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BUDGETING STRATEGY

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Budget smarter with the 50/20/30 rule

Looking at your spending in a new light could make a substantial difference to your financial future. The 50/20/30 budget rule works for one main reason – it's easy.

New to budgeting? You may know how much money you make and have a rough idea of how much you spend. But do you know what you're actually spending it on, or if your spending patterns will benefit you in the long run? The good news is, you don't need complicated spreadsheets and formulas to get your personal finances in check.

Enter the 50/20/30 budget rule, a kind of yardstick to guide your spending patterns. The concept was popularised by bankruptcy expert and US senator Elizabeth Warren, who co-wrote All Your Worth: The Ultimate Lifetime Money Plan with her daughter, Amelia Warren Tyagi. The essence is to keep your personal budget simple: the easier it is to understand, the easier it is to stick to.

What is the 50/20/30 rule?

Needs: Ideally, you'd spend 50% of your after-tax income on essential living expenses, like rent or your mortgage, other loan payments, groceries, bills, insurance and transport.

Savings: Next, you'd channel 20% of your income into your financial goals, whether that's building an emergency fund, boosting your superannuation or saving for a house deposit.

Wants: The final 30% of your money would be allocated to things that make your life a little more enjoyable but aren't necessary to get by. Think new clothes, concert tickets, a holiday or a meal out with friends.

Consider the figures for needs and wants as a guiding principle – if you spend less than what you budgeted for in either category, the surplus can be channelled into things such as extra mortgage repayments, general savings or investments.

How to create a 50/20/30 plan

To put this budgeting plan into action, you need to have more than a rough idea of what you spend. Make a list and tally up your monthly expenses – remember to include averages for bills that might be infrequent – and then break them up into 'needs' and 'wants'.

If you're currently spending 60% of your income on needs and 40% on wants, you probably won't be surprised to find you're not saving anything for your future. Take some time to reassess where you can cut back to start saving more in each category.

- **Needs:** Can you get a better deal on your phone plan? Can you plan weekly menus to reduce your grocery bills? Do you need to take more drastic measures, like moving to a new house to reduce the amount you spend on rent or your mortgage?
- **Wants:** Can you go without takeaway coffee this month? Do you really have to go out to dinner three times a week? Is that new jacket a must-have?

One way to make sure you stay on track with saving money is by splitting your pay packet as soon as you get paid. You could keep your everyday bank account for your needs, for frequent and easy access. Then consider additional accounts, for wants and savings. Set up an automated direct debit for the day after you get paid, so that the cash split from your everyday bank account happens without you having to do a thing.

Why the 50/20/30 rule works

The 50/20/30 budget rule is popular because it may allow you to manage your money without making too many sacrifices. You pay your bills, grow your savings and still get to have some fun. It also gives you a way to look at your spending in a different light – would you have moved to a cheaper apartment sooner if you'd realised what a large chunk of your income your rent was consuming? Having a new perspective of what's absolutely necessary can be refreshing and rewarding.

When the 50/20/30 rule doesn't work

Like all rules, the 50/20/30 rule was made to be broken – in some situations. If you have a hard time separating your needs from your wants, you'll probably find this form of budgeting tricky to stick to. And it can be downright detrimental if, for example, you have large debts but are still stashing away 30% of your pay for personal splurges. This is the time to consider shifting some of the money in your 'wants' column to your 'needs' column – not forever, but just until you get your spending on essentials down to a more manageable level.