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Bank of Canada interest rate cut: 5 ways consumers will be affected

The Bank of Canada surprised financial markets by cutting its key interest rate by 0.25 per cent on Wednesday.

Here are five ways the central bank's move will affect Canadian consumers:

1. Cheaper mortgages for some, but not all

"This is good news if you're a variable-rate mortgage holder," said Penelope Graham, editor at RateSupermarket.ca.

Variable-rate mortgages are determined by the prime interest rate, which is in turn linked to the overnight interest rate the Bank of Canada just lowered.

"It remains to be seen just how much [the banks] are going to cut the prime rate, but it will be cut," said Graham.

Holders of fixed-rate mortgages, of course, won't enjoy an immediate cut in monthly payments. Canadians taking out a new fixed-rate mortgage or renewing their old one right now could see rates edge down. Fixed mortgage rates are linked to long-term government bond yields. Those bond yields have already begun to fall in light of the Bank of Canada's interest rate cut.

Graham warned Canadian home buyers that what goes down, must come up.

"When rates do eventually go up, when the economy recovers, [mortgage holders] are going to see their monthly debt servicing costs go up," said Graham. "If they can't handle that, they could see themselves underwater on their mortgages."

2. Borrowing on lines of credit, credit cards

Like variable-rate mortgages, interest rates for lines of credit are generally tied to a bank's prime interest rate, which is tied to the Bank of Canada's overnight rate. That means Canadians borrowing money through a line of credit can expect their borrowing costs to come down.

Canadians hoping for a break on their credit card bills, though, are out of luck.

"Your credit card interest [rate] is actually a stated amount," explained Craig Alexander, chief economist at TD Bank. "So when the Bank of Canada cuts rates or raises rates it doesn't have an influence on them."

As with mortgages, Canadians shouldn't necessarily take further advantage of cheaper borrowing costs just because they can.

CIBC deputy chief economist Benjamin Tal sees a potential risk to the Canadian economy if Canadians start racking up even more debt. A credit-fuelled spending spree is "something that the Bank of Canada would like to avoid," said Tal.

"Our debt-to-income ratio, at 165 per cent, is relatively high," said Tal. "That's a risk that the Bank of Canada is taking."

3. The loonie flies south

The Canadian dollar fell dramatically against a variety of major currencies as soon as the Bank of Canada made its announcement, and that means Canadians immediately have less purchasing power abroad. That's bad news for snowbirds with homes in the U.S., or any Canadian planning an international trip.

If Canadians are wondering when to transfer money to a foreign bank account, they can try to take advantage of short-term volatility in exchange rates, according to Karl Schamotta, director of foreign exchange research at Cambridge Mercantile Group.

"Typically exchange rates do not follow a nice linear trend," said Schamotta. "There's certainly potential to harness any gains that might occur over the coming months, but at the same time it's very important to look at that overall backdrop and understand that the Canadian dollar is likely to remain depressed for a long period of time."

How long could the loonie fly so low? Schamotta sees a clue in the Bank of Canada's own outlook, which says lower oil prices will have an "unambiguously negative" effect on the Canadian economy for 2015 and beyond.

"What we're looking at here is a relatively bearish outlook for interest rates and for growth in Canada for at least a one- to two-year period here, and that is likely to keep the Canadian dollar contained," said Schamotta.

That negative outlook could turn more positive, added Schamotta, if some kind of geopolitical shock causes oil prices to surge once again.

4. No immediate effect on auto loans

Auto loans tend to be fixed-rate, not variable-rate. That means the Bank of Canada's interest rate cut won't have an immediate effect on auto financing, according to Canadian Auto Dealers Association chief economist Michael Hatch.

"I don't think that tomorrow automotive consumers are going to wake up necessarily to easier or harder financing conditions," said Hatch. "It's going to remain par for the course."

Still, Hatch didn't rule out cheaper auto financing in the near future. "It's a very competitive [interest rate] environment out there. It could well happen in the next few months, going into the spring selling season."

5. A bad time for savers

If you enjoy interest generated from a traditional savings account, the Bank of Canada's move is bad news for those returns.

"We saw when the Bank of Canada cut interest rates during the last recession that interest rates on savings accounts went down almost linearly with the decline in the Bank of Canada overnight rate," said Randall Bartlett, senior economist at TD Economics.

"There's not going to be a massive change, but at the same time … if you're not earning much interest before, you're going to be earning less interest now," added Bartlett.

This could be a good time for savers to think about changing their strategy, said Bartlett.

"As interest on things like savings accounts and government debt … comes down, at the same time it does provide incentives for people to invest in other types of assets that have higher returns," said Bartlett. "Things like stocks, ETFs, mutual funds … tend to benefit from rate cuts" as businesses take advantage of cheaper credit to make investments that could improve their share prices down the line.