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Interest rate increases by Lenders

Investors,

RBA Moves to Increase Cash Rate

The recent RBA increase to the Cash Rate of 0.25% in two consecutive months has surprised some commentators at being the first developed nation in the world to increase interest rates. Whether this is an inspired move or the RBA has taken action far too early and unnecessarily remains to be seen.

It appears that the RBA has bowed to media hype that the housing market is growing faster than expected. Remember that the RBA put in place a series of increases in 2006 onwards (last rise March 2008), presumably targeting the higher than expected inflation rates but it appeared really aimed at reducing this housing 'bubble'. It is now obvious that the RBA had no idea of the effects on the world and its finances of the US lending practices of selling mortgages to people who could not make repayments, or more specifically the gullible banks that purchased the packaged CDO's in the fantasy of chasing better returns and not understanding the risks. The RBA were still raising interest rates when it was obvious to many that the world finances were looking shaky. RBA was one of the organisations predicting doom gloom and recession. We have had little of any of those. Their track record has not inspired confidence that they have much idea of what is happening.

Housing prices did not back off or come down during the periods of increases from 2006, in fact acted almost the opposite by gaining momentum during these interest rate rises. The property market lost momentum when the banks started tightening credit policies and conditions and a whole bunch of the smaller lenders pulled up shop by mid 2008. The RBA has a main focus, to keep inflation within its agreed boundaries. If inflation is now within these boundaries and there are no obvious inflationary drivers on the horizon, why do they need to increase rates? We all may pay the consequence of the RBA's action.

Banks and their Propaganda

The stuff Banks spin makes me wonder if they think us simply to be stupid or that we have very short term memory. This is an extract from a report on 9th November 2009 by David McIntyre - AAP.

Wholesale funding is sourced from fixed interest investors in Australia and overseas. The average cost of funding has been rising for banks as they roll over cheap term debt sourced before the global financial crisis with more expensive borrowings.

While the cost of debt has fallen from the extreme highs at the height of the crisis, the cost is still higher than two years ago, which continues to raise the average cost. The average term debt before the financial crisis was 3.6 years, with some of that having a maturity of five years, Mr Craig said. "So we've got five years from the beginning of the crunch before the last of the cheap stuff's gone," Mr Craig said.

Banks have been crying poor due to the increases in wholesale funding costs. I doubt whether there is any argument about the increasing costs but what they are saying here is that they have had cheap

money at fixed rates for up to 5 years, with the average at 3.6 years, so from November 2007 at the earliest of March 2008 more realistic, as consumer, we should have had the benefit of those cheap funds. Alas no, banks have increased their profits at our expense increasing their rates well before the RBA moves and well above the RBA official increases.

Lenders

This leads me to the Banks (the Big 4) and their actions and strong hints that the cost of funding is higher than it was and that they may be forced to lift their mortgage rates higher than the RBA movement. Some have already. None of the banks will quantify the cost of funding, just throwing out the spin or conditioning that the costs of funding is higher. Their profits continue to increase into the billions each year, even with using their provisions for doubtful debts to decrease their reported profits. The losses they make are not in the residential lending sectors, it is with their corporate lending, the ABC Child Care, the Optus Prime, the Westpoint, the Timbercorp's of the world, this is where they lose money and it is the home owners and investors that have to pay for the lenders own incompetence.

While all the lenders have quickly passed on the full 0.50% rate, some have taken the opportunity to lift even higher on selective products especially where there is less competition and less ability to move to another lender. Banks are not there to help you, they are there to make money for its shareholders (read executive pay and bonuses).

It may now be time to consider what you are currently paying and whether your loan is structured properly for your needs. There are literally hundreds of products available on the market, some offering more interesting options than just the standard principal and interest loan at the full standard variable rate. One lender has a capped product, a variable rate with a three year interest rate cap. Another lender has a product that instead of offering a discount rate, offer to pay up to 100% of a medical health insurance policy or a 25 cents discount fuel deal, quantity depending on loan amount.

I am surprised at talking to clients who have gone to their local branch, obtained a loan and not looked at it again. They can be paying thousands of dollars more for that loan. A $250k loan over 30 years could cost $48k more over that period by not obtaining a better deal.

Are you paying more than you need to and is your loan structured to best suit your lifestyle now? If RBA continues to lift rates, will this cause enough discomfort that you are forced to compromise your lifestyle? It is always better to arrange your finances before you need to rather than relying on lenders to assist when you are in trouble, they may not. If you think your circumstances may change in the near to medium future, get your finances in order now while you can show income and servicing ability.

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If you have any questions about any of these topics, give me a call.

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