



## Paul Clitheroe

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# fixed or variable?

The Reserve Bank may be taking a hiatus from its run of rate cuts, but with official interest rates already at a 49-year low, many homeowners may be wondering if they should fix their home loan interest rate now, or wait and see if rates fall further in the future.

On the plus side, fixing your loan rate provides certainty of repayments and the protection from future rate hikes for the duration of the fixed term.

However unlike variable rates, which are heavily influenced by the official cash rates, fixed rates tend to be shaped by wholesale funding costs. These have risen sharply in recent weeks as global financial markets start to return to more normal conditions, and some banks like Westpac and the Commonwealth Bank, have responded by increasing their fixed rates at a time when the official cash rate remains unchanged.

This highlights how fixed rates can behave quite differently from variable rates. By way of example, the ANZ currently charges a standard variable rate of 5.81% compared to 5.45% if you fix for one year, rising to 6.84% for borrowers who lock in for five years.

It's a similar story with other lenders. Most are charging around 6.50% on a 5-year fixed loan compared to between 5.0% and 5.5% on a standard variable loan ('basic' home loans tend to be cheaper).

This poses something of a conundrum for borrowers – whether it's better to pay slightly more over the near term and reap the benefits if variable rates rise in the future, or take a punt on variable rates remaining low.

Frankly there's no easy solution to this issue. No one knows exactly where interest rates will head in the future, with even the experts often calling it wrong.

If you come across a good deal on fixed rates, it may be worth taking an each way bet, fixing part of your loan and leaving the rest to a variable rate.

Despite some favourable economic news popping up here and there amidst the gloom, and a recent jump in share prices, there is still lots of uncertainty out there and potential for further interest rate falls, so variable rate loans still make plenty of sense for homebuyers.

However, if you do opt to fix, aim for one of the new breed of

fixed rate loans offering flexible features like the option to make extra repayments and even a redraw facility.

Be aware too that exiting a fixed rate loan before the term is over, could involve substantial 'break' costs especially if market rates have fallen in relation to the fixed rate. As many fixed rate borrowers have discovered over the last year, these exit penalties can run into tens of thousands of dollars, often wiping out the benefit of switching back to a cheaper variable rate further down the track.

*Paul Clitheroe's 'Making Money' for the week beginning 11 May 2009*



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