Borrow

29 July 2024

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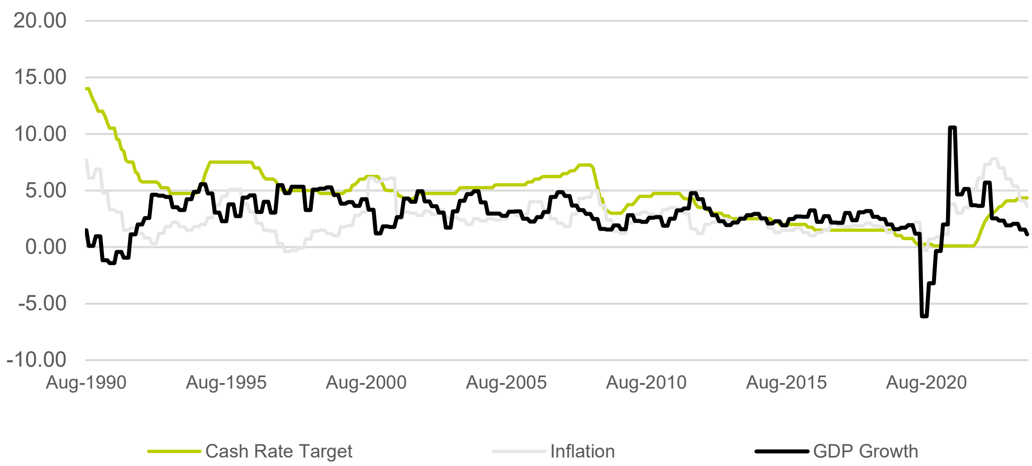
Interest rates set to rise? The latest inflation results surprised with an increase in inflation. The RBA appears to be running out of excuses for reasons not to lift rates to calm inflation.

Cash Rates, Inflation, Wages and Real Estate Asset Prices

- On 18 June 2024, the RBA left the cash target rate unchanged at 4.35%, with its exchange settlement balances also unchanged at 4.25%. During April, the CPI indicator rose by 3.6 per cent in headline terms and by 4.1 per cent, excluding volatile items and holiday travel. All outside of the 2 to 3 per cent target range desired by the RBA.
- In deciding to maintain rates unchanged this month, the RBA commented, "*Returning inflation to target within a reasonable timeframe remains the Board's highest priority. This is consistent with the RBA's mandate for price stability and full employment. The Board needs to be confident that inflation is moving sustainably towards the target range. To date, medium-term inflation expectations have been consistent with the inflation target, and it is important that this remains the case."*
- The most recent RBA Chart released on 19 June 2024 shows a number of interesting developments. Australia's GDP growth continues to decline. Aside from imports and exports, the largest single driver of GDP growth has been Government spending for the last 12 months ending 31 March 2024. Consumer sentiment continues to be at the lowest level for the past 15 years. Private dwelling investment fell below 2014 levels, while the savings rate declined to near zero.

Exhibit 1: GDP, Inflation and RBA Cash Rate



Source: ABS, RBA

Exhibit 2: Wage Growth and Unemployment

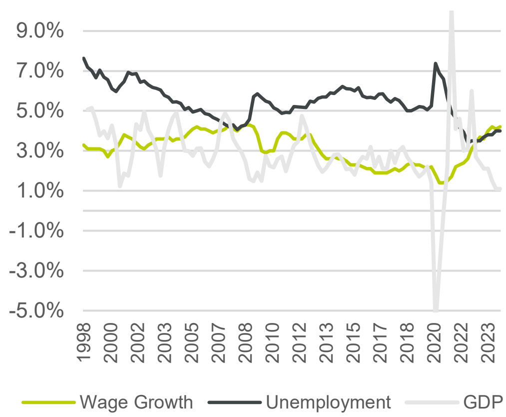
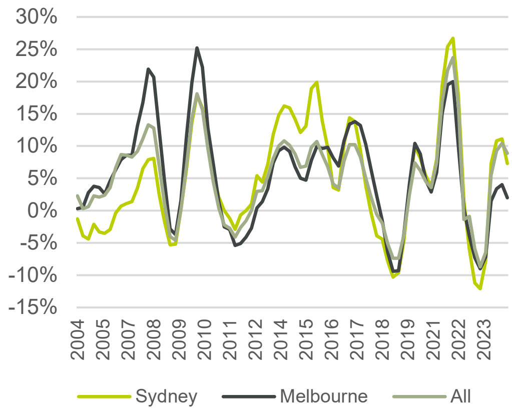


Exhibit 3: Annual House Price Movements



Source: ABS, RBA, CoreLogic

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Monetary Policy and Home Servicing Ratios

- The RBA reduced its balance sheet materially during June, with a reduction of approximately $65 billion, mostly associated with emergency lending made available to the Australian banking industry during COVID-19. That said, the amount outstanding remains materially higher than in the pre-COVID-19 period, which may indicate there is still more stimulus to come out of the economy.

