Borrow

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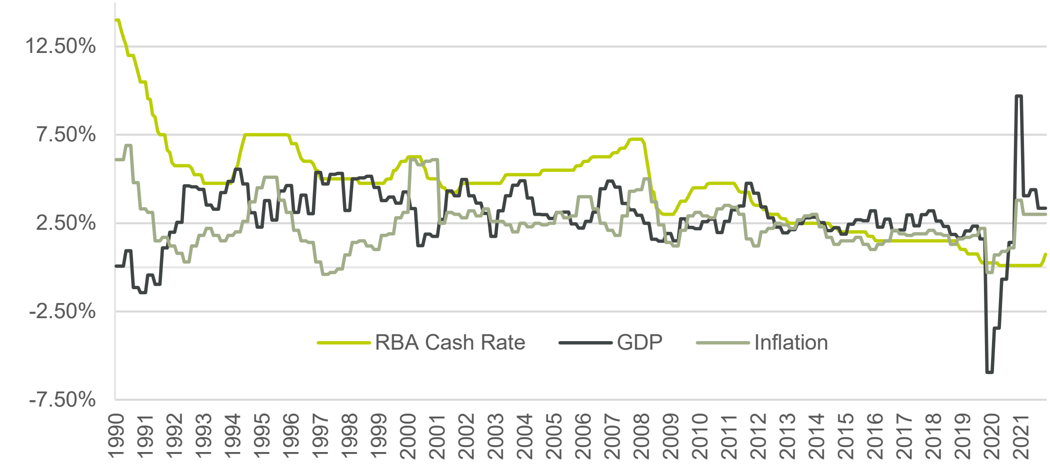
Far from the top. Over the past few months, we've seen sharp increases in the RBA cash rate target. On August 2, the RBA – as expected – increased the cash target rate to 1.85%. While we would like to say this is the top, the reality is we're far from it. Market consensus expectations are for the target rate to increase to 3.35% during 2023, which will result in home loan interest rates of 4.98%.

Cash Rates, Inflation, Wages Growth and Asset Pricing

- At the RBA Monetary Policy Decision meeting on August 2, 2022, the RBA decided to increase the cash rate target by 50 basis points to 1.85%. This was consistent with the forecasts and commentary in the RBA's previous meetings. Money market activity is also decreasing and the RBA has a desire to reduce its AUD investments from the current unprecedented, historical highs.
- While debate rages about the cause of the latest inflation figure of 6.1%, without federal and state authorities reducing infrastructure and social spending or changes in global trade, the only tool available to the RBA to reduce inflation to the target 2-3% is quantitative tightening.

Exhibit 1: GDP, Inflation and RBA Cash Rate



Source: ABS, RBA

Exhibit 2: Wage Growth and Unemployment

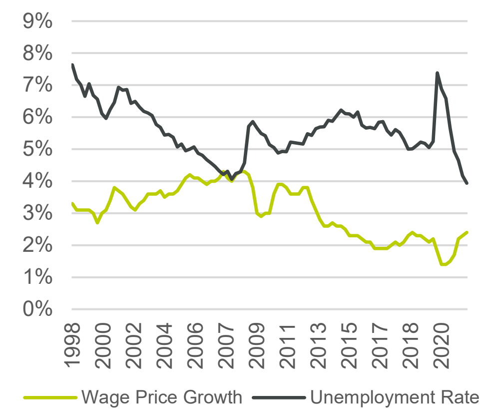
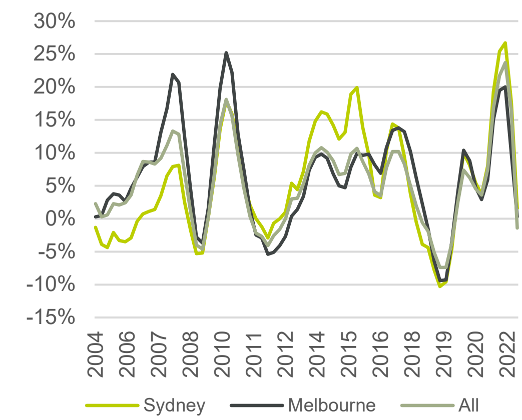


Exhibit 3: Annual House Price Movements



Source: ABS, RBA, Corelogic

Funding Costs

- The RBA injected a huge amount of capital, around $465 billion, into the local economy during the peak of the COVID pandemic. This – alongside huge social support and infrastructure spending by the state and federal governments, and disruption in global logistics – has been the main driver of inflation, which has reached its highest rate since the early 1990's. With effective full employment and inflation not under control, the RBA is doing what it should be doing – restoring normal monetary policy. Unfortunately for debt consumers, this means much higher funding costs compared to the ultracheap rates that we have seen over the past five years.

