



Banks 'will raise rates'

RBA holds the key to mortgages and investments

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AUSTRALIAN savers and borrowers are at a crossroads.

On the one hand they must soon decide whether to fix or leave their variable mortgages unchanged. And on the other, depositors must decide if term deposits have peaked.

The key to that decision is the movement of official interest rates.

Last week, the Reserve Bank of Australia left the official cash rate unchanged at 4.5 per cent.

Consensus among economists is that the central bank will leave the rate unchanged at 4.5 per cent for the balance of the year.

Figures last month showed the consumer price index rising 0.6 per cent in the June quarter, less than experts had been expecting, taking some of the pressure off rates.

But from next year, the RBA is tipped to start the next phase of interest rate rises.

By some estimates, the official rate could peak at 5.5 per cent by the end of 2011.

"My guess remains that policy will be on-hold at 4.5 per cent in to 2011," says Macquarie interest rate strategist Rory Roberson.

Without another disappointing consumer price index report to lean on, "the case for a start to phase two of the RBA's tightening cycle is weak to say the least", he adds.

However, one big and immediate threat remains over interest rates — the higher funding costs the banks are facing.

It is likely that the banks will raise interest rates regardless of what the

RBA does, and possibly soon rather than later.

Against that backdrop, some rate specialists believe if you are going to lock in your mortgage rate, now would be the best time.

"Our strategy is that for most of the time we are going to be better off with a variable rate and the highest possible repayments," says Damian Smith, chief executive of financial comparison website RateCity.

"But there are brief windows in the market when it makes sense to look at fixing and that window opens when a fixed rate is less than a 100 basis points (one percentage point) higher than a variable rate. Right now, that window does appear to be open."

For example, he says the average three-year fixed rate across its database was 7.71 per cent and the average standard variable was 7.06 per cent, a difference of 61 basis points.

For borrowers who want that sense of security, he says "it's worth thinking about right now".

Mortgage broker Loan Market predicts that the major banks will look to increase their variable home loan rates regardless of any movement in official rates by the central bank and that they "could strike soon after the August 21 federal election".

He is not alone.

FIG economist Steve Nash believes that after the federal election the banks could increase rates.

He suggests a better option for consumers was splitting their rates between fixed and variable so "you are not exposed to any particular tightening cycle".

InfoChoice chief executive Shaun Cornelius says the three-year fixed rate is offering good value.

In that past few months, he says, the three-year fixed rate has dropped, in some cases by more than 50 basis points, and that now was a better time to lock in a fixed rate than it had been

in 18 months.

Despite that, Cornelius says that what history has told us is that "more people tend to have lost than gained when they have tried to lock in a rate".

He points out that there is a fair bit of uncertainty around the variable rates and what they are going to do.

The best standard variable rates on offer are from Standard Custodians at 6.39 per cent, Homestar at 6.47 per cent and IMB Banking and Financial Services at 6.52 per cent.

Community First Credit Union and Holiday Loan Credit offer the best three-year fixed rate at 7.09 per cent, followed by Rams at 7.23 per cent.

As for term deposits, experts believe these will remain an attractive investment.

By historical standards, term deposits have never been higher, says Cornelius.

He believes the longer-term rates — 12 months plus — are more compelling than the shorter.

For example, you can get a five-year term deposit at a rate of 7.3 per cent.

He suggests the best option for a higher short-term return, is a high interest rate online account, rather than a three-month deposit account.

The average three-month term deposit is about 5.70 per cent. Virgin Money last month launched an online savings rate of 6.75 per cent per annum.

Based on InfoChoice's data, the leading three-month term deposit rates came from ME Bank, which had two offerings, at 6.15 per cent and 5.90 per cent, UBank at 5.71 per cent and ING Direct at 5.50 per cent.

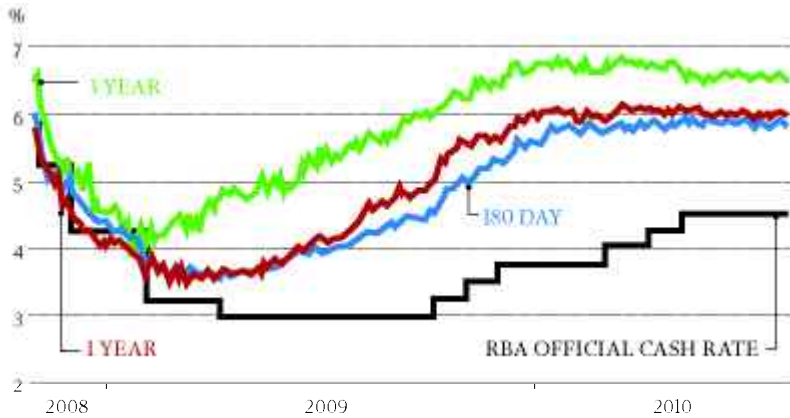
Nash argues that the funding pressure for the banks remains and is likely to intensify towards the end of the year. As such, he says term deposit rates will remain elevated or "probably go up a little bit higher".



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FIG term deposit index



Source: FIG Securities