Article from: news.com.au

Borrowers not prepared for rate rise

By Kate Perry December 20, 2007 11:30am

RESEARCH shows that many Australian borrowers wrongly believe that retail banks can't raise home loan interest rates if the Reserve Bank doesn't move the official cash rate.

Although movements in home loan rates generally follow the Reserve Bank, the banks can move independently – and lately they've been hinting they're planning to do just that.

Research by online home loan lender myrate.com.au showed that 60 per cent of Australians would be caught off guard if home loan rates rose outside of an official movement by the RBA.

"If banks don't raise interest rates before Christmas it is likely they will in January, so don't blow out your credit cards hoping to repay them later because 2008 may well get a lot tougher," said Kevin Sherman of myrate.com.au.

The RBA left the official cash rate unchanged at 6.75 per cent when it last met in early December. The central bank is expected to raise rates by 25 basis points when it next meets in early February. But variable home loan rates could rise before then as banks try to cope with higher wholesale borrowing costs.

The sub-prime mortgage crisis in the United States has pushed up wholesale borrowing costs and squeezed local banks' margins. A recent report by JP Morgan said big four banks were losing profits of almost $600 million a year by not passing on the higher funding costs to borrowers.

Earlier this month second-tier player Adelaide Bank hiked its variable rate by 25 basis points.

So far, none of the big four banks have moved, but there have been rumblings.

The head of CBA's retail bank, Ross McEwan, warned last month that a rise in variable home loan rates was not too far off, saying he was prepared to be the first bank to move.

St George said earlier this week that the higher borrowing costs would eventually have to be passed on to customers.

St George chief executive told Paul Fegan shareholders at the bank's AGM that funding remains tight and expensive.

"The longer this continues the more upward pressure will be applied to interest rates," he said. "We will continue to monitor the market in this regard as to future movements."

Loan misunderstandings

It's not just interest rate movements that borrowers are struggling to get their heads around. Mr Sherman from myrate.com.au said the research showed many borrowers did not understand other basic features of their loans or the market.

Twenty-five per cent of borrowers thought lender's mortgage insurance would cover their repayments if they became incapacitated or unable to work, 25 per cent of borrowers had no idea how a redraw facility works, and 76 per cent of borrowers did not understand their loan documents.