financial goals.

Let's say you want to purchase a car, but you don't have the money to buy it outright. You'll probably consider taking out a car loan, where you'll pay interest over time.

If you need the car right away, you may be willing to pay a higher interest rate to get it immediately. But if you can wait, you may want to consider saving money to pay for the car, so you can pay little or no interest.

This is the same principal for mortgage interest rates or credit card interest rates.

If interest rates are high, you may decide to save or invest more money in a savings account to take advantage of earning more interest. When saving, interest earned can snowball as it compounds over time, helping you to build wealth.

However, if interest rates are low, you may choose to borrow for a car or a house, or to start a small business or help fund college.

Those who borrow responsibly are considered lower risk to the lender, resulting in a lower interest loan and less to pay back over time.

Interest rates influence the cost of borrowing, the return on saving and whether households and businesses choose to spend. This can impact our individual choices about money and the economy as a whole.

More information

The Kansas City Fed believes individuals who understand how the economy functions make better financial decisions. Visit our Education page to browse our collection of free economic and personal finance resources.

You can also check out our YouTube page for dozens of video lessons designed for students, parents and teachers.

Media

This first installment of Snack-Sized Econ from the Kansas City Fed focuses on the basics of interest rates and how they impact consumers, businesses and national economy.
https://www.youtube.com/watch?v=D4ILSgz9_rY&list;=PLRuFDlAZCtQ1M0Xl-fU6u3IZV1JMxgbL5&index;=1&t;=2s

This installment of Snack-Sized Econ from the Kansas City Fed discusses how the Federal Reserve impacts interest rates, as well as how banks borrow and lend money.
https://www.youtube.com/watch?v=xenBiA3LtdI&list;=PLRuFDlAZCtQ1M0Xl-fU6u3IZV1JMxgbL5&index;=2

Learn how interest rates impact consumers in the third installment of Snack-Sized Econ from the Kansas City Fed.
https://www.youtube.com/watch?v=T4qrun6vBkY&list;=PLRuFDlAZCtQ1M0Xl-fU6u3IZV1JMxgbL5&index;=3