

# DON'T FIX YOUR RATES YET

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## Fixed rates rising

This is what John Collett / SMH has to report about fixed rates:



The banks have been quick to raise fixed rates but there could be another chance to lock in at a low level later.

Those hoping to lock their mortgage at a low interest rate have probably missed the boat for the time being as lenders have raised their fixed rates in recent weeks.

In March, the typical three-year fixed rate was just a little over 5 per cent. That has now risen to about 6.3 per cent, which is expensive when compared with today's standard variable rate of 5.8 per cent. And that's only the advertised rate. Most borrowers with big mortgages are able to secure a discount of up to 0.5 of a percentage point on variable loans.

The reason fixed rates are higher now than a couple of month ago is because the bond market, which largely determines fixed mortgage rates, expects the economic crisis to abate.

However, there may be a second chance for borrowers to lock in a good rate. Many economists disagree with the bond market and think fixed rates are likely to fall again, albeit not to the low levels seen earlier this year.

"My inclination is to think that now is not a good time to fix," says Shane Oliver, the chief economist at AMP Capital Investors. He says it is likely variable rates will stay low for an extended period and may even go a bit lower. That is because unemployment is still rising and, historically, the Reserve Bank of Australia (RBA) tends to cut rates while unemployment is rising.

Variable rates are mostly priced off the official cash rate set by the RBA. Any movement in the cash rate also affects fixed rates. If the cash rate is cut, fixed rates should also fall.

Oliver says the bond market has "got ahead of itself" and over-reacted to a relatively small amount of positive economic news. "Home-buyers who missed out on fixed rates a few months ago may get a second bite of the cherry with lower fixed rates some time later this year," he says.

The RBA is leaving the door open for more rate cuts. Oliver is expecting at least one more 0.25 percentage point cut, or perhaps two 0.25 percentage point cuts, by the end of the year.

Further cuts by the RBA would bring down the rates on longer-dated bonds, which should flow through to a fall in fixed-rate mortgages. But Oliver says they are unlikely to return to their lows of earlier this year. He says the 10-year government bond yield could fall by up to 0.5 of a percentage point, which could see fixed rates fall by a similar amount.

The chief economist at BT Financial Group, Chris Caton, says rising unemployment will prompt the RBA to cut the cash rate by up to 0.5 of a percentage point over 12 months.

"I think the market has got a bit ahead of itself and is pricing in future tightening [a higher cash rate] by the RBA and that has lifted the yield curve, which is flowing through to fixed rates. If it dawns on the market that the RBA could still indeed cut again, as the unemployment rate goes up, then fixed rates could come down."

Last week, futures markets were still pricing a rise in the cash rate of 0.5 of a percentage point in the next 12 months.

The chief economist at CommSec, Craig James, is more optimistic about an economic recovery. He says the cash rate has "probably bottomed" because unemployment will probably not rise by as much as official forecasting. "If we are not at the low point [of the cash rate] we are not far off," he says. "We have seen stabilisation across financial sectors, with less bad news coming through and a good recovery under way in China."

James is not expecting the RBA to rush to lift rates. But it will not want to keep the cash rate too low for too long as it will not want to help create another boom in the housing market, he says.

The RBA has lowered the cash rate aggressively over the past 10 months and, when the recovery eventually comes, the cash rate could go up just as quickly. In the middle of last year, variable mortgage rates were about 9.5 per cent. The RBA has made cuts to the cash rate totaling 4.25 percentage points since it started cutting last September. At 3 per cent, the cash rate is now the lowest it has been since 1960.

Rates will probably continue to head down but eventually, perhaps as early as a year or 18 months from now, the cash rate and mortgage rates may well rise again. That is when the security of a fixed-rate mortgage may come into its own.

"Some people like to have a punt on where interest rates are heading," says James. But the problem is that not even the experts have a good idea about where rates are heading. James says trying to second-guess interest-rate trends is risky.

The normal level for the cash rate is about 5.25 per cent and it now stands at 3 per cent. That means the normal level of the standard variable rate is more like 8 per cent rather than the 5.8 per cent it is now. When the variable rates return to normal, the five-year fixed rates available from major lenders of about 7 per cent today do not seem so expensive.

For those who are concerned by how much rates will rise in these uncertain economic times, fixing will be more important. Most lenders will allow home-buyers to split their mortgage between fixed and variable. But there will be costs if the fixed-rate mortgage is exited early.

[Dave comments](#)

As property investors who are building a portfolio we need to be wary of reading too much into saving money and try to focus our thoughts, energies and ideas into what will think can make us money.

Just about everything we do has a cause and affect scenario and this always needs to be looked into and evaluated before making a decision.

Fixing our interest rates may seem like a good idea, but what ramifications could it have on our overall plan? What impact could it have if our decision is right or wrong?

Could it also possible that the banks are using a marketing strategy here? It would not be the first time banks have been in this situation and they are often ahead of the game when it comes to making money for them. I distinctly remember similar scenarios in the past when predictions of higher interest rates have taken hold and the opposite has eventuated.

Could there be some double standard at play? We have to consider everything before making our decisions. I have been reading for some time that interest rates are likely to fall further, just as predicted in the article above. Do the banks know full well that rates are likely to go down and yet they are feeding us the thoughts we should fix now to gain a benefit which could be that when rates do go down soon the majority of loans will be fixed at the higher level.

As property investors our decisions should be more influenced by where we are in our property investing journey than the current popular theory on rates;  
Does fixing rates fit in with our overall plan? Would it suit our current circumstances?

Consider the 3 stages of creating a property portfolio;

- 1) Accumulation - While in the accumulation stage of building a portfolio we require flexibility – so fixing may not be right for this strategy as we would be looking at refinancing within 12 months and this may entail taking our loan to another lender who would give us a better valuation and perhaps better terms.
- 2) Consolidation - When we enter the consolidation stage we are looking for more long term certainty while we wait for our properties to double in value and this would appear to be a great time to fix rates. So if you already own 15 cheapies then now would be a great time to seriously consider fixing, especially while rental incomes are almost making the properties we buy cash-flow positive.
- 3) Celebration - When we hit the celebration stage we won't care that much because we would have sold some of our accumulated properties and would now own 10 properties outright. We would have entered the financial freedom stage where we can live off the rental income if we choose.

*Trying to help you keep property investing simple*

*Dave*