Higher Rates to Challenge the Consumer: Are You Prepared?

Description

Low rates and the resulting increase in consumer spending have been big drivers of economic growth in Canada. From automobile purchases to real estate to everyday items, consumers have been taking advantage of cheap credit and living beyond their means.

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But, at the end of the day, the fact remains that long-term growth is sacrificed when rates are low and debt levels soar.

The CMHC reported on an international study that concludes that a one percentage point increase in household debt to GDP tends to lower growth in a country's GDP by 0.1 percentage point at least three years later.

It's been years that we've been hearing the same story. Household debt is at record highs and is too much of a burden. But household debt continued to get even higher, as economists kept on sending warning signals that investors and consumers alike ignored.

Here we are today, with rates finally having risen for the first time in seven years to the current overnight rate of 1%, and with all signs pointing to further increases, investors and consumers would be wise to heed the warning.

According to Statistics Canada, household debt is currently at a record 167.8% of household disposable income — up from 166.6%.

So, what can you do?

Besides getting your finances in order and ensuring that you keep our own debt levels in check as best as you can, there is a place in the market that will benefit from these higher rates, and a place that will be hit; namely, the financial sector and the consumer discretionary sector.

With $1.2 billion in total assets, **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD) is currently Canada's biggest bank with the most assets and the second-most deposits.

As interest rates rise, the spread between the rate the banks pay customers and the rate the bank receives widens, bringing more profit to the bank's bottom line.

Since 1995, the bank's dividend has grown at an annualized rate of 11%, and the current dividend yield is an attractive 3.6%.

Life and health insurance companies also stand to benefit from a rising interest rate environment, as rising interest rates mean that the cash flows generated by the company's assets will be invested at higher yields, falling to the bottom line.

With a primary focus on the Canadian market, **Industrial Alliance Insur. & Fin. Ser.** (TSX:IAG) stands to gain the most of its peer group from rising interest rates. The company has disclosed that a 10-basis-point increase in interest rates will impact net income by $23 million.

Industrial Alliance currently has a dividend yield of 2.4%, and I believe that recent stock price strength has reflected this fact.

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2. Dividend Stocks
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2. TSX:IAG (iA Financial Corporation Inc.)
3. TSX:TD (The Toronto-Dominion Bank)

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