Fixed vs Variable Interest Rates

To fix or not to fix?

This is a question many people are considering in the current climate of potential rising interest rates. Unfortunately there is no crystal ball that can predict what will happen to the economy and interest rates in the future.

Fixed Rates

A fixed rate is just that: the rate that your loan settles at will stay fixed for the period you have chosen.

Fixed rates are what w call predictive. That is, lenders look at the cost of holding money at a certain rate for a specific term and determine the interest rate. Fixed rates are generally higher than the variable rates to take into account possible increases in the cash rate.

In essence when a borrower takes a fixed rate they are predicting that the variable rate will rise above the rates which they have locked in at.

Benefits of a fixed rate loan include:

- Having set monthly repayment amounts for the whole fixed period
- Being protected against any possible future variable rate rises

Drawbacks include:

- Restrictions may apply on any extra repayments you make into the loan
- Fixed Rates are generally higher than Variable Rates
- Any extra repayments you do make may not be able to be redrawn again
- There may be penalties which apply if you break your fixed rate term
- If variable rates decrease lower than your fixed rate, you will be paying more than you otherwise might have been

After a fixed rate term expires, you have the choice of renewing your loan with another Fixed Rate for a set period, or reverting to a Variable Rate loan.

Variable Rates

A variable rate will vary according to the condition of the economy as determined by the Reserve Bank of Australia and market forces. Lenders variable interest rates vary approximately in parallel with the Reserve Bank's cash rate.

Variable rates are a reflection of the current economic climate.

The Reserve Bank uses the cash rate as a blunt instrument to try to control inflation – when inflation is getting too high (generally when the economy is doing well) the cash rate goes up; when the economy is weakening (inflation is usually low) the cash rate often comes down.

Benefits:

- Greater flexibility, such as the ability to make and redraw additional repayments
- If your variable rate falls, you may be making lower repayments than if you had fixed your rate

Drawbacks:

- If the variable rate rises, your monthly payments increase

Historically, higher interest rates prevail for only short periods of time, from a few months to a couple of years. When the higher rates have achieved the desired result of slowing an economy that is growing too fast, rates will start to come down again.

To talk further with us at CORE Lending please drop into our office at 8/9 Longland St Newstead or call us directly on 07 32 600 600 today.

Fixed vs Variable Interest Rates - continued

Should I choose a Fixed Rate?

Many experts say that fixed rates are a better option in a rising interest rate environment; however, the benefits gained in the short term may not be enough to counter the lack of flexibility associated with these loans.

The key is to examine your financial position closely, paying particular attention to:

- Your work situation
- The length of time you expect to stay in your property
- Whether you plan to have children
- Any prospects of increases in your income

Always remember, it is difficult, even for the experts, to predict which way interest rates will go.

Tip:

Perhaps the solution is to have a split loan facility, with one split being for a variable interest rate and the other for a fixed interest rate. That way you have some certainty into the future with the fixed rate and are hedging a component of the loan at a variable rate based on market conditions.