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Interest Rates and Your Financial Strategy

Tags: investment planning [1]

Working towards financial independence includes assumptions about how the world operates and how we navigate within that environment. These assumptions work best when the world remains the same allowing you to make reasonable future projections.

Challenges come when changes occur in the operating environment which may require reassessing wealth building strategies. The disruptions from early 2020 (Covid, supply-chains, etc.) seem to have ushered in some significant changes in our world.

The most critical change since 2020 is the amount of debt in all areas - Government, Corporate and Personal. In the next 1-5 years, policy choices by Governments - and your choices as an investor and consumer - will impact how much you can save and borrow to build your wealth.

Some background is needed. The current Canadian Federal Government has increased the national debt by an amount equal to the total historical debt incurred by all previous governments. The current US administration continues to add to the US national debt at a pace that dwarfs previous historical debt level growth. The specific amounts of government debt levels can easily be verified via a Google search.

Why do these numbers matter? The latest increases in government debt coincide with the end of a 40-year period of historically low interest rates – that bottomed around 1% in 2020. This period of ultra-low interest rates ended in early 2022 when the US Fed and Bank of Canada began increasing interest rates. Many Canadians will likely face higher payments as their mortgage terms renew within next 2 - 4 years.

World governments (US figures are easier to access) also face increasing financing costs on their debt. The US Government’s interest expense has gone from about $300 Billion to an estimated $1 Trillion this year and is projected to hit $2 Trillion soon. The interest expense alone currently equals the entire US military budget. Also, the US Government is running budget deficits (like most household spending) with the US national debt projected to hit $40 Trillion within the near future (a few years) rather than in decades.

The key consideration for investors is how the global debt situation impacts you, your household cash flows and your ability to create savings for investment. To pay their debts, Governments will have to either increase taxes or reduce services and programs to you as Citizens, or let inflation run higher to deflate the future value of the debt or some combination of these tactics.

Investing and building nest eggs may become more difficult as interest rates rise and possibly stay higher for longer than expected. A $100,000 loan at 10% comes with $10,000 in annual interest charges – the same interest cost as a $500,000 loan at 2%.

Only time will tell exactly how much our "low interest rate" world has changed since early 2020. New realities may require new tactics and assumptions regarding saving, investing and debt management.

Please contact us [2] if you have questions about these new realities.

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