

Interest rates

Contributed by Stuart Barker

The Reserve Bank recently increased interest rates again. Why does this occur and how do you best protect yourself?

Most of you will know that interest rates have risen again by a quarter of one percent. You may also be aware that they may move again by a quarter of one percent in the near future.

Many people become concerned when a tightening of monetary policy occurs but the reaction should in fact be quite the opposite. It is important to understand the dynamics of interest rate movements and why they happen.

The reserve bank has been given a charter by the government that basically states that inflation must be kept under 3% and wage rises below 4.5%. If the reserve feels that all the economic data points toward either of these levels being breached it will use monetary policy i.e. interest rates to force a correction.

By increasing rates they effectively suck money out of the general economy thereby reducing the capacity of people to spend, which slows growth to sustainable levels. This is why rising interest rates occur during times of great prosperity. A rising rate environment means that our country is enjoying the good times. When rates fall the reserve is attempting to put more money in your pocket which you will spend thereby creating growth and more jobs. Falling interest rates occur when the economy is in a rut.

So a slight tightening of monetary policy as we are seeing now indicates that we are in the good times and we should not be fearful of borrowing money to undertake sound investment strategies. The correct financial structure should take much of the risk away from borrowing funds. Ideally this structure should incorporate flexibility, protection and lifestyle to ensure that you minimise risk and are still able to enjoy your lifestyle while sensibly investing for the future. A combination of fixed and floating rates is important in your financial structure.

Remember, although nobody likes interest rates going up it is certainly not a reason to stop living now and planning for the future because the future is still going to come around whether you like it or not. Do not get caught in the media fear campaign, as they love to embellish a story and make it sound much more than it really is.