- The longer-term government bond rates have traded consistently between 4.2% and 4.3% over the past 3 months, while the short-term rates have maintained their position around 4.0%.

- As the domestic GDP slows, the ongoing trend of slowing or declining household assets and debt to income has also continued.

Exhibit 4: Reserve Bank of Australia Assets
$billion

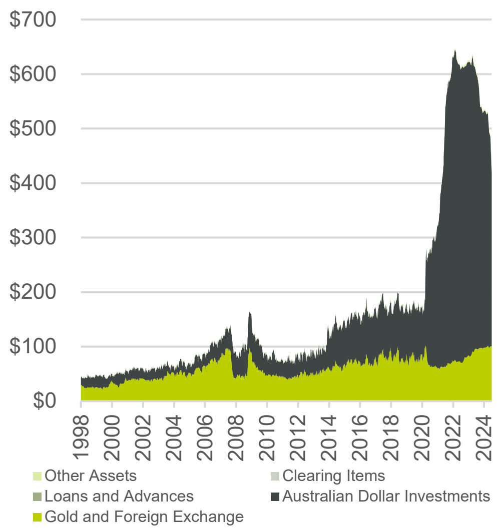
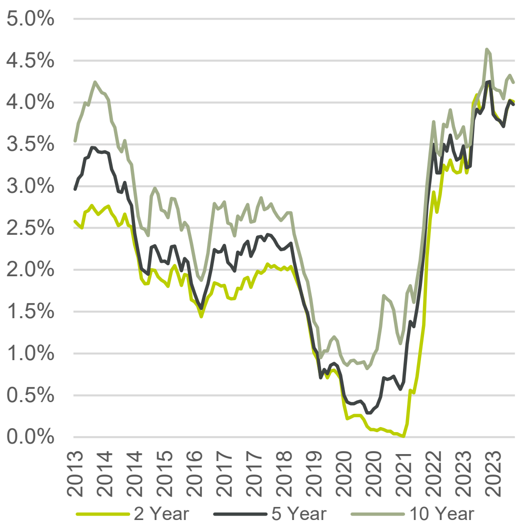


Exhibit 5: Australian Government Bond Yield



Source: ABS, RBA

Exhibit 6: Household Debt Servicing Ratios

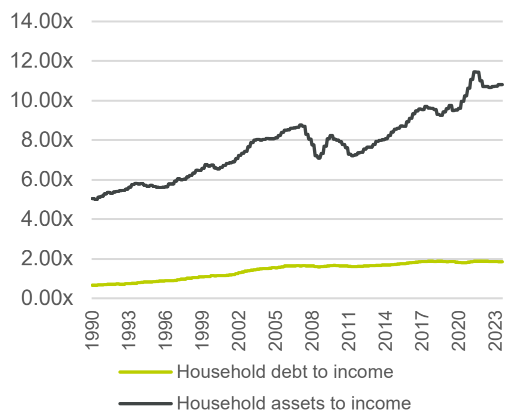
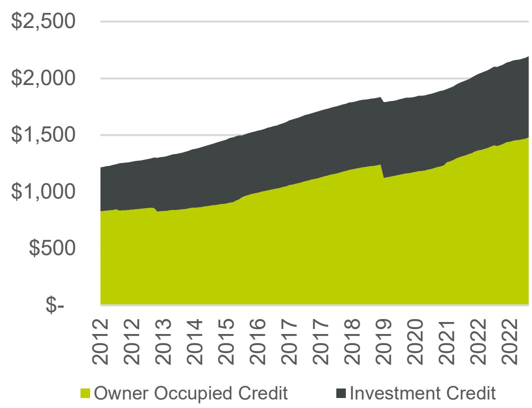


Exhibit 7: Housing Loan Commitments
$billion



Source: ABS, RBA

Historical House and Business Rates

- Residential and business interest rates have flattened over the past quarter. There is a meaningful incentive to refinance to new lenders with the most competitive variable rates, typically around 0.50% lower than existing outstanding mortgages.

