



# QUARTERLY FINANCE REPORT

## Q1 2011

Global solutions provider  
for mortgage finance

### **Complete Finance**

12/F, 88 Gloucester Road  
Wanchai, Hong Kong  
Tel: +852 3965 9365  
Fax: +852 3965 9389  
Email: [finance@complete-ltd.com](mailto:finance@complete-ltd.com)



complete finance



## UNITED KINGDOM

