Bank of Canada: You Need to Save More and Expect Less

Description

This week the senior deputy governor of Bank of Canada released a troubling speech, outlining a permanently changed world, complete with a shrinking labour supply, limited productivity gains, and ultimately lower growth.

“We have to adapt to this new reality of lower potential growth,” she said. Bank of Canada lowered its potential growth in global GDP from a peak of 5% in 2005 to a sustaining rate of just 3%. “If there is one thing we have learned from the past decade, it is that imbalances can take a long time to develop and even longer to resolve,” Wilkins added.

What does this mean for you?

Due to its slow-growth projections, Bank of Canada is calling on investors to reset their investment strategies and risk expectations to reflect lower rates of return.

“For households, this may mean saving more before retirement or planning for a lower post-retirement income,” Wilkins said. “It also means acknowledging a reduced capacity to grow out of existing debts. The faster we do this, the safer the financial system will be.”

For example, even with dramatically lower growth expectations, most economists estimate the interest rate needed to balance the Canadian economy stands at just 1.25%–down from above 3% early 2000s. With current rates at just 0.5%, many Canadians may start to see rising debt costs as rates are raised. This could be perilous.

According to a TransUnion report released on September 13, up to one million Canadian borrowers may not be able to absorb the increase in their monthly payments if interest rates rise by just one percentage point. The number of Canadians in trouble could balloon fairly quickly considering approximately seven million Canadian consumers carry a variable-rate mortgage or a line of credit with a variable interest rate.

If you think that your savings are going to generate enough income to offset the increase in debt costs, think again.

This month, **Deutsche Bank AG (USA)** (NYSE:DB) also released a report agreeing with Bank of Canada's findings. It stated that the global economy is at an "inflection point," marking an end not only to a long-term economic boom that started in the 1980s, but also for bonds as an asset class.

Included in Deutsche Bank's report is an important reminder of this insight: a table outlining just how odd the previous four plus decades have been. Since 1980, every single global bond market has seen positive annualized returns. The four preceding decades, however, were rife with measly or even negative returns.

The long-term bond party may already be at an end. For dozens of countries, government bond yields across are already near record lows with many in negative territory.

If you're on the path to retirement, don't expect an easy road ahead. "A challenging few decades likely awaits us," Deutsche Bank wrote.

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1. Bank Stocks
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1. Editor's Choice

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1. NYSE:DB (Deutsche Bank)

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rvanzo