Bank of Canada Raises Interest Rates 0.50%: Prepare for Impact

Description

The Bank of Canada has just announced a 0.50% hike in the official policy rate. That's the biggest boost to Canada's benchmark rate of interest since May 2000. This decision has far-reaching effects on the national economy and could eventually trickle down to your portfolio. Here's what you should know.

What happened?

At 10am this morning, the Bank of Canada announced a 50-basis-point (0.50%) boost to the key interest rate. This rate was last hiked 25 basis points (0.25%) on March 2, 2022. The official rate is now 1% — four times higher than it was at the start of the year.

This unusually aggressive move was widely anticipated by economists. The sudden rise in inflation over the past year made the government's policy of quantitative easing unsustainable. Canada's inflation rate is 5.7% at the moment — the highest pace in 30 years. With the ongoing conflict in Eastern Europe and lockdowns in China impacting the supply chain, inflation is likely to rise higher in the months ahead.

Economists believe that the only way to tame this inflationary wave is to raise interest rates and stop printing money. Thus, the Bank of Canada suspended its quantitative easing program in October 2021 and is now raising interest rates to curb inflation.

So what?

Today's rate hike may not be enough to end the crisis. This means that the central bank will have to keep raising rates in the months ahead. By the end of 2022, borrowers across the economy could be under pressure.

The most noticeable impact of this could be observed in the real estate sector. Mortgage rates tend to climb instantly when the Bank of Canada raises its benchmark. That means fewer Canadians will be able to afford homes this year, which could lower the market value of real estate across the country. Since 10% of Canada's economic growth is derived from real estate activity, this slowdown could push us into a recession.

Higher rates also impact stocks. Growth stocks with low or no profits come under pressure when rates rise. Meanwhile, higher rates could also magnify the risk of default for companies that have too much debt on their books.

Now what?

Investors need to consider rising rates while making investment decisions this year.

If you have any exposure to real estate, this could be the right time to reassess that allocation. Residential real estate is particularly vulnerable to higher rates. Investors should expect some capital losses in this segment of the economy.

Stock investors, meanwhile, may need a more defensive strategy. If you expect rates and inflation to remain elevated for the year ahead, you could protect yourself with defensive stocks that have pricing power.

Metro is the perfect example. Grocery stores are essential businesses that are insulated from the market cycle. Meanwhile, the stock is relatively cheap, trading at a forward price-to-earnings ratio of 19. Metro's debt-to-equity ratio of 70% also makes it more resilient to rate hikes.

Protect your portfolio as economic pressures build in 2022. Good luck!

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Date
2025/07/22
Date Created
2022/04/13
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