Why It's Not Too Late to Finally Switch to a High-Yield Savings Account

Many expect the Federal Reserve to keep interest rates high for a while

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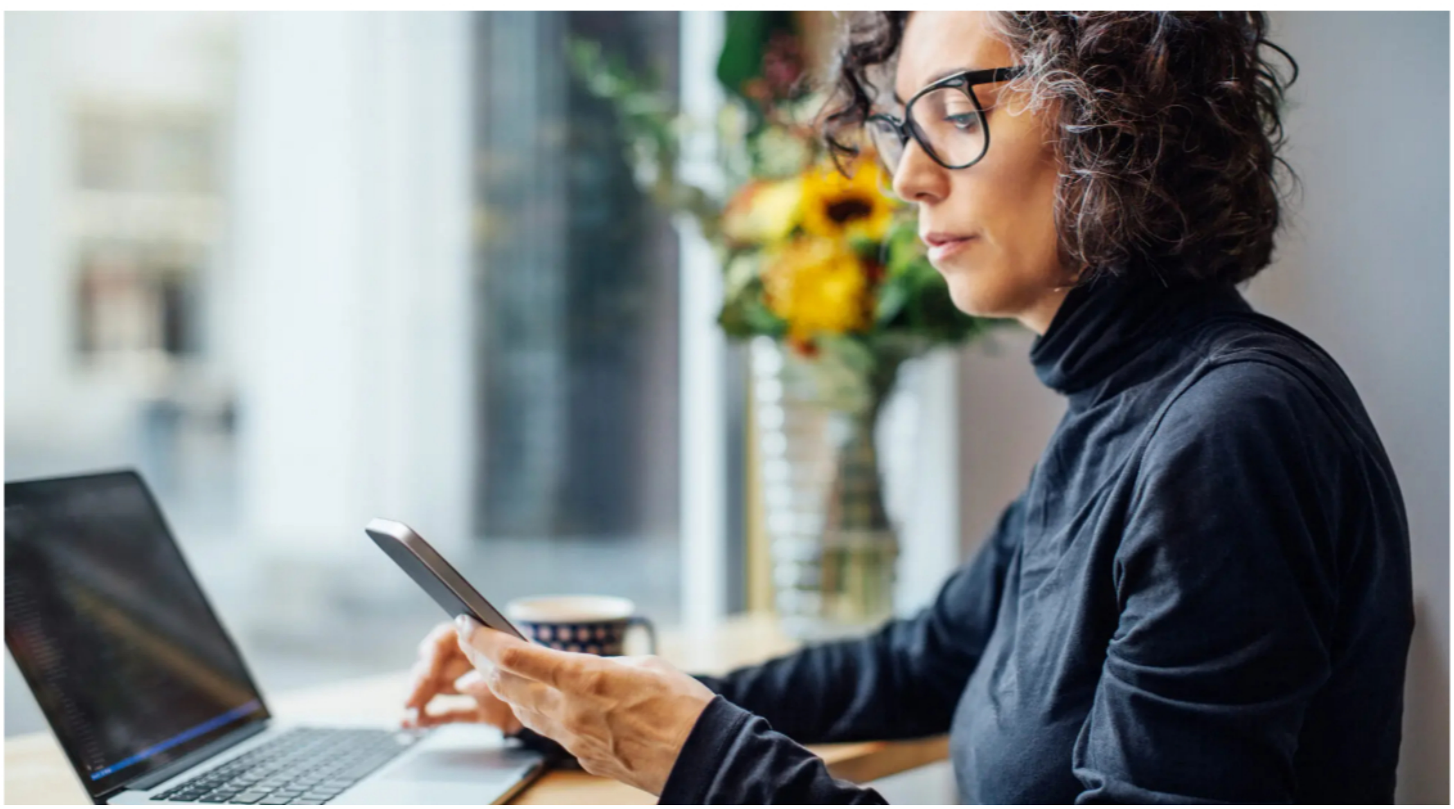

Most middle-income Americans aren't taking advantage of the silver lining in this recent rate-hiking campaign. Luis Alvarez/Getty Images

With benchmark interest rates at their highest levels since 2001, borrowing to buy a car or house, pay for a renovation or carry a credit card balance is all more expensive.

