

Sunday Mail

Don't get caught in rate-rise trap

Jason Bryce

11 April 2010

Research shows Australians have learnt nothing from the global financial crisis and are not prepared for interest rate rises, writes Jason Bryce

MANY Australian adults still do not grasp very basic financial concepts and are in danger of losing their homes if economic conditions deteriorate.

“Australians haven't learnt anything from the GFC and are still confused over important financial issues like compound interest, equity and credit ratings,” said Kevin Sherman, chief executive of online lender MyRate.

MyRate's ongoing survey has collected information from 7000 people about their level of financial knowledge.

Most concerning perhaps is the revelation that 40 per cent of survey participants, who were mostly people looking for a mortgage, did not understand the importance of a regular income when applying for a home loan.

Many apparently believed that if they had assets already, a steady income was not that important when applying for further debt.

Widespread asset-based lending in the US was a key cause of the global financial crisis.

When interest rates rise and asset values do not, borrowers can be caught out not being able to sell and not being able to meet repayments.

“This research shows, as we head into a higher-rate environment when more people are going to come under pressure, that many people still don't understand the basics,” Mr Sherman said.

“That is going to affect the decisions they make.

“I think the low interest rates meant that many people didn't take a lot of notice of their finances because they didn't really have to.

“People just haven't focused on understanding the basic fundamentals.”

Already there are strong signs that rising interest rates are hurting many households.

More than 80 per cent of Australians are worried about their ability to repay debt during the next 12 months - up from 76 per cent six months ago, according to research by the credit reference agency Veda Advantage.

Almost one in five (19 per cent) of Australians with debt are already finding it difficult to keep up with their repayments, raising the prospect of widespread financial hardship as rates continue to rise or economic conditions deteriorate.

That is the highest level of debt stress in the past 2 1/2 years of Veda's study.

Yet despite problems dealing with their debts, some people were actively looking for more debt, said Chris Gration, head of external relations at Veda Advantage.

`` Our research indicates 13 per cent of Australians who are struggling to repay their bills are looking to take on yet more credit when they should be paying down debts they have," he said.

The thousands of first-home buyers who entered the property last year, and took advantage of boosted government grants to do so, were the people most at risk and least prepared for higher rates, said Damian Smith, chief executive of financial comparison site Ratecity.

`` Last year all the banks told us that the vast majority of their borrowers were paying more than the minimum repayments on their mortgage," Mr Smith said.

`` But I think most of those people are the ones who bought before the GFC and they maintained their repayments at the previous high level.

`` People who bought when rates were low are the people most in danger from rising rates. Many of those people would not be paying more than the minimum."

The Reserve Bank's 25 basis point rate hike on Tuesday was the fifth rate rise since October last year.

All major lenders quickly announced they would apply the Reserve Bank's rate rise across their loan, savings and credit card products.

RBA governor Glenn Stevens has warned borrowers to factor in higher interest rates to their budgets.

Rates are expected to rise further during 2010, by at least another 75 basis points.

Each 25 basis point interest rate rise adds about \$50 to monthly repayments on an average \$300,000 mortgage.

Household budgets are also taking a hit from rising petrol prices, which have gone up by about 25 per cent over the past six months.

Mr Sherman said borrowers needed to be able to make big decisions about their mortgage before they faced a situation where they couldn't sell and couldn't meet the repayments.

`` Negative equity is what you have to avoid - when you owe more than what the property is worth," he said.

`` Making a decision to sell your property because in six months' time you might not be able to afford to sell or make repayments is a very big call to make, but it is the proactive option to think about.

`` Always people who get financially stuck say, `Damn, I should have sold six months ago,' but getting people to make that call now is tough.

`` People usually say, `Let's hold on, let's see what happens,' and obviously the longer they go on the worse the situation gets."