



A GUIDE TO INTEREST RATES

If you have a home loan, or are thinking about taking out a home loan, you should understand how interest rates are applied to mortgages. You can also assess how an increase or decrease in interest rates will affect your repayments.

How Interest Rates are Determined?

The Reserve Bank of Australia (RBA) sets the official interest rate, dependent upon how the economy is performing at the time. In its monthly meetings, the RBA looks at the inflation rate and key economy indicators such as unemployment, consumer price index (CPI), Producer Price Index (PPI) and Retail Sales, and from analysing this information sets the interest rate.

The RBA use interest rates as a tool for controlling monetary policy. For example, if economic activity is deemed too high it may try to slow things by raising the official cash rate – i.e. stops you from spending money by increasing your loan repayments.

The lending institutions then lend the money to you, the consumer (at the rate they borrowed it at plus their margin – the fee you pay for the use of the money).

Visit the RBA website to find out more information about Monetary Policy.

Interest Rates on Home Loans

There are two types of interest rates that apply to home loans - variable and fixed. You can choose whether you'd like a variable or fixed interest rate, or a combination of both, depending on the type of loan product you decide on.

Variable Interest Rates

The majority of home loans in Australia have been taken at a variable interest rate. As the name implies, variable loan rates will fluctuate as the market and the official cash rate does. Therefore if the official cash rate rises, your loan interest rate rises and so does your repayments on the loan, and vice versa. Loans

with variable interest rates tend to offer more flexibility in payment options.

Fixed Interest Rates

This type of interest rate allows you to fix the interest rate you borrow at for a certain period of time within the overall loan term. Fixed terms tend to be from one to three years however some lenders may offer 10-15 year terms. With a fixed interest rate you have the certainty of a set monthly repayment as you are not affected by changes in the official cash rate. This provides benefits when the official cash rate rises as your repayments would not increase, however you cannot reap the benefits of a reduced repayment if the official cash rate falls. With a fixed interest rate your loan provider is taking the risk on the market, which is based on their assumptions about future interest rate movements.

What's Been Happening in the Market?

Interest rates have been decreasing for over a decade, and for the last few years Australians have enjoyed low interest rates - on 23 January 1990 the official cash rate was 17 – 17.50%, and on 2 July 2004 the rate was 5.25%. As a result household borrowings are at a record high – in June 1997 Australians owed \$202.8 billion in housing and in May 2004 this figure has increased to \$577.1 billion.

What Interest Rate is Best for You?

- Your loan decision should be based on a mortgage product suited to your individual needs not on a type of interest rate.
- Ensure that an increase in interest rates is factored into your loan so you are not left short.
- You should be able to switch between interest rates over the loan term without having to refinance.

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