

October 6th, 2009 - Update

Is it time to fix or have the bank's already moved fixed rates too high?

HOW ARE FIXED RATES FUNDED?

Refresher from my comment in our May newsletter on fixed rates:

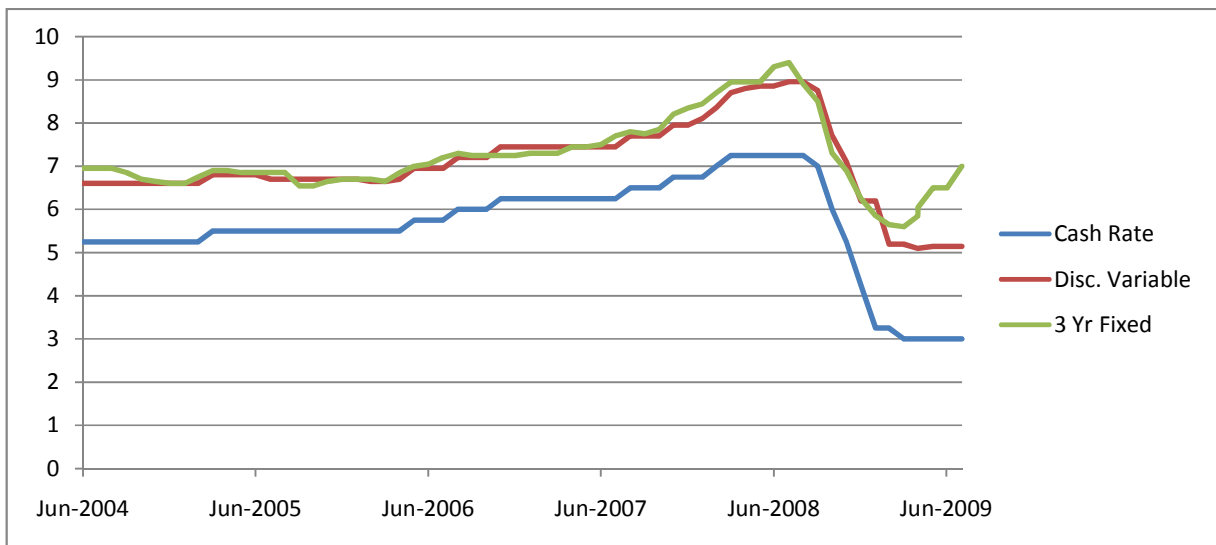
Funding Fixed Mortgages - Lenders tend to outsource funding on money markets, via other banks/lenders – swap rates, through government bonds or via fixed savings deposits of similar duration which they collect from their own retail deposits, locking in their spread or profit margin for similar timeframes, as they plan to lend out this money. Bill Evan's – Westpac Chief Economist noted in his April 20th comment in Westpac weekly economic report called Australian Weekly "Around 40% of banks' funding costs are affected by the bank bill rate but the remainder are determined by retail deposit rates (40%) while around 20% of funding costs are independent of market rates (capital; non interest bearing deposits)."

HOW HAVE FIXED RATES PERFORMED AGAINST 'COMPETITIVE' VARIABLE RATE MORTGAGES?

The chart below shows the historical 'margin' between a 3 year fixed rate and discount variable rates since it has been tracked by the RBA.

Month	Cash Rate	Discount Var.	3 Yr Fixed	Margin b/w Discount Var. & 3 Yr Fixed Rates
Jun-2004	5.25	6.60	6.95	-0.35
Jul-2004	5.25	6.60	6.95	-0.35
Aug-2004	5.25	6.60	6.95	-0.35
Sep-2004	5.25	6.60	6.85	-0.25
Oct-2004	5.25	6.60	6.70	-0.10
Nov-2004	5.25	6.60	6.65	-0.05
Dec-2004	5.25	6.60	6.60	0.00
Jan-2005	5.25	6.60	6.60	0.00
Feb-2005	5.25	6.60	6.75	-0.15
Mar-2005	5.50	6.80	6.90	-0.10
Apr-2005	5.50	6.80	6.90	-0.10
May-2005	5.50	6.80	6.85	-0.05
Jun-2005	5.50	6.80	6.85	-0.05
Jul-2005	5.50	6.70	6.85	-0.15
Aug-2005	5.50	6.70	6.85	-0.15
Sep-2005	5.50	6.70	6.55	0.15
Oct-2005	5.50	6.70	6.55	0.15
Nov-2005	5.50	6.70	6.65	0.05
Dec-2005	5.50	6.70	6.70	0.00
Jan-2006	5.50	6.70	6.70	0.00
Feb-2006	5.50	6.65	6.70	-0.05
Mar-2006	5.50	6.65	6.65	0.00
Apr-2006	5.50	6.70	6.85	-0.15
May-2006	5.75	6.95	7.00	-0.05
Jun-2006	5.75	6.95	7.05	-0.10
Jul-2006	5.75	6.95	7.20	-0.25
Aug-2006	6.00	7.20	7.30	-0.10
Sep-2006	6.00	7.20	7.25	-0.05
Oct-2006	6.00	7.20	7.25	-0.05
Nov-2006	6.25	7.45	7.25	0.20
Dec-2006	6.25	7.45	7.25	0.20
Jan-2007	6.25	7.45	7.30	0.15
Feb-2007	6.25	7.45	7.30	0.15

