

Home loan rate hike inevitable

Analysts say the uptrend is in line with economic recovery

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PETALING JAYA: Financial institutions, in particular banks, have in general agreed to raise mortgage lending yields, which will have an impact of increasing their net interest margins (NIMs).

An analyst with OSK Research said banks with strong mortgage lending growth would be the key beneficiaries, while the eventual increase in benchmark interest rates would benefit all banks on a greater scale as loan assets tended to re-price faster than deposits.

He said higher home loan rates were imminent and expected housing loan rates to trend upwards in the not-so-distant future as the banking industry moved towards risk-based pricing in determining more sustainable interest rates for the industry.

The upswing in home loan rates is inevitable as economic conditions improve.

"The pricing war among banks earlier this year had brought housing loan interest rates to a level that was below or near the cost of funds and was not sustainable. With early signs of economic recovery, the rates are bound to increase," he noted.

The average lending rate (ALR) rose to 4.91% in September from 4.9% in August. The current average base lending rate (BLR) is 5.51%. With home loan rates improving, OSK Research has maintained an "overweight" call on the banking sector.

"We are maintaining an 'overweight' call on the sector on the grounds that non-performing loans are likely to be benign.

"Meanwhile, the downtrend in provisions and strong capitalisation positions should provide future earnings and capital management upside surprises, which may not be fully reflected in banks' valuations," he said.

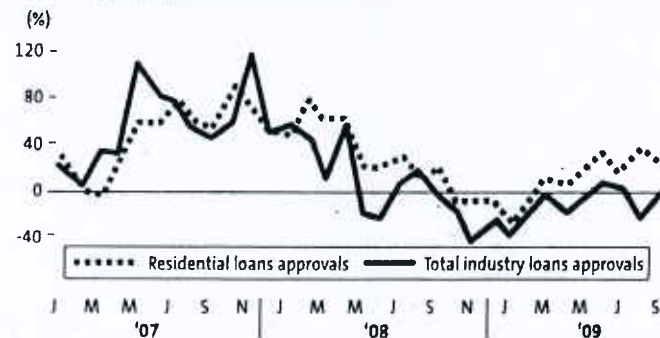
The analyst said the banking sector was currently trading at a mid-cycle price-to-book value of 1.68 times.

An analyst with HwangDBS Vickers Research also said mortgage rates needed to be increased to remove irrational price competition.

"Rate hikes are positive for banks," he said, adding that for now, the price change would mainly affect the secondary property market, leaving the primary market unscathed.

"Pricing power depends on banks' cost structure and incidences of default. We believe banks will price products based on risk," he said, add-

Residential loans approvals have recovered since reduction in BLR



Source: OSK

ing that margins were now extremely thin.

The analyst said banks were barely breaking even with irrational competitive pricing for mortgage products. "At BLR minus 2.4%, it effectively takes banks at least two to three years to break even. The BLR now stands at 5.55%, while average cost of funds for banks was about 2%.

"Taking into account implied costs set aside for credit default ranging from 20 basis points (bps) to 30bps, coupled with overhead costs (agent's commission and fees) another 30bps, net yield gain on a mortgage loan was merely 1%.

»We believe banks will price products based on risk«

HWANGDBS VICKERS
RESEARCH ANALYST

"Rate levels are already at an all-time low. We believe it is a matter of time before rates pick up," he noted.

The HwangDBS analyst said pricing power was within the prerogative of the individual banks.

"Every bank will price products based on their respective cost structure and also incidences of default.

"While we agree that mortgage pricing has reached a level of irrationality, we believe banks will price products based on risk," he said.

For instance, if a customer had a healthy credit profile, it was possible for the bank to offer him an attractive rate, he said, adding: "From our

checks, we understand the pricing change affects the secondary market, while the primary market is left unscathed at this juncture."

On the evolving banking landscape, the analyst said the overnight policy rate was anticipated to rise in the third quarter of 2010. This is in line with the stronger-than-expected growth (HwangDBS forecast of 5% versus official forecast of just 2% to 3%) as well as inflation trending toward 2.3% to 2.5% by July 2010.

"We are looking at 25bps in the third quarter 2010 and another 25bps in the fourth quarter. With the repricing of loans quicker than deposits, the impact would generally be positive on NIM," he said.

The analyst said banks with positive impact on rate hikes were Hong Leong Bank Bhd and RHB Capital Bhd by virtue of their higher proportion of variable rate loans.

However, he said, Public Bank Bhd's mortgage loan volumes might dwindle but the research house expected higher rates should more than neutralise this impact.

On the property sector, a HwangDBS property analyst said the rate hike had a double whammy. "The mass developers should not be adversely impacted due to resilient demand."

However, with banks standardising mortgage rates and eliminating zero-entry cost packages for secondary market transactions, it will dent sentiment.

The analyst said the banks had agreed to end the mortgage price war. "We understand some banks have started to raise mortgage rates for new applications since this week.

"Mortgage rates have been standardised to BLR minus 1.8% from BLR minus 2.3%, while banks are no longer funding upfront costs such as legal fees and other costs."