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What Happens to Munis When the Fed Hikes Rates?

The Federal Reserve has indicated it plans to start raising short-term interest rates soon. Because bond yields and bond prices generally move opposite one another, investors may assume that rate hikes lead to negative returns for municipal bonds. However, that hasn't been the case during the three most recent cycles.

While each cycle is unique and this time may be different, we don't think the prospect of Fed rate hikes is a reason to wait to invest in munis.

No two rate-hike periods have been identical. The table below illustrates how the economic situation varied at the start of each period. However, we can still draw some conclusions. For example, the most recent rate-rising cycle began in December 2015, a period during which the Fed raised the federal funds rate target nine times. The federal funds rate (the rate at which commercial banks borrow and lend their excess reserves to each other overnight) rose from the zero-to-0.25% range to the 2.25%-to-2.50% range over the course of three years. The Fed raised rates despite stubbornly low inflation and relatively weak economic growth in an attempt to bring the rate back to a more normal level following the 2008 credit crisis.

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Advisor Perspectives

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