

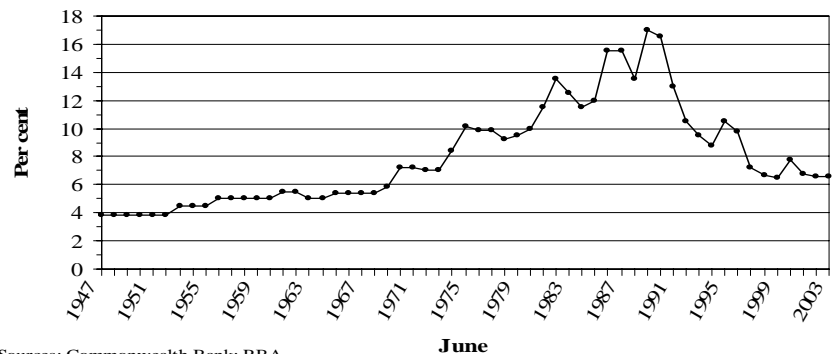
Interest Rates, Home Loans and Repayments

Introduction

On Wednesday 5 November 2003, the Reserve Bank of Australia (RBA) announced that it would be operating in the money market to increase the cash interest rate by a quarter of a percentage point (or 25 basis points) to 5.00 per cent.

Changes in the cash rate—often (mistakenly) called the official interest rate—form the basis for the

Chart 1: Home Loan Interest Rates



Sources: Commonwealth Bank; RBA

Table 1: RBA Monetary Policy Changes

Date	Change in cash rate	New cash rate target
	percentage points	per cent
23 Jan '90	- 0.50 to - 1.00	17.00 to 17.50
15 Feb '90	- 0.50	16.50 to 17.00
4 Apr '90	- 1.00 to - 1.50	15.00 to 15.50
2 Aug '90	- 1.00	14.00
15 Oct '90	- 1.00	13.00
18 Dec '90	- 1.00	12.00
4 Apr '91	- 0.50	11.50
16 May '91	- 1.00	10.50
3 Sep '91	- 1.00	9.50
6 Nov '91	- 1.00	8.50
8 Jan '92	- 1.00	7.50
6 May '92	- 1.00	6.50
8 Jul '92	- 0.75	5.75
23 Mar '93	- 0.50	5.25
30 Jul '93	- 0.50	4.75
17 Aug '94	+ 0.75	5.50
24 Oct '94	+ 1.00	6.50
14 Dec '94	+ 1.00	7.50
31 Jul '96	- 0.50	7.00
6 Nov '96	- 0.50	6.50
11 Dec '96	- 0.50	6.00
23 May '97	- 0.50	5.50
30 Jul '97	- 0.50	5.00
2 Dec '98	- 0.25	4.75
3 Nov '99	+ 0.25	5.00
2 Feb '00	+ 0.50	5.50
5 Apr '00	+ 0.25	5.75
3 May '00	+ 0.25	6.00
2 Aug '00	+ 0.25	6.25
7 Feb '01	- 0.50	5.75
7 Mar '01	- 0.25	5.50
4 Apr '01	- 0.50	5.00
5 Sep '01	- 0.25	4.75
3 Oct '01	- 0.25	4.50
5 Dec '01	- 0.25	4.25
8 May '02	+ 0.25	4.50
5 Jun '02	+ 0.25	4.75
5 Nov '03	+ 0.25	5.00

Note: Monetary policy decisions are expressed in terms of a target for the cash rate, which is the overnight money market interest rate.

Source: RBA *Bulletin*

other interest rates in the financial sector. One group of interest rates that always draw most attention are those that apply to home loans.

With increasing speculation that there are further interest rate rises to come, this note looks at changes in the cash rate, home loan interest rates, the size of home loans and home loan repayment levels.¹

Cash Rate

In the deregulated financial system that operates in Australia, the RBA's most effective monetary policy instrument—to help form a sound basis for long-term economic growth by controlling inflation—is through influencing short-term interest rates. It does this by operating in the overnight money market

to set a cash rate target.² The RBA has officially announced its cash rate target only since the beginning of 1990, see Table 1.

For the 17 months before the latest announcement, the cash rate had remained unchanged at 4.75 per cent. The previous change, on 5 June 2002, was also a quarter of a percentage point increase.

Home Loan Interest Rates

Prior to the latest change, the (predominant) interest rate of the banks on a standard home loan was 6.55 per cent; the rate on a basic loan was 6.00 per cent.³

Chart 1 shows the level of home loan interest rates since the Second World War. Generally, current rates are lower than at any other period since the end of the 1960s.

Home Loans: Sizes and Repayments

According to the Australian Bureau of Statistics (ABS), the average size of new home loans in September 2003 was \$189 100. Table 2 shows the average size of new loans in each of the States and Territories for

owner occupied housing issued by all significant bank and non-bank lenders. These loans include either construction of dwellings, purchase of new dwellings and purchase of existing dwellings (including refinancing).

