rise financial

Take Control - With Your Independent Financial Adviser

Low rates are a mixed blessing

Snapshot

Interest rates in Australia have plunged to their lowest level ever with the Reserve Bank's latest cut bringing the official rate down to 2.5 per cent – a far cry from the 17 per cent of 1989.

While the late 1980s proved a shocking time for home buyers with mortgage rates peaking at 17 per cent, investors were earning exceptionally healthy returns of 18.95 per cent from money invested risk-free in the bank!

Of course while the rates were high and repayments crippling, mortgages were smaller. Indeed, the average mortgage back then was just under $75,000, compared to $300,000 today.

Baby boomers may be accused of getting all the best deals in life, but it might be worth considering that not only did they have to pay 17 per cent on their home loan, they are now faced with really low interest rates for their retirement savings.

Life is all about ebbs and flows!

Low returns

Fast forward to 2013 and low interest rates. The maximum return on a 12-month term deposit is about 4.1 per cent, while money in an online bank account is earning about 3 per cent.

Just two years ago, you could put money in the bank and get a risk-free return of about 5 per cent a year. To get a similar return in today's market, you would need to take on more risk than a term deposit and look to growth assets such as shares or property.

The low rates are certainly good news for those with a mortgage. The average standard variable mortgage rate is now 5.69 per cent.

According to comparison website Ratecity.com, payments on a $300,000 mortgage are currently about $1,423 a month (based on 5.69 per cent). Compare that with $1,825 a month in August 2011 when the average standard variable mortgage rate was 7.30 per cent. This represents a saving of around $400 a month.

Snapshot

Weak Aussie dollar

Lower interest rates also impact on our dollar. The currency was trading well above parity when Australian rates stood head and shoulders above the rest of the world. However once interest rates started to fall – at the same time as rates elsewhere were showing signs of rising – offshore interest in Australia began to wane.

Of course there are two sides to a weak Australian dollar. While it may make it more expensive to travel overseas, local manufacturers, tourist operators and exporters all stand to gain from the lower dollar. If these industries start to feel confident then this will lead to greater business investment, which in turn will bolster the economy as productivity (output per worker) increases.

This is good news, and it comes at a time when the Chinese investment boom is drawing to a close and other areas of the economy need to step up to the mark.

The commodity boom created an imbalance in the Australian economy with the non-mining sector floundering as individuals and businesses grappled with global economic uncertainty.

Indeed, it is this imbalance in the economy that the Reserve Bank has been attempting to fix with interest rates while keeping the inflation rate within its target of 2-3 per cent (see table below).

Impact on the economy

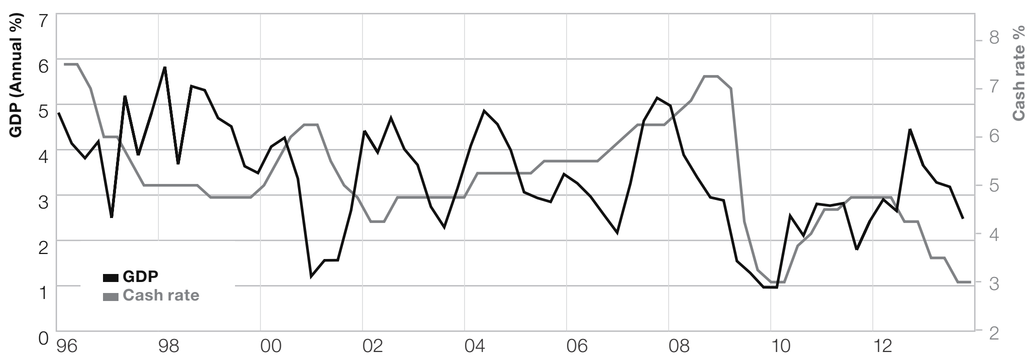
Lower interest rates can have a far reaching influence over the whole economy. For instance, if you are paying less interest on your mortgage and are confident of staying employed, then you are more likely to spend money on non-discretionary items such as cars and clothes.

Equally, low interest rates are a boost to investors who want to use gearing.

But of course, not everybody is at the borrowing stage of their lives and low interest rates can prove a negative.

No matter what your circumstances are, we can help you to make the most of the current environment.

GDP growth and RBA cash rate



Source: RBA, ABS

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