



## Will Negative Interest Rates Come to Canada?

### Description

The world was first introduced to negative interest rates back in 2014, when the European Union used the policy in an attempt to help boost the economy out of a persistent funk. Japan's central bank joined the party in 2016, officially dipping into negative territory after years of holding rates around zero.

Both Canada and the United States have recently cut interest rates as COVID-19 impacted the economy in an attempt to help fuel an economic recovery. Both nations' central banks have set interest rates at 0.25%, which is about as low as you can go while still staying positive.

But that might not be enough. A second wave of COVID-19 could force us all into isolation again, which would cripple an already fragile recovery. Other issues could also derail an economic recovery, something we don't even see coming.

In other words, if the economy stumbles, negative interest rates could make their way to Canada. Is your portfolio prepared for such a reality? Let's take a closer look.

## Your personal finances

Europe and Japan's experience can help shine a little light on what would happen if rates officially turn negative.

If you're hoping for a future where the bank pays you to take on a [mortgage](#), I'm afraid you're going to be disappointed. Yes, mortgage rates in Europe are cheap right now, but the average borrower is still paying around 2%. Rates are even higher for longer-term loans.

Savvy savers won't even have to pay the bank to keep their money. High-interest savings accounts in Europe are still paying interest on deposits, although rates are well under 1%. European GICs still pay around 1% annually on three to five-year terms, too.

If Europe and Japan's experiment in negative interest rates is any indication, it really just translates into a benefit for borrowers at the expense of savers. Just like any other rate cut.

## Your investments

Every company's situation is complex, but for the most part negative interest rates will be good for Canadian firms who do a lot of borrowing and negative for those who count on interest income.

A lower cost of borrowing can only be a good thing for REITs, especially for ones that didn't feel the pain from a tepid economy. Apartment owner **Canadian Apartment Properties REIT** ([TSX:CAR.UN](#)) will certainly be happier in such a world.

Including mortgages and general bank indebtedness, Canadian Apartment Properties owes around \$5 billion at an interest rate of 2.84%. That translates into approximately \$85 million per year in interest. If it can get the average interest rate paid down to 2%, that's an extra \$35 million in net income.

Lower interest servicing costs could also enable the company to take on more debt, which would also goose earnings.

Cap rates will also go down in such a scenario, boosting the value of the [real estate](#) portfolio. That's exactly what investors want.

Negative interest rates wouldn't be great for an insurance company, as investing the excess cash is a big part of that business model. An expectation that negative interest rates might be coming is one of the reasons why **Great-West Lifeco** ([TSX:GWO](#)) has fallen so much. Shares are down more than 10% over the last three months.

Insurance companies like Great-West Life invest in various types of fixed income assets, including bonds and mortgages. Bonds dominate its portfolio, with 68% of assets invested in these safe securities. When 68% of your investment portfolio suddenly pays less interest, it's not a good thing.

Analysts agree. Even without negative interest rates hitting North America quite yet, Great-West Life is still expected to see its earnings fall 20% in 2020.

## The bottom line on negative interest rates

Negative interest rates could very well come to Canada. But as we've seen in Europe and Japan, they really don't matter that much. Certain companies will be impacted, and it'll cost slightly less for a mortgage.

Ultimately, however, the conclusion is a slightly negative interest rate isn't a whole lot different than a slightly positive one.

### CATEGORY

1. Dividend Stocks
2. Investing

## TICKERS GLOBAL

1. TSX:CAR.UN (Canadian Apartment Properties Real Estate Investment Trust)
2. TSX:GWO (Great-West Lifeco Inc.)

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