Table 2: Size of New Home Loans (a)

	\$
NSW	231 900
Vic	187 200
Qld	176 900
SA	132 800
WA	150 600
Tas	106 700
NT	150 600
ACT	207 000
Australia	189 100

(a) Average for September 2003.

Source: *Housing Finance for Owner Occupation*, ABS (5609.0).

Over the last 15 years, the size of home loans has increased by an average 7.3 per cent each year; however, the increase over the year to June 2003 was nearly double that at 14.3 per cent. Only one other increase comes close to this: the 13.6 per cent increase between June 1998 and June 1999.

Table 3 shows the size of the average new home loan at June in each of the last 15 years. It also gives the size of the repayments on the loan at the interest rate of the time. It is interesting to note that although the loan size doubled between 1989 and 1999, the monthly repayments in 1999 were

Table 3: Average New Home Loans and Repayments, 1989 to 2003

June	Average loan \$	Loan repayment (a)	
		\$ per month	% of AWE (b)
1989	66 700	959	44
1990	68 200	954	41
1991	75 100	847	35
1992	79 300	749	29
1993	83 400	729	28
1994	91 000	748	28
1995	98 000	925	33
1996	99 100	883	30
1997	109 400	787	26
1998	117 200	806	26
1999	133 100	899	28
2000	136 100	1 032	30
2001	145 000	1 006	28
2002	156 900	1 064	28
2003	179 300	1 216	30

(a) On 25 year loan at interest rate existing at the time.

(b) Ordinary time earnings for full-time persons (converted to monthly).

Sources: *Housing Finance for Owner Occupation*, ABS (5609.0); *Bulletin*, RBA; and, *Average Weekly Earnings*, ABS (6302.0).

Table 4: Loan Repayments

Principal	Monthly loan repayments									
	Interest rate (% p.a.)									
	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00
\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
1 000	6.29	6.44	6.60	6.75	6.91	7.07	7.23	7.39	7.55	7.72
10 000	63	64	66	68	69	71	72	74	76	77
25 000	157	161	165	169	173	177	181	185	189	193
50 000	315	322	330	338	345	353	361	370	378	386
100 000	629	644	660	675	691	707	723	739	755	772
120 000	755	773	792	810	829	848	867	887	906	926
140 000	881	902	924	945	967	989	1 012	1 035	1 057	1 081
160 000	1 007	1 031	1 055	1 080	1 105	1 131	1 156	1 182	1 209	1 235
180 000	1 132	1 160	1 187	1 215	1 244	1 272	1 301	1 330	1 360	1 389
200 000	1 258	1 289	1 319	1 350	1 382	1 414	1 446	1 478	1 511	1 544
220 000	1 384	1 417	1 451	1 485	1 520	1 555	1 590	1 626	1 662	1 698
240 000	1 510	1 546	1 583	1 621	1 658	1 696	1 735	1 774	1 813	1 852
260 000	1 636	1 675	1 715	1 756	1 796	1 838	1 879	1 921	1 964	2 007
280 000	1 761	1 804	1 847	1 891	1 935	1 979	2 024	2 069	2 115	2 161
300 000	1 887	1 933	1 979	2 026	2 073	2 120	2 168	2 217	2 266	2 315

lower than in 1989; the amount of the repayments reflected the level of the interest rates: 17 per cent in 1989 and 6.5 per cent in 1999.

More interestingly is the comparison of repayments to average earnings⁴ or an indication of income needed to service a loan. As is to be expected, a high proportion of income was required in the late 1980s and early 1990s but since then an average rate of 28–29 per cent has been needed.

Over the last year, because of the large increase in average loan size, the proportion of income (30 per cent) is higher than the average for the previous 10 years and if the loan interest rate is increased by 25 basis points then the 2003 repayments amount to 31 per cent of income.

Loan Repayments Calculator

Table 4 shows the monthly repayments that are payable on various size loans at different rates of interest, assuming a 25 year term with interest calculated monthly.

At the previous home loan rate of 6.55 per cent, the monthly repayments on a loan with a principal of \$100 000 is approximately

\$675. For the same loan at 6.8 per cent, the repayment is approximately \$691.

The table can also be used to calculate repayments for loan sizes other than those shown e.g. a loan of \$189 100 (average new loan from Table 2) at 6.5 per cent gives monthly repayments of (189.1 x \$6.75=) \$1276. The repayment on the same loan at 6.75 per cent (a rate rise of a quarter of a percentage point) gives repayments of \$1307—an increase of \$31 per month.

1. Also see recent related *Research Notes*: 'Tightening the Mortgage Belt' by Peter Hicks; and, 'Mortgage Stress' by Tony Kryger.
2. See *Research Note*, no. 19, 1997–98, 'Reserve Bank Control of Interest Rates' by Guy Woods.
3. A standard loan includes such facilities as a redraw option or ability to make early repayments, while a basic loan has very limited options. Source: RBA *Bulletin*.
4. A single income earner on average weekly ordinary time earnings for all employees (converted to a monthly figure).

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