Mar-2007	6.25	7.45	7.30	0.15
Apr-2007	6.25	7.45	7.45	0.00
May-2007	6.25	7.45	7.45	0.00
Jun-2007	6.25	7.45	7.50	-0.05
Jul-2007	6.25	7.45	7.70	-0.25
Aug-2007	6.50	7.70	7.80	-0.10
Sep-2007	6.50	7.70	7.75	-0.05
Oct-2007	6.50	7.70	7.85	-0.15
Nov-2007	6.75	7.95	8.20	-0.25
Dec-2007	6.75	7.95	8.35	-0.40
Jan-2008	6.75	8.10	8.45	-0.35
Feb-2008	7.00	8.35	8.70	-0.35
Mar-2008	7.25	8.70	8.95	-0.25
Apr-2008	7.25	8.80	8.95	-0.15
May-2008	7.25	8.85	8.95	-0.10
Jun-2008	7.25	8.85	9.30	-0.45
Jul-2008	7.25	8.95	9.40	-0.45
Aug-2008	7.25	8.95	8.90	0.05
Sep-2008	7.00	8.75	8.50	0.25
Oct-2008	6.00	7.70	7.30	0.40
Nov-2008	5.25	7.10	6.90	0.20
Dec-2008	4.25	6.20	6.25	-0.05
Jan-2009	3.25	6.20	5.85	0.35
Feb-2009	3.25	5.20	5.65	-0.45
Mar-2009	3.00	5.20	5.60	-0.40
Apr-2009	3.00	5.10	5.85	-0.65
May-2009	3.00	5.10	6.05	-0.95
Jun-2009	3.00	5.15	6.50	-1.35
Jul-2009	3.00	5.15	6.50	-1.35
Aug-2009	3.00	5.15	7.00	-1.85
AVERAGE	5.60	7.04	7.22	-0.18



- The variance over the long term as been around the 0.1% range until this latest year, were as the graph demonstrates, there is a very disproportionate variance of 1.85% currently and for fixed rates of 4 or 5 years this variance is even greater.