Exhibit 4: Reserve Bank of Australia Assets
$billion

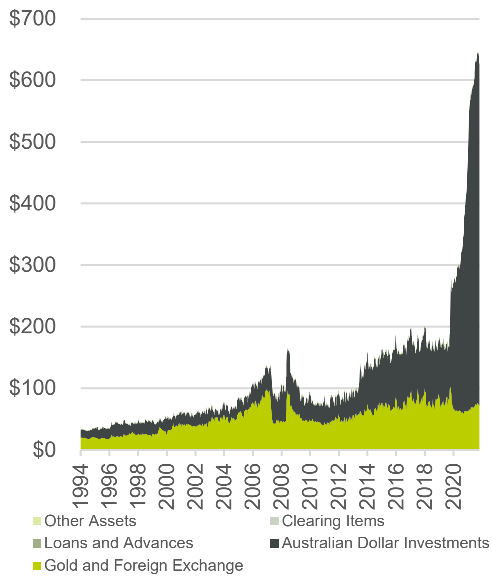
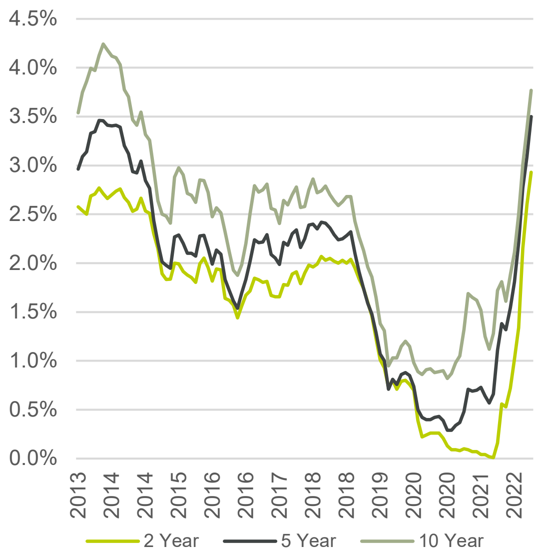


Exhibit 5: Australian Government Bond Yield



Source: ABS, RBA

Exhibit 6: Household Income and Consumption

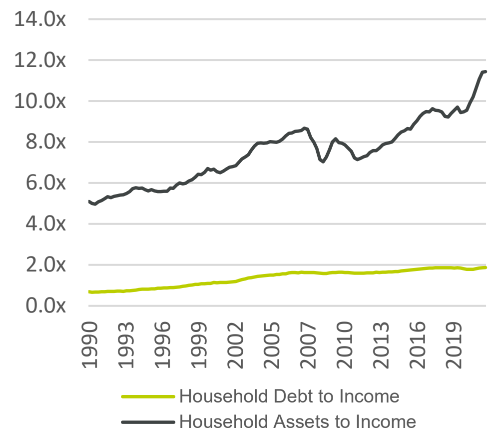
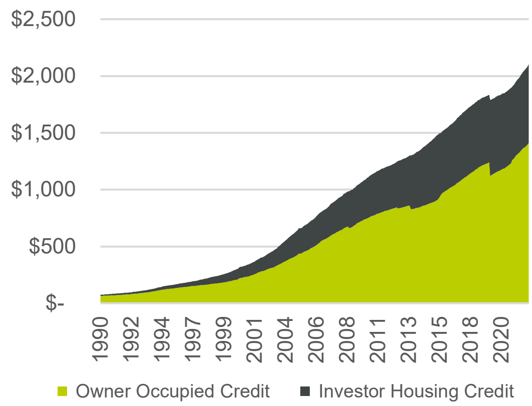


Exhibit 7: Housing Loan Commitments
$billion



Source: ABS, RBA

Historical House and Business Rates

- Over the past quarter, we have seen a material rise in interest rates associated with both residential and business lending. The interest rates remain below historic levels, but they are significantly higher than recent memory.

Exhibit 8: Owner-Occupier Home Rates
Outstanding and new loans in % per annum

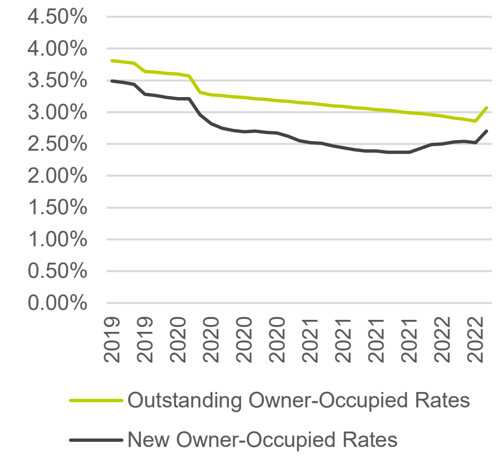
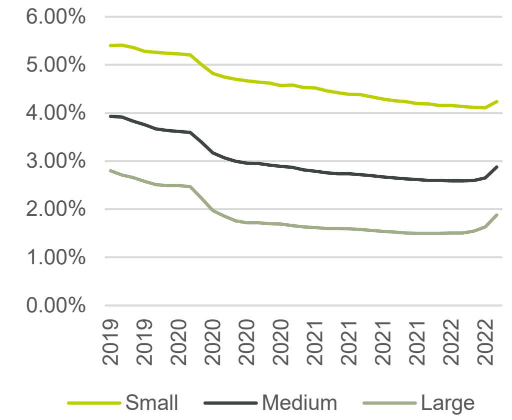


