They are likely to continue on upward trend, largely due to hikes in Fed funds rate

Leong Chan Teik

SO YOU have worked hard and are looking forward to a nice salary increment next year. No sooner will you get your hands on that pay rise than a large part of it will go to pay higher interest charges on your home mortgage every month.

You can count on mortgage rates to continue their upward climb next year, say experts. Mortgage rates have already been rising this year, taking a big bite out of many people's salary increments this year.

DBS Bank customers, for example, have received letters from the bank telling them it will bump up their mortgage rate next month — for the third time this year — by a quarter of a percentage point. So far, two increases totaling half a percentage point would have cost them an extra $130 or so a month, assuming they have a $500,000 loan that is repayable over 30 years.

That $130 is all that they would have received as a pay rise this year if they earned $3,500 a month and had a 3.7 per cent increment, the average for Singapore workers.

Mortgage rates are picking up after falling from 2001 and scraping rock bottom for about a year until last year. The increases are being largely driven by the upward nudges made by the United States Federal Reserve in the Fed funds rate — the rate that banks charge each other for overnight loans — to rein in inflation there, says Ms Selena Ling, head of treasury research at OCBC Bank.

For trade and foreign currency reasons, there is a close link between the direction of interest rates in Singapore and the US. Now, the direction is decidedly north. The US futures market is widely expecting the Fed funds rate to go up by a quarter point next month, and another quarter point in January, says Ms Ling.

The question then is: How much will mortgage rates in Singapore rise? It seems that forecasting is risky business.

"We won't know how much mortgage rates will rise, but they are definitely on the rise," says Mr Tan Chia Seng, Citibank's business director for the secured assets group.

"Says Associate Professor Benedict Koh of the Singapore Management University: 'The quantum of increase is anybody's guess, but half a percentage point in 2006 is likely. "Thereafter, the trend is less clear." It is not clear to the banks either. Most lenders do not offer home loan packages with rates fixed for more than two years, notes Associate Professor Ong Seow Eng, deputy head (research) in the department of real estate of National University of Singapore.

"This shows that banks are not placing any bets on rates after the next two years." Prof Ong figures that rates will move up gradually, and by perhaps between only half an a percentage point over the next two years. "Economic growth here is benign and inflationary pressures are absent," he explains.

Mortgage rates here do not rise in lockstep with the Fed funds rate also due to, thank goodness, competition among banks.

As Mr Gregory Chan, OCBC's head of consumer secured lending, says: "From time to time, we will review market conditions to ensure that our home loan interest rates are competitive."

Given that rates will rise, should home owners opt for fixed rates instead of floating ones? Citibank's Mr Tan says this is a trade-off for supposedly relatively lower rates in later years.

It may seem unlikely, but what if mortgage rates do not rise in future, revenues drop unexpectedly?

Under the Citibank scheme, customers would enjoy bonus payouts if the six-month Singapore interbank rate falls below 1.75 per cent. It would have to be a sharp plunge, though, because this interbank rate is now hovering at 2.93 per cent.

Says Prof Koh: "The general rule is that if interest rates are expected to rise, it's better to go for fixed rates."

However, the choice is not straightforward as most fixed-rate loans are priced at half a percentage point higher than floating rate loans, he says. You should go for fixed rates if you think that interest rates are likely to rise by more than half a percentage point during the two-year period that most mortgage rates are fixed. So says Prof Koh, who adds that after the lock-in period, you can ask your bank to re-price your loans to the prevailing interest rates for the first and second years of a home loan package. If you do not, you will be paying higher third-year interest rates. Either you ask for a repricing or you switch to another bank with lower interest rates for the first two years.

If you have yet to commit to a house purchase, do not overstretch yourself financially as interest charges will cost more in future, say experts.

"Never base your budget purely on current "teaser" rates which are offered for the initial two years of a package," says Citibank's Mr Tan.

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