

More in your pocket now and later

Aggressive rate cuts by the Reserve Bank of Australia since October 2008 have seen interest rates drop from a high of 7.25% to below 4% for the first time since the 1960s.

The idea behind this is to put more money into ordinary Australian's bank accounts so they can spend more, and by so doing, keep our economy out of recession. However, there is another option for those of you with mortgages – keeping your repayments at the higher level and saving more money in the longer term.

How much could you save?

Most people will find that a 0.25% cut in mortgage rates will deliver only a modest reduction in repayments. For example, new home buyers Angus and Sue found themselves with an extra \$15.00 each week when the interest rate on their 25-year, \$400,000 mortgage dropped from 7% to 6.75%. That's about enough to buy each of them a takeaway croissant and coffee at the local café every Sunday morning. Still, little things add up. By paying that extra \$15 each week into the mortgage, they could wipe almost one and a half years off their mortgage and save \$28,965 in interest! This is quite substantial for a 0.25% reduction.

To be fair, we need to compare this result with what could be achieved if the interest saving was put into a high interest online bank account rather than the mortgage. Angus and Sue examine the option of contributing their mortgage savings to a high interest cash account paying 4.5% pa. However, they realise that the interest on this account will be taxable. They are both on a 31.5% marginal tax rate (including Medicare), so their "after-tax" rate of interest drops to 1.42%. In comparison, the additional payments on their mortgage are giving them an after-tax return of 6.75% pa. It's no surprise that maintaining the higher mortgage repayments provide a better outcome. In Angus and Sue's case, the net benefit is almost \$30,000 over the life of their home loan compared with savings in the bank of \$23,753 (calculated at 1.42%).

With interest rates being cut in increments of 1%, the benefits just get better. If you can save nearly \$30,000 in repayments after a 0.25% drop, imagine the savings on reductions of 1%!

With such substantial rate cuts, you can help the economy by buying a few extra things and also help yourself by reducing your mortgage. Have you done your sums lately? Now is certainly an appropriate time to reassess your budget.

Date: Feb 2009

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Important Information

The information and any advice do not take into account your personal objectives, financial situation or needs and so you should consider its appropriateness having regard to these factors before acting on it.