Exhibit 9: Outstanding Business Rates
Small, medium and large businesses in % per annum



Source: ABS, RBA

Lending Standards and Credit Policy

- There have been no notable changes by APRA over the past few months with regards to lending standards affecting consumers. The early work that APRA has done to strengthen banks for the current quantitative tightening has been well forecast and if there is a material increase in defaults, it should not materially impact any of the “Big 4” lenders.

- We’ve also seen increased misunderstanding by consumers about how the current perfect storm of market events and legislation will affect new borrowing, for example:

    - Top tier financiers are heavily focused on evidence of income to service debts and less so on security (as per the National Consumer Credit Protection Act, which reinforces responsible lending to borrowers who can afford repayments without triggering asset sales)
    - A reduction of asset prices
    - An increase in construction and household expense measures
    - An increase in stress-tested servicing rates
    - Increasing credit scrutiny and the use of newly available data points for technology credit decisions.

- Well-prepared borrowers can use this to their advantage. However, many others will be pushed into non-prime and private lenders for capital (if they still want it).

Exhibit 10: Credit Policy

	12 m Ago	Current	12 m Forecast	Consumer Effect
Loan to Value Ratio (without LMI)	80.00%	80.00%	80.00%	**Unchanged** – However we are seeing reducing in house prices
Debt to Income Ratio	~7.0x	<6.0x	<5.0x	**Negative** – Lenders are seeking to reduce consumer leverage, given increased interest rates
APRA Servicing Buffer + Reference Rate	4.48%	5.84%	8.48%	**Negative** – Material increase in interest rates
Household Expense Measure				**Negative** – Material increase in household expenses, due to inflation

Source: Cashel Family Office

Borrower Loan Rates

- Following the initial shock of September 2021, the current forecast fixed rates have been relatively stable over the past few months. We still see value in holding variable debt (as long as it’s at the lowest-possible rates). However, we expect this to change soon due to further increases in the RBA cash rate target over the next six to 12 months. Factoring in the most recent RBA changes, one-to-two-year fixed rates should now be considered, especially given the risk that the RBA will increase rates above current forecasts in order to get inflation under control.

Exhibit 11: Owner Occupied Rates

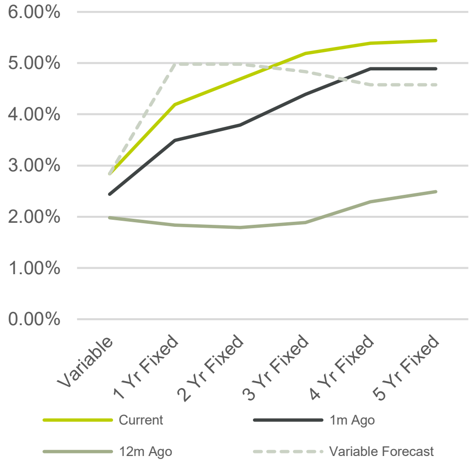
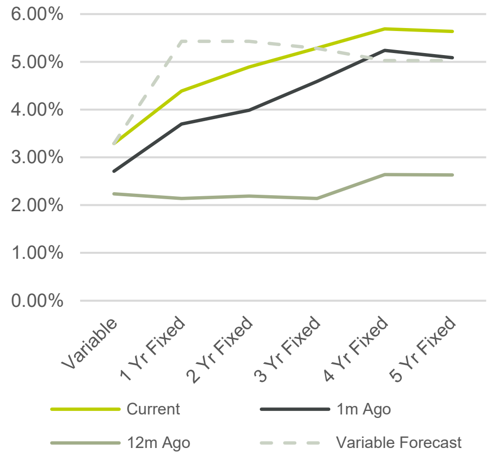


