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Seize the savings: Smart moves to make when interest rates fall

On February 18, 2025, the Reserve Bank of Australia (RBA) reduced the official cash rate by 0.25% points, bringing it down to 4.1%. This marks the first rate cut since November 2020, prompted by a decline in core inflation to 3.2% in the fourth quarter of 2024.

When interest rates drop, it often sparks excitement, as people start thinking about lower repayments, cheaper loans, and extra cash flow. While it's tempting to pocket the savings and treat yourself, a drop in interest rates presents an incredible opportunity to make smarter financial decisions that can set you up for the future.

Interest rates are a key lever in the economy, and changes impact everything from your mortgage to your savings. If you play your cards right during a period of low rates, you can turn this into a financial win that pays off in the long term. Here's how to be smart and get ahead.

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CONSIDER KEEPING YOUR REPAYMENTS AS THEY ARE

If you're paying off a mortgage, keeping your repayments at the same level when rates drop is one of the smartest moves you can make. Why? Because every extra dollar you pay above your minimum repayment goes directly toward reducing the principal amount. This reduces the overall interest you'll pay in the long term and helps you pay off your loan faster.

For example, if your home loan interest rate drops from 6% to 5%, calculate your new minimum repayment but continue paying the old amount. That difference, which you were already used to paying, will work harder for you by chipping away at your debt.

CONSIDER BUILDING AN EMERGENCY FUND

Lower interest rates often mean lower returns on savings accounts, but this doesn't mean saving becomes any less important. Use the extra cash flow from lower loan repayments or other expenses to bolster your emergency fund.

Aiming to have three to six months' worth of living expenses set aside in case of unexpected events like job loss or health issues can be a good strategy for many people. If you don't already have an emergency fund, now is the perfect time to consider starting onestart.

REASSESS YOUR DEBTS

A drop in interest rates is the perfect time to review all your debts and see where you can save even more money. Look at credit cards, personal loans, or car loans. If the rates on these debts haven't decreased in line with broader rate cuts, it may be worth shopping around for a better deal.

Debt consolidation can also be a smart move. By rolling high-interest debts into a single, lower-interest loan, you can save on interest payments and streamline your finances.

INVEST STRATEGICALLY

Low interest rates can be a double-edged sword for savers. On one hand, borrowing becomes cheaper, but on the other, returns on cash and term deposits may decline. This is a good time to think strategically about investing, you may wish to consider diversifying investments into other more growth oriented asset classes like shares.

If you're new to investing, you might want to start with small amounts and diversify your portfolio. Low-cost exchange-traded funds (ETFs) or superannuation contributions can offer good growth potential over time. Remember, investing comes with risks, so make sure you're comfortable with your risk tolerance and do your research or seek financial advice.

CONSIDER REFINANCING

With lower rates, refinancing your mortgage or loans can lead to significant savings. Lenders often compete aggressively for new customers when rates drop, so you may find an attractive offer with lower fees or a better interest rate. Before refinancing, check for any exit fees on your current loan and calculate whether the savings from switching outweigh the costs. Use tools available online to compare rates and ensure you're getting the best deal.

SUPERCHARGE YOUR SUPER

Lower rates can also mean reduced returns for retirees and those close to retirement. If you're still working, consider making extra contributions to your superannuation. Even small amounts can make a big difference due to the power of compounding interest.

There are strict rules around contributing to superannuation and the tax you'll pay, so please talk to a financial adviser if you are unclear about those rules and how they impact you.

PREPARE FOR THE FUTURE

Interest rates don't stay low forever, so now is the time to think ahead. If you're enjoying lower repayments, consider using use this time to create a buffer for when rates inevitably rise again. Whether it's saving extra in an offset account or paying down your debts faster, small actions now can protect you in the future.

EDUCATE YOURSELF

Take this opportunity to build your financial knowledge. Whether it's understanding how interest rates impact your investments, learning about property markets, or brushing up on your retirement planning, education is key to staying ahead.

MAKE LOW RATES WORK FOR YOU

Periods of low interest rates can feel like a relief, but they're also a unique opportunity to get ahead financially. By being intentional with your extra cash flow, you can reduce debt, build wealth, and prepare for the future.

Remember, the smartest financial decisions often require discipline and planning. Use this time to take control of your money and set yourself up for long-term success.

Transfer Balance Cap Increase

to $2M from 1 July 2025

Following the release of the Consumer Price Index (CPI) for the December 2024 quarter on the 29th of January, it is now confirmed, based on current legislation, that the general Transfer Balance Cap (TBC) will be increased from $1.9M to $2M from 1 July 2025.