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

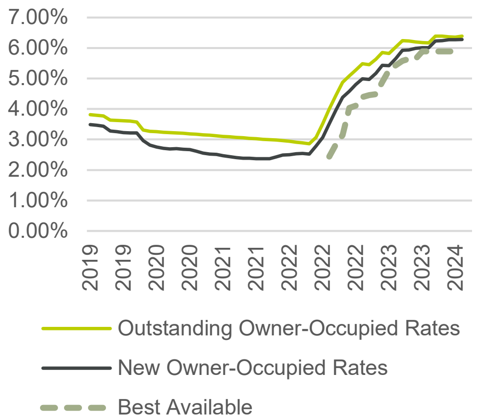
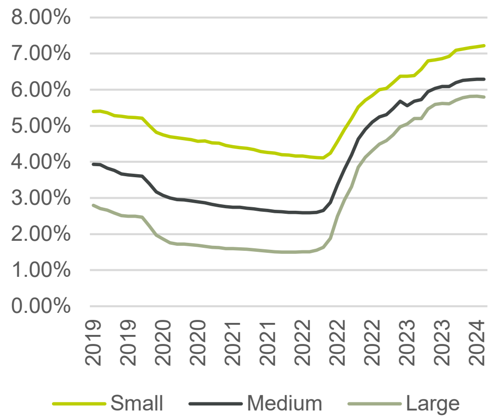


Exhibit 9: Outstanding Business Rates
Small, medium and large businesses in % per annum



Source: ABS, RBA

Access to Funding

- We expect no change at the next few meetings unless there is a material change in inflation or other economic conditions.

Exhibit 10: Indicative Credit Policy Measures

	12 m Ago	Current	12 m Forecast	Consumer Effect
Loan to Value Ratio* (without LMI)	80.00%	80.00%	80.00%	**Neutral** – Valuations have remained relatively stable in Melbourne over the past 12 months, with greater growth in Sydney, Perth and Brisbane.
Debt to Income Ratio	<6.0x	<6.0x	<6.0x	**Neutral** – Lending standards have been relatively stable over the last 12 months.
Bank Servicing Buffer + Reference Rate	8.43%	7.95%	8.28%	**Negative** – There has been no change in the buffer rates over the past 6 months. The only changes are through natural market movements in the variable rates.
Household Expense Measure (2 Adults, 2 Children, Modest Lifestyle)	$6,045	$6,500	$6,708	**Negative** – We expect to see further increases in credit underwriters' expectations of household expense measures as inflation increases expenses higher than wage growth.
Indicative Borrowing Capacity - For $500,000 Income Household	$2,406,131	$2,454,509	$2,352,419	**Neutral/Negative** – We expect a near-neutral effect on borrowing capacity over the next 12 months. While short-term rates may rise, we expect a small decline next year.
		2.0%	-2.2%	

Source: Cashel Family Office, Refinitive
*Typical loan-to-value ratio loan limits.

Borrower Loan Rates

- Following the latest inflation results, lenders took the opportunity to lift future rates. This contradicts the forecast consensus, which still appears to be promoting a rise in rates over the next year, followed by a cut in the 2-to-5-year period.

Exhibit 11: Owner-Occupied Rates

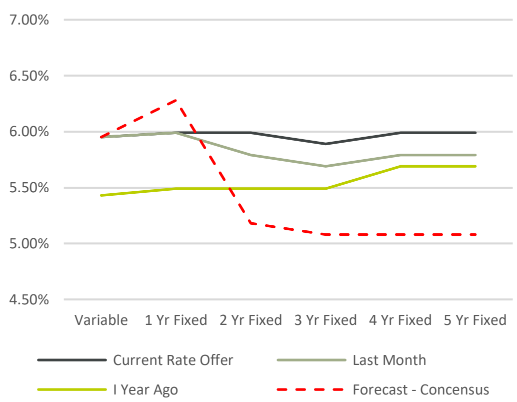
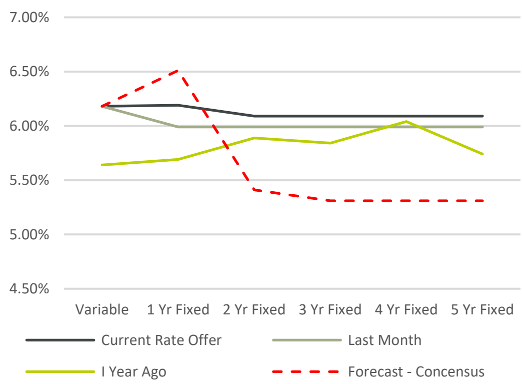


