BMO Nesbitt Burns
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Financial Insights

from Quinn+Cardy Wealth Management
of BMO Nesbitt Burns

Teaching Kids: Coping with Higher Rates

For the younger generations, the past year has been the first time that many have experienced rising rates and high inflation. As such, here are a few thoughts on helping them adapt tor this changed landscape.

Since the start of the millennium until the pandemic, inflation levels never surpassed four percent and often struggled to reach two percent. Since the start of 2022, due to persistently high inflation, the Bank of Canada has taken aggressive action to hike interest rates to try and temper inflation.

How do higher interest rates fight inflation? In general, by raising rates, the central banks have been trying to reduce demand to ease rising prices. Higher interest rates make borrowing money more expensive, which discourages borrowing and, in turn, helps to reduce demand. With reduced demand, companies are likely to have more supply and may be encouraged to lower their prices to try to stimulate demand.

Helping Younger Folks Think About Personal Finances

Due to many years of predictably low interest rates, it was easy to assume debt with little worry. With rising rates, borrowing has become most costly and many may not have been prepared for rates to rise as quickly as they have. As such, for many young people, during times of rising rates and high inflation, a focus on personal finances may be a good starting point. Here are some areas to consider:

Pay down debt. If there are debts to service, suggest the importance of paying this down, especially prioritizing debt subject to high interest rates, such as credit card debt. It is important to understand the terms of any loan and the effect of rate increases. For instance, for a variable-rate mortgage, consider how interest rate increases will impact interest payments or reduce the amount of principal that is paid down. As an example, raising interest rates from 1.5 to 4 percent while keeping the payment amount fixed will increase an amortization period (the time taken to pay down the mortgage) from 25 to 45 years.

Create or revisit a budget. For those who hold debt, it may be beneficial to create or revisit a budget to prioritize paying off debt.

Even if no debt exists, the effort of sitting down to map out income and expenses each month can be revealing, especially in this period of high inflation where the cost of most goods and services has increased. There may be value in having a comprehensive view of overall spending, to uncover and correct poor spending habits or better balance spending priorities. Equally important, minor reductions in consumption can lead to worthwhile savings.

Pay yourself first! By "paying yourself first," younger folks can be encouraged to prioritize saving and investing for the future. This may involve putting aside a portion of a paycheque through a payroll deduction at work or automatic bank account debit, with the idea being that what you don't see, you won't miss...and otherwise spend. Recent market downturns may be seen as an opportunity to build an investment portfolio for the future. With higher interest rates, low-risk savings vehicles that have been previously overlooked may become more attractive and many younger folks may not be aware of these products, such as opportunities to save and generate income through guaranteed investment certificates (GICs).

These are just a handful of ideas to provide guidance to the younger generation in this time of rising rates and high inflation. If we can help with these conversations, please don't hesitate to contact the office.

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