Exhibit 12: Investment Rates



Source: Cashel Family Office, Connective

Exhibit 13: Home Loan – Indicative Available Interest Rate Hedging

	Current	2023	2024	2025	2026	2027
Forecast Variable Rates	2.84%	4.98%	4.98%	4.83%	4.58%	4.58%
1 Year Fixed	4.19%	4.19%	4.98%	4.83%	4.58%	4.58%
2 Year Fixed	4.69%	4.69%	4.69%	4.83%	4.58%	4.58%
3 Year Fixed	5.19%	5.19%	5.19%	5.19%	4.58%	4.58%
4 Year Fixed	5.39%	5.39%	5.39%	5.39%	5.39%	4.58%
5 Year Fixed	5.44%	5.44%	5.44%	5.44%	5.44%	5.44%

Source: Cashel Family Office, Connective

Exhibit 14: Investment Home Loan – Indicative Available Interest Rate Hedging

	Current	2023	2024	2025	2026	2027
Forecast Variable Rates	3.29%	5.43%	5.43%	5.28%	5.03%	5.03%
1 Year Fixed	4.39%	4.39%	5.43%	5.28%	5.03%	5.03%
2 Year Fixed	4.89%	4.89%	4.89%	5.28%	5.03%	5.03%
3 Year Fixed	5.29%	5.29%	5.29%	5.29%	5.03%	5.03%
4 Year Fixed	5.69%	5.69%	5.69%	5.69%	5.69%	5.03%
5 Year Fixed	5.64%	5.64%	5.64%	5.64%	5.64%	5.64%

Source: Cashel Family Office, Connective

Exhibit 15: Personal, Asset, Commercial and Business Lending Indicative Interest Rates

	Indicative Rates	Commentary
Home Mortgage (Full Doc)	2.84%	
Home Mortgage (Low Doc)	3.69%	Products for those able to present full financial statements to show debt servicing income.
Investment Mortgage (Full Doc)	3.29%	
Investment Mortgage (Low Doc)	3.65%	
Commercial Loan	3.19%	
Investment Mortgage (Private Doc)	7.00%	These products apply to non-consumer borrowers who cannot show income to service debts.
Margin Loan	6.75%	
SMSF Loan	4.79%	
Chattel Loan	5.45.%	
Personal Loan	7.27%	
Credit Card	16.64%	
HECS	3.90%	
Outstanding Taxation	8.00%	

Source: Cashel Family Office, Connective

Implications of Interest Rate Outlook

- Based on consensus estimates plus two- and five-year government bond yield forecasts, we expect variable home loan rates to peak just below 5% in 2024 and investment rates to hit 5.43% in the same period. This will result in monthly principal and interest repayments increasing by around 30% compared to current variable rates (prior to the most recent RBA announcement) and around 45% compared to variable rates available September 2021.

Exhibit 16: Impact of Interest Rate Forecasts and Fixed Rates on $1 Million Borrowing

	August 2022	2023	2024	2025	2026	2027
Current Available Rates (Home)						
Variable Rates	2.84%					
Fixed Rate		4.19%	4.69%	5.19%	5.39%	5.44%
Current Available Rates (Investment)						
Variable Rates	3.29%					
Fixed Rate		4.39%	4.89%	5.29%	5.69%	5.64%
Cashel Forecast						
Inflation	5.10%	3.60%	2.90%	3.50%	3.00%	3.00%
RBA Cash Rate	1.35%	3.00%	3.00%	2.85%	2.60%	2.60%
Variable Rates – Home	2.84%	4.98%	4.98%	4.83%	4.58%	4.58%
Variable Rates – Investment	3.29%	5.43%	5.43%	5.28%	5.03%	5.03%
Monthly P&I Payments on $1m	$4,130	$5,356	$5,356	$5,265	$5,114	$5,114
Change in Monthly Payments ($)		$1,226	$1,226	$1,135	$984	$984
Change in Monthly Payments (%)		29.7%	29.7%	27.5%	23.8%	23.8%

Source: Cashel Family Office, RBA, NAB, Westpac and ANZ

Recommended Strategies

Refinance or Reprice Existing Banking Products

- If you're not already paying the lowest variable or fixed rates, you should be seeking to do the same. If you have the income to show servicing you should now be using this opportunity to reset the cost of your debt, especially as income may be harder to predict in the future.

Deleverage, Consolidate and Cut Costs

- If you are carrying high levels of debt (i.e. debt to income of over 5x) you should be using this opportunity to reduce unnecessary costs and unproductive assets, or seek to renegotiate income as soon as possible, especially as we expect the cost of debt servicing to rise about 45% between September 2021 and its peak in 2023.

Position for Opportunities

- Those with low leverage and the ability to increase income should arrange pre-approved debt so they can act quickly and negotiate aggressively if they see financially distressed sellers offloading quality assets.

Consider Fixed Rates

- Following the latest rate rise, the difference between variable and fixed rates has reduced to the point that it's now worth considering fixing some rates, given the risk of further rate rises above expectations if the RBA cannot get inflation under control.

Reach out to your Cashel Relationship Manager for assistance and advice on any of these strategy recommendations.

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