Lender	Date	Discount Var.	3 Yr Fixed	5 Yr Fixed	Margin b/w Dis. Var. & 3 Yr Fixed	Mthly Int. Savings Dis. Var. to 3 Yr Fixed	Margin b/w Dis. Var. & 5 Yr Fixed	Mthly Int. Savings Dis. Var. to 5 Yr Fixed
CBA - Pro Pack	04-Jun-09	5.14%	6.04%	6.69%	-0.90%	\$ 187.50	-1.55%	\$ 322.92
	01-Jul-09	5.24%	6.54%	7.19%	-1.30%	\$ 270.83	-1.95%	\$ 406.25
	05-Aug-09	5.24%	6.54%	7.19%	-1.30%	\$ 270.83	-1.95%	\$ 406.25
	06-Oct-09	5.24%	7.14%	7.64%	-1.90%	\$ 395.83	-2.40%	\$ 500.00
NAB - Pro Pack	04-Jun-09	5.04%	5.74%	6.39%	-0.70%	\$ 145.83	-1.35%	\$ 281.25
	01-Jul-09	5.04%	6.39%	7.09%	-1.35%	\$ 281.25	-2.05%	\$ 427.08
	05-Aug-09	5.14%	6.39%	7.19%	-1.25%	\$ 260.42	-2.05%	\$ 427.08
	06-Oct-09	5.24%	6.89%	7.59%	-1.65%	\$ 343.75	-2.35%	\$ 489.58
WBC - Pro Pack	04-Jun-09	5.11%	5.89%	6.49%	-0.78%	\$ 162.50	-1.38%	\$ 287.50
	01-Jul-09	5.11%	6.39%	6.99%	-1.28%	\$ 266.67	-1.88%	\$ 391.67
	05-Aug-09	5.11%	6.99%	7.59%	-1.88%	\$ 391.67	-2.48%	\$ 516.67
	06-Oct-09	5.11%	6.99%	7.64%	-1.88%	\$ 391.67	-2.53%	\$ 527.08
ANZ - Pro Pack	04-Jun-09	5.21%	6.34%	7.19%	-1.13%	\$ 235.42	-1.98%	\$ 412.50
	01-Jul-09	5.21%	6.34%	7.19%	-1.13%	\$ 235.42	-1.98%	\$ 412.50
	05-Aug-09	5.21%	6.34%	7.19%	-1.13%	\$ 235.42	-1.98%	\$ 412.50
	06-Oct-09	5.21%	6.99%	7.74%	-1.78%	\$ 370.83	-2.53%	\$ 527.08
St G - Pro Pack	04-Jun-09	5.09%	5.99%	6.64%	-0.90%	\$ 187.50	-1.55%	\$ 322.92
	01-Jul-09	5.09%	6.49%	7.14%	-1.40%	\$ 291.67	-2.05%	\$ 427.08
	05-Aug-09	5.09%	6.94%	7.59%	-1.85%	\$ 385.42	-2.50%	\$ 520.83
	06-Oct-09	5.09%	7.09%	7.64%	-2.00%	\$ 416.67	-2.55%	\$ 531.25
ING	04-Jun-09	5.09%	5.89%	6.69%	-0.80%	\$ 166.67	-1.60%	\$ 333.33
	01-Jul-09	5.09%	6.69%	7.39%	-1.60%	\$ 333.33	-2.30%	\$ 479.17
	05-Aug-09	5.09%	6.89%	7.39%	-1.70%	\$ 354.17	-2.20%	\$ 458.33
	06-Oct-09	5.09%	7.09%	7.49%	-1.90%	\$ 395.83	-2.30%	\$ 479.17

Note: The interest rates shown in this table are based on advertised rates - no comparison rates are shown and therefore no decision on taking out a loan should be based on these interest rates, as other costs, such as fees and charges will impact on the overall cost of the loan - this illustration is purely to show the dollar variance between the interest rates on a \$250,000 interest only loan, between the two different interest rates.

Findings: The above comparison clearly demonstrates that current variable rates are offering considerable savings on the current fixed rate price. Comparison between the best 3 year fixed rate and the discount variable is a saving of \$344 per month and against 5 year fixed is \$479 per month.

The difficult question is how quickly variable rates will increase to the level of fixed rates, or will fixed rates come off their current highs and move back to their long term average variance of around .1% of one per cent.

The answer to this will be the just how quickly the world's largest economies bounce back from their current economic recessions and what part Australia plays in this process.

Summary:

History shows us that the margin between historical 3 year fixed rates and Discount Variable has been a lot smaller than it currently is now (and growing). If financial markets return to further normality, then will this margin return to more historical levels with less difference between them? One hopes so! If it is the case, then I suspect fixed rates won't keep going too much higher and variable rates will catch up, but that means variable rates will then give you a saving on interest paid.

Furthermore if you are wise, these interest savings should be focused on paying down your current mortgage, by keeping your repayments as high as you can possibly afford. This could save you tens of thousands on interest over the full term of the loan and also build a buffer for you, which will be available as 'redraw' in the event of an emergency.

So why would you fix – My message remains the same

History has shown us that variable rates have been the cheapest over the long term, so those who are in a position to meet their repayments even if they got to 8% or more, should be financially better off, as they can afford to take a calculated risk. Given no one really knows how quickly we will recover both domestically and globally, if it's a more gradual rebuilding and improvement in the economy, then variable rates, will more than likely be the cheaper outcome and also offer far more flexibility than fixed rate loans, given how expensive they are at the moment.

Those whose household budgets will struggle with rates higher than 8%, well they need to be vigilant and let us know, so we can keep an eye on the movement in fixed rates so as to give them some warning when rates start exceeding 8%. These clients will then be able to make a more informed decision further down the time track, whereby the overall economic picture maybe clearer, which may result in a better decision on whether to fix or not.

Ben Kingsley
Director
Empower Wealth.

Please feel free to contact us to review your own circumstances, so you can make a more informed decision on your current options.

*Tel: (03) 9326 8900 - Ask to speak with one of our Finance Strategists or
Email: equiries@empowerwealth.com.au*