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Bank of Canada Raises Rates - What does it mean for you?

Executive Summary

As expected the Bank of Canada raised its key lending rate last week by 0.25% to 1.25% - this was the fourth 0.25% increase in the last twelve months. Canadians responded with the same question: how will this affect me and my family?

Canadian families pay interest on outstanding debt, and receive interest, dividends and capital gains on their investments. This means that each person's situation will be affected differently, in accordance with their unique debts and investments.

For borrowers, the cost of capital is going up, and for lenders, their income is increasing. If you have more invested assets than you have in outstanding debt, consider yourself to be a 'lender'. As a lender, the interest rate hike is good news. If you are a net-borrower, some of the bad news will be immediate, but most of the effects are likely to be delayed.

The most complicated implication will be the reaction by equity markets. As with most economic and financial changes, there will be winners and losers.

What you need to know

Depending on the investment vehicle, the effects of an interest rate increase can experience a time-lag, or be immediate. If you have investments or loans that have a floating rate or are exposed to market fluctuations, you will see immediate effects. If you have a GIC or a mortgage with a fixed term, your rates will stay in effect until maturity or renewal, and be unaffected until then. Variable rate mortgages, Home Equity Lines of Credit (HELOC) and high interest savings accounts will see the Bank of Canada rate implemented immediately, and Canadians will start to receive or pay higher interest. The effect of increased interest rates on the stock market is not as uniform. For example, financial firms, such as banks and insurance companies, are typically more profitable when rates are higher. Firms that borrow to finance their production, like utilities with long-term bonds, will face higher costs that could lower profits.

The Bottom Line

If an investor's portfolio is dominated by a small number of large stock holdings, they might experience some short-term volatility and risk, since profitability drives share price, all other things being equal. However, most investors who have some locked-in investments (GICs, bonds) and variable investments (stocks, ETFs, Mutual Funds), have domestic and international exposure, and diversification across multiple industry sectors will see that an interest change is a situation to monitor, and not a reason to act rashly or veer to far from existing financial plans. There is no need to undo years of planning and progress toward retirement plans; more so, each situation should be monitored and adapted if and when that is necessary.

This increase is small, and interest rates continue to be low when compared to historic levels. Continued vigilance and the careful attention of your wealth advisor will continue to be the solution to these types of economic changes.