But there's an upside to high rates too — an upside there's still time to take advantage of as the Federal Reserve holds firm on the status quo: You can also earn about five times more money off your savings.

Before the Fed started raising its benchmark rate last year, the highest-paying national savings accounts paid less than 1% a year, according to data from Investopedia. Now the best pay over 5%, and the Fed is signaling rates could stay high for a while.

"The committee is not thinking about rate cuts right now at all," Fed Chairman Jerome Powell said at a press conference Wednesday. "The question of rate cuts just doesn't come up."

A higher fed funds rate is one of the most powerful weapons the Fed has against inflation because it's harder for people to spend money when it's more expensive for them to borrow it.

That's why the central bank raised the target range for this rate from 0%-0.25% to 5.25%-5.5% between March 2022 and July 2023. It's also why it opted to keep it at that 22-year high at its two meetings since, including on Wednesday.

But just as the fed funds rate is the baseline for the interest consumers must pay on many types of loans, it directly influences what people can earn if they stash their savings with a bank or other financial institution.

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So far, though, most middle-income Americans don't appear to be taking advantage of this silver lining — even if it could easily earn someone with a $20,000 balance an extra $800 or more a year.

Just 34% of U.S. financial services customers surveyed by Morning Consult in September said they had moved money into higher-yielding accounts since the Fed first started raising its rate. Only 42% said they even knew what a high-yield savings account was, according to Santander, the U.S. division of Madrid-based Banco Santander that commissioned the survey.

High-yield savings accounts, often offered by online banks, aren't all that different from regular savings accounts, beyond the higher rate of return. (At the moment, there's about a 10-fold difference, with the rate on traditional savings accounts averaging 0.46% nationally, according to the Federal Deposit Insurance Corp.)

The tradeoffs can be a lack of convenience (if the online bank with the high-yield account doesn't also offer a checking account,) withdrawal limits, or monthly service fees.

High-yield accounts usually pay the saver a little less than a certificate of deposit, or CD, but give the saver more flexibility. With a CD, you must keep your money in the account for a set amount of time — typically three months to five years — to avoid a penalty.

"A high-yield savings account would allow you to withdraw your funds at any time without penalties," Chikako Tyler, an executive vice president and chief financial officer of California Bank & Trust, said in an email. "You can also add to the high-yield savings account if you have additional, excess funds."

On the other hand, unlike a CD, high-yield accounts don't guarantee a fixed rate of return, so you'll earn less once the Fed starts to lower the fed funds rate. That's something most market watchers don't believe will happen until at least June of 2024, if not later.

For those who hadn't moved money into a high-yield account — the vast majority of those surveyed by Morning Consult — there were multiple reasons.

The most common reason was not having enough savings to make it worthwhile, followed closely by the preference to use available funds to pay off debt instead. The third-most popular reason was wanting to have money in a more accessible account like a checking account, and there were some who even said they weren't aware interest rates had increased.

Separate data from J.D. Power, the market research firm, seems to validate this. In October, U.S. bank customers said 37% of their savings was in a savings account at their primary bank, but a total of only 13% was in a “higher yielding” account at either their primary or secondary bank.

Suffice it to say, consumers aren’t maximizing their potential returns even when they are using high-yield savings accounts.

The Morning Consult survey showed just over a fifth of people with high-yield accounts didn’t know the interest rate they were getting. But of those who did know, 64% said they were earning less than 3%. Just 16% said they were earning in the 3% range, 15% in the 4% range, and 4% over 5%.

Meanwhile, the Federal Reserve’s comments have many economists thinking rates will stay high for some time. On Wednesday Powell wouldn’t even rule out raising the fed funds rate again at its December or January meeting if inflation isn’t well in hand.

“Powell was clear that the Fed will be quite patient before raising rates again,” said Nancy Vanden Houten, lead U.S. economist at Oxford Economics. “At the same time, the bar for cutting rates remains high as well.”

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