

Potential homebuyers' patience rewarded

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[With interest rates expected to stabilize, prices forecast to rise and a new index, the time is ripe to enter the property market](#)

Hong Kong's equity and property markets have been buoyed by news from the United States Federal Reserve last month that future interest rate increases are likely to be muted. Since then, the Hang Seng index has risen more than 900 points (or more than 6 per cent) and several property analysts have predicted a faster rebound in property prices and an increase in transaction numbers this year. What does this mean for would-be Hong Kong homebuyers who have been sitting on the sidelines for the past several months? Your time has come, and good things come to those who wait.

Property prices in the secondary market softened during the second half of last year, falling 10 per cent to 15 per cent. And interest rate and, therefore, mortgage rates are expected to peak in the first half of this year. If this interest rate outlook is correct, it is inadvisable to secure a fixed-rate mortgage when buying a property over the next few months. Why lock in a rate of 5 per cent or more when interest rates are likely to fall? Predictions that interest rates will fall are supported by the market and the flat US Treasury yield curve. This curve is inverted, with short-term interest rates yielding more than long-term ones, leading to market expectations that rates will remain stable or begin falling in the near future.

Traditional Hong Kong mortgage products – with a floating interest rate linked to the prime index – would therefore be the most desirable for property buyers this year. But do borrowers have any choices in the market other than these floating-rate mortgages? The Hong Kong Monetary Authority last month announced the introduction of a new composite interest rate (CIR), which it hopes banks in Hong Kong will adopt this year in pricing consumer loan products. This index is based on a similar methodology used in the United States, the popular adjustable-rate mortgage (ARM). The US's 11th District Cost of Funds Index (COFI) ARM strives to offer a uniform market index rate for all banks to follow. In Hong Kong there is a disparity in the best lending rates, or prime rates, offered by small, medium-sized and large banks. All banks in Hong Kong used to follow the major banks when adjusting their interest rates – until deregulation in July 2001 permitted them to set their own deposit and lending rates. But interest rate disparities place small to medium-sized banks at a considerable disadvantage because more than 30 per cent of all bank loans are mortgages. It is difficult to draw any definitive conclusions on the CIR as the Hong Kong Monetary Authority has presented calculations of this only for eight financial quarters, beginning with the quarter to end December 2003. However, if the rate is modeled on the 11th District COFI, borrowers may be interested to use it rather than the Hong Kong interbank offered rate (Hibor) as a reference because it is likely to be far less volatile. The volatility of Hibor (particularly when it spiked briefly above prime in 1998) is still the main reason borrowers are reluctant to choose mortgages indexed to this rate. This is expected to be a banner year for Hong Kong's property market, with prices and transactions predicted to

make a significant rebound. With interest rates in the US and mortgage rates in Hong Kong expected to stabilize or even fall, borrowers should take advantage of floating-rate products off stable and predictable indices. Potential homebuyers and lenders have been rewarded for waiting. The market may even soon see the first mortgages priced off the new CIR.



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