**Interest Rate Hikes And Annuity Payouts**

by [Rino Racanelli](https://www.canadianmoneysaver.ca/authors/rino-racanelli)

With inflation continuing to hover just below seven per cent and the cost of living increasing for all Canadians, we shouldn't be surprised that the Bank of Canada would use interest rate hikes to control soaring inflation. At the beginning of 2022, I recall the Federal government was contemplating at least six periodic increases in interest rates beginning in March 2022. They have kept their word, and in April and June of last year, we saw substantial increases in interest rates of 50 basis points. When July rolled around, the Bank of Canada made another interest rate hike by a full 100 basis points bringing the Bank of Canada rate to 2.50%. At the time of writing this article (December 2022), we had our seventh consecutive interest rate hike. The latest hike was 50 basis points bringing the Bank of Canada rate up to 4.25%. Quite the jump compared to 0.25% at the beginning of 2022.

**What Effect Do These Interest Rate Hikes Have On Annuity Payouts?**

I've been posting the best annuity rates in *Canadian MoneySaver* magazine for the past couple of years, showing the best rates for $100,000 non-registered prescribed annuities with a 10-year guarantee. Lately, I've been receiving inquiries about how current interest rate hikes have affected annuity pricing, so I thought I'd put pen to paper and show our readers.

Let’s take a walk back to January 2022 *MoneySaver*edition and compare what annuities were paying out then to what they were paying at the end of last year.

**January Rates 2022:**

**$100,000 Prescribed (non-registered) Annuity for Life**

Male age 65                $5,671 annual income

Female age 65             $5,313 annual income

Joint (M/F) age 65       $4,840 annual income

Now let’s compare the above rates to what annuities were paying in December 2022

**December Rates 2022:**

**$100,000 Prescribed (non-registered) Annuity for Life**

Male age 65                $6,545 annual income

Female age 65             $6,205 annual income

Joint (M/F) age 65       $5,729 annual income

Although short-term interest rate hikes did have an impact, they were not the only factor contributing to annuity pricing. We need to observe what long-term bond rates are doing simultaneously. Long-term bond rates can have a greater impact on annuity pricing since annuity providers are big purchasers of long-term bonds. When long-term bond rates go up, the interest component on annuities also goes up as annuity rates are floating based on long-term bond rates (i.e., 10-year bond rates and beyond).

**Canada 10-Year Benchmark Bond Yield 2022**

* January 24      1.42%
* June 24            3.32%
* July 24             2.86%
* August 24        3.10 %
* September 1   3.18%
* October 20      3.66%
* December 1    2.83%

(*Note:* Annuities were paying slightly higher in June compared to July and August when long-term bond rates slightly declined).

Along with short-term interest rates and long-term bond rates, each Canadian insurer calculates its own annuity income rates using the following criteria:

* the amount of annuity purchased.
* the type of annuity purchased.
* mortality rates and the calculation of insurance credits.
* age of the annuitant.
* gender of the annuitant.
* expenses of the insurer, including agent commission.
* source of funds used to purchase the annuity, registered or non-registered.

While higher short and long-term rates do translate into higher income received in an annuity, it's not as great as people think. As the criteria above suggest, annuity payments depend on several factors, with your life expectancy (mortality experience and the calculation of insurance credits) making up the largest shift in annuity income payments. All of this is calculated by the insurance company's actuaries ahead of time and priced into annuity income that the retiree receives from the very first day.

If you're considering purchasing an annuity, future inflation projections should be considered. If inflation continues to increase (rising prices), the return on a bond could also increase but be reduced in real terms, meaning adjusted for inflation. Typically, bonds are fixed-rate investments, and inflation can be a bond's worst enemy, eroding the purchasing power of a bond's future cash flow. For example, if a bond pays a 4% yield and inflation is three per cent, the bond's real rate of return is one per cent.

If inflation expectations start to dampen, then long-term rates will start to decline in anticipation of lower inflation. We have also seen in the past that short-term rates could end up getting pulled back in the next year or so, which would also potentially lower long-term rates as inflation expectations may reverse and come back down. Since the rates are locked in when you buy an annuity, this can represent an opportunity to take advantage of these higher rates while they still exist.

**Updated at Time of Printing:**

**Annuity Rates May 2023:**

**$100,000 Prescribed (non-registered) Annuity for Life**

* Male age 65                $6,832 annual income
* Female age 65             $6,446 annual income
* Joint (M/F) age 65       $5,924 annual income

(*Note*: Long term bond rates slightly higher May 9 2023 @2.95%, compared to rates posted above on December 1st @ 2.83%)

*Rino Racanelli, Independent Annuity Advisor*

*racanelli@sympatico.ca, www.bestannuityrates.ca*