The Transfer Balance Cap is a lifetime limit on the amount an individual can move from a superannuation accumulation account to the tax-free retirement phase. This cap is designed to ensure that tax benefits from superannuation are distributed fairly and to prevent very wealthy individuals from taking excessive amounts into their tax-free retirement accounts.

The increase in the TBC is good news for retirees. With the new $2 million cap, couples can have a total of $4 million in the tax-free retirement phase.

TRANSFER BALANCE CAP HISTORICAL 2025-26

Financial Year	General Transfer Balance Cap
2017-2018	$1,600,000
2018-2019	
2019-2020	
2020-2021	
2021-2022	$1,700,000
2022-2023	
2023-2024	$1,900,000
2024-2025	
2025-2026	**$2,000,000**

Indexation of the general TBC also has a flow-on effect on other rates and thresholds from 1 July 2025:

- The Defined Benefit Income cap, currently $118,750 pa will be increased to $125,000. This is the threshold above which tax concessions are reduced for individuals receiving income from capped defined benefit income streams.
- The limit which prohibits an individual from claiming the tax offset for superannuation contributions they make on behalf of their spouse will increase from $1,900,000 to $2,000,000.
- The limit which determines if an individual is entitled to a government super co-contribution will increase to $2,000,000.

IMPLICATIONS OF THE TBC INCREASE

If you have more than $1.9 million in your superannuation and are ready to start a retirement income stream, you might want to wait until after 1 July 2025 to take advantage of the new cap. However, this decision depends on various factors, including the tax on earnings while waiting make sure you speak to your adviser about this first.

It's important to note that the new $2 million cap will only be available to those who have never used any of their TBC before 1 July 2025. If you have already used your TBC, you will not benefit from the increase.

WHAT TO KNOW BEFORE

becoming a guarantor on your child's loan

These days, many Aussies are stepping in to help their kids get their home loan applications over the line. That often takes the form of cash gifts, but there are other ways to assist that don't involve parting with your hard-earned savings, such as acting as a guarantor on the loan.

Put simply, going guarantor means using your assets – typically the equity in your home – as security for your child's loan, potentially allowing them to get on the property market sooner than they would have otherwise.

At a time when prices might be rising faster than potential borrowers might be able to save, a guarantor agreement can provide a much-needed leg-up for your child. But as a parent, there's a lot you'll need to know before jumping on board.

HOW DOES A GUARANTOR ARRANGEMENT WORK?

Let's say Jacob is hoping to buy a $500,000 home and has saved up $40,000 towards that goal. Banks typically like to see a deposit equal to 20% of a property's value, so Jacob is $60,000 short of the mark. Here's where his homeowner parents, Lucy and Tom, might be able to step in.

So long as the bank is confident that Jacob can comfortably service the loan, it might agree to let his parents act as guarantors. The security they provide (in the form of equity in their home) will then make up for the shortfall in Jacob's deposit.

This means Jacob won't have to purchase Lenders Mortgage Insurance, which is usually necessary to offset the risk banks face when a borrower doesn't have a 20% deposit saved up.

The money he saves on LMI can then be put towards the mortgage, stamp duty or legal fees.

Before any documents are signed, the bank will do their best to make sure Lucy and Tom understand the risks involved. They'll also be encouraged to seek legal advice from an independent third party.

Lucy and Tom's guarantee can cover the entire amount Jacob intends to borrow or just part of it. And when Jacob builds up enough equity, whether by chipping away at the loan principal or seeing his home increase in value, he can arrange for his parents to be released from the guarantor arrangement.

What to know before becoming a guarantor on your child's loan

WHAT ARE THE RISKS?

Being a guarantor for your child isn't a decision that should be made lightly. While both of you might have the best of intentions at the outset, a sudden change of circumstances could spell trouble for the entire arrangement. Before you make any decisions, make sure you understand the risks:

- **You're on the hook for the loan if your child can't pay: If your child is unable to service their mortgage, you'll be liable for the portion you guaranteed. Failure to pay could result in the bank seizing your assets in order to settle the loan.**

- **It might affect your ability to get a loan: When you apply for a loan, banks and lenders will typically ask about any other loans you have as part of their serviceability assessment. If the guarantor arrangement is still in place, you might find you're unable to take out any new loans or borrow as much as you want.**

- **It might strain your relationship: It's not just your child's chances at home ownership that hang in the balance — your relationship might suffer too. If things don't go according to plan and you wind up having to step in to cover your child's mortgage, it could create long-lasting tension, embarrassment or remorse.**

HOW WILL CENTRELINK ASSESS THIS?

