Newsday

MONEY FIX: LOW INTEREST RATES CAN BOOST PURCHASING POWER FOR YOUNGER-SET

By: Sheryl Nance-Nash - October 28, 2020

The Federal Reserve's recent announcement that it will keep interest rates near zero for the next three years was no real cause for celebration for the under-35 crowd.

Here's a look at what this low interest rate environment will mean for them.

The upside

Having interest rates held this low for a few years will increase "purchasing power" when it comes to purchasing real estate with a loan. "You can afford to borrow more with less qualifying income. To a young adult, this could be an amazing opportunity because they can borrow so cheaply," says Juan Carlos Cruz, founder of Britewater Financial Group in Brooklyn.

Many people 35 years old and younger may not have the savings needed for a down payment, so they borrow as much as they can. Banks are also able to lend more, adding more liquidity to the markets. These individuals can use this leverage at low rates, allowing them to have income left to fund their investments. "If rates were higher, this would be very difficult because the borrower would have a larger down payment and higher monthly payments," Cruz says.

Now is ideal for refinancing. If you're a homeowner, do the math to see if it makes sense. Also consider refinancing any remaining student loans, says Anand Talwar, deposits and consumer strategy executive for AllyBank.com.

Another plus, young folks might get more interested in investing. "They will get worn out by earning zero on their cash and become lifelong investors in the equity markets, which is where their money should be invested!" says Thanasi Panagiotakopoulos, principal with LifeManaged in Phoenix.

On the one hand, auto loan rates are often connected to the prime rate so they may be low when the Fed's interest rate is low as well. But before you rush to get a loan, "Understand that auto loans may be harder to get right now because lenders are concerned about people defaulting on their loans," points out Joshua Zimmelman, president of Westwood Tax & Consulting in Rockville Centre.

The downside

With low interest rates, it's challenging to find yield with "safe" investments. "Any savings in the bank will get eaten up by inflation over time. The bond market, historically considered to be a 'safe' market, may not be attractive for young people's portfolios," says Ivan Watanabe, managing partner of Opus Private Client in Rye Brook, in Westchester County.

If you are earning below or even around 1%, yet the cost of all goods and services (i.e. inflation) is increasing at the rate of 2% or higher, you're losing money by losing purchasing power." Simply put, that safe money won't buy as much as it does today when you need to use it," says Neel Shah, owner of Beacon Wealth Solutions in Monroe, New Jersey.

Patrick McDowell, a certified financial planner with Arbor Wealth Management in Miramar Beach, Florida, doesn't mince words, "A zero interest rate policy absolutely hurts young people. In many cases this damage is irreparable."

He tells his friends in their 20s, 30s and early 40s that they will have to save far more of their income than their parents did because interest rates were higher (i.e. savers actually earned a return on cash) and starting investment valuations were far lower (and future returns higher).

"Today, young savers earn effectively nothing in safe instruments like CDs and riskier assets like stocks trade at historically high valuations," he says. They are in an unenviable position.

Unfortunately, lower interest rates generally signal a slowing economy. "In this environment, younger workers may find it tougher to win raises or find better jobs. This means they may have to carry that debt on their shoulders much longer than they ever expected," says Paul Tyler, chief marketing officer of Nassau Financial Group in Hartford, Connecticut.

The bottom line

Says Shah, "Don't take unnecessary risks with your emergency funds to chase returns. However, you must be strategic and consistent with your financial plan with respect to the amount of money you keep subject to these low-interest rate environments."

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