Exhibit 12: Investment Rates



Source: Cashel Family Office, Refinitive, Connective

Exhibit 13: Home Loan – Indicative Available Interest Rate Hedging

	Current	2025	2026	2027	2028	2029
Variable Rates	5.95%	6.28%	5.18%	5.08%	5.08%	5.08%
1 Year Fixed	5.99%	5.99%	5.18%	5.08%	5.08%	5.08%
2 Year Fixed	5.99%	5.99%	5.99%	5.08%	5.08%	5.08%
3 Year Fixed	5.89%	5.89%	5.89%	5.89%	5.08%	5.08%
4 Year Fixed	5.99%	5.99%	5.99%	5.99%	5.99%	5.08%
5 Year Fixed	5.99%	5.99%	5.99%	5.99%	5.99%	5.99%

Source: Cashel Family Office, Connective

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

	Current	2025	2026	2027	2028	2029
Variable Rates	6.18%	6.51%	5.41%	5.31%	5.31%	5.31%
1 Year Fixed	6.19%	6.19%	5.41%	5.31%	5.31%	5.31%
2 Year Fixed	6.09%	6.09%	6.09%	5.31%	5.31%	5.31%
3 Year Fixed	6.09%	6.09%	6.09%	6.09%	5.31%	5.31%
4 Year Fixed	6.09%	6.09%	6.09%	6.09%	6.09%	5.31%
5 Year Fixed	6.09%	6.09%	6.09%	6.09%	6.09%	6.09%

Source: Cashel Family Office, Connective

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

	Indicative Rates
Home Mortgage (Full Doc)	5.95%
Home Mortgage (Low Doc)	7.12%
Investment Mortgage (Full Doc)	6.18%
Investment Mortgage (Low Doc)	7.32%
Commercial Loan	6.69%
Investment Mortgage (Private Doc)	8.05%
Margin Loan	9.50%

	Indicative Rates
SMSF Loan	7.15%
Chattel Loan	6.57%
Personal Loan	6.57%
Credit Card	20.57%
HECS	4.70%
Outstanding Taxation	11.36%

Source: Cashel Family Office, Connective, NAB, ATO and comparethemarket.com.

Implications for Interest Rate Outlook

- Consensus forecasts expect a potential short-term rise followed by a gradual reduction in interest rates. While we do expect the possibility of a single rate rise, we do not expect interest rates will materially lower anywhere near the ultra-low rates we had leading into the COVID-19 period.

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

	Jul 2024	2025	2026	2027	2028	2029
Current Available Rates (Home)						
Variable Rates	5.95%					
Fixed Rate		5.99%	5.99%	5.89%	5.99%	5.99%
Current Available Rates (Investment)						
Variable Rates	6.18%					
Fixed Rate		6.19%	6.09%	6.09%	6.09%	6.09%
Cashel Forecast						
Inflation	3.80%	3.20%	2.80%	2.60%	2.60%	2.60%
RBA Cash Rate	4.35%	4.30%	3.20%	3.10%	3.10%	3.10%
Variable Rates - Home	5.95%	6.28%	5.18%	5.08%	5.08%	5.08%
Variable Rates - Investment	6.18%	6.51%	5.41%	5.31%	5.31%	5.31%
Monthly P&I Payments on $1m	$5,963	$6,177	$5,479	$5,417	$5,417	$5,417
Change in Monthly Payments ($)		$213	-$485	-$546	-$546	-$546
Change in Monthly Payments (%)		3.6%	-8.1%	-9.2%	-9.2%	-9.2%

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

Recommended Borrowing Strategies

Consider splitting rates between variable and 3 years fixed – hedge your bets.

- Given the current and forecast variable rates, the 3-year fixed rates for investment and home loans look attractive compared to the variable and longer-term rates. For many Borrowers, it will be lower than their current variable rates and provide a hedge against any unexpected interest rate rises. At the same time, maintaining some variable exposure will provide some upside should the rates decline (as many hope) and you wish to accelerate repayments (particularly for non-tax effective home loans).

Be vigilant about your interest rates.

- If you are not already paying the lowest variable, you should look to do so. We can aid you with renegotiating with your current lender or refinancing with a new lender. There is typically a saving of 0.5% to 1.5% based on refinancing.

Position for opportunities.

- While there appears to be ongoing bad news in some areas of housing and business, we know that this is often a lagged reflection of where we have been and not where we are going. As such, you should consider the effect of news on market sentiment as an opportunity to invest when prices and vendors are beaten up.

Ensure your finance application is ready!

- As a self-employed applicant, if you have not prepared and lodged your 2023 tax returns, you should do so. Lenders will require these before providing finance to you in 2024.

Contact your Cashel Relationship Manager for help and advice on any of these strategy recommendations.

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