When a pensioner becomes a guarantor for their child's loan, it does not immediately impact the Age Pension because no money has been transferred, and the pensioner has not incurred an actual debt or liability. If the child defaults and you pays off part or all of the child's loan to the lender and does not expect repayment, Centrelink may consider it as being a gift. Under Centrelink gifting rules, a pension can give away up to $10,000 per financial year (or $30,000 over five years) without affecting their pension. Amounts exceeding this limit are assessable as asset for five years.

As a parent, going guarantor might be preferable to some of the other ways to help your kids buy a home, such as gifting (or loaning) a lump sum or even signing up as a co-borrower. But before you make any decisions, make sure to weigh up the pros and cons as a family.

For advice tailored to your unique circumstances, consider speaking to a financial adviser.

Are you in the retirement risk zone?

There's no telling how the market will perform in a given year. While many investors like to consider themselves expert prognosticators, the market operates according to whims that are difficult to accurately predict.

But all the ups and downs you learned to live with throughout your working life become much more consequential as you approach retirement. Naturally, higher stakes call for careful planning and, as is often the case, good financial advice.

An important term here is what's called the 'retirement risk zone.' This is the five to ten years on either side of your retirement date when your savings are particularly vulnerable to market downturns.

Whereas those who are still decades out from retirement are able to wait out any slumps long enough to see their investments recover, recent or soon-to-be retirees may not have that luxury.

Instead, they could find themselves dealing with an unfortunate one-two punch: not only is the value of their portfolio decreasing because of poor market conditions, the losses are being crystallised each time they draw down on their capital.

This is the basis for a concept known as sequence of returns risk, or sequencing risk for short. While it might sound a bit technical, it really just describes the bad luck of retiring in a down market and the future value that's lost because of it.

> **That last bit is crucial — negative returns at the outset of your retirement can have an outsized impact on your returns over time. This can force some people to completely rethink their plans, put major purchases on ice, and even choose to delay retirement altogether.**

HOW CAN SEQUENCING RISK PLAY OUT?

Under current super rules, anyone receiving an account-based pension has to draw down a minimum amount of super each year, starting at 4% for under 65s and gradually increasing to 14% for those aged 95 and above. This applies regardless of how the market is performing.

Let's imagine you retire with $1 million in super and intend to withdraw at least $40,000 annually in line with the minimum drawdown requirements. In the first year, the market suffers a 15% drop, followed by gains of 5% in the second year, 10% in the third year, and 20% in the fourth.

While three of those first four years were positive, the fact you started your retirement with negative returns can make all the difference.

A good chunk of your retirement portfolio will have been liquidated to fund your retirement spending, meaning it no longer has a chance to recover or generate any compound returns. And from there, there's a much greater chance that your super balance won't last you as long as you originally hoped.

But if luck is on your side and you retire in a bull market, the trajectory of your investments will be completely different. Yes, you're still drawing down on your super and this affects your bottom line, but the gains generated by the market upswing will help offset this.

HOW CAN SEQUENCING RISK PLAY OUT?

A market downturn can be stressful enough on its own, but having it coincide with your retirement can add a whole new layer of unease. Fortunately, there are a few things that might help minimise the impact on your hard-earned wealth.

- **Diversify your investments:** It often pays to have your investments spread out across different asset classes, including ones that are less affected by market fluctuations. A rental property is one of the most sought-after among retirees, but you might want to look into fixed income investments too.
- **Adjust your spending:** Trimming your expenses in the lead-up to retirement can help preserve your savings. And if you've already retired and the amount you're drawing down exceeds the minimum drawdown requirements, consider reducing it so it's in line. You might have to sideline any overseas travel plans for the time being, but the long-term security you stand to gain can be worth it.
- **Delay retirement:** Not everyone will be in a position to do this, but if you can spend a bit longer in the workforce it can give you time to ride out the downturn. You can then hang up your hat when your portfolio has recovered (and you've benefited from an extra period of employer super contributions).
- **Take on part-time work:** Many retirees find value in re-entering the workforce, if only on a part-time basis. Not only can this help smooth out your income, you might find it also helps you keep social and mentally sharp.

While there's no telling in advance whether you'll have to deal with sequencing risk, there are things you can do to prepare for and potentially counter it. Like many problems we face, it pays to be flexible. And if you're looking for advice tailored to your circumstances, consider speaking to a financial adviser.

Looking to plan ahead? Let's discuss strategies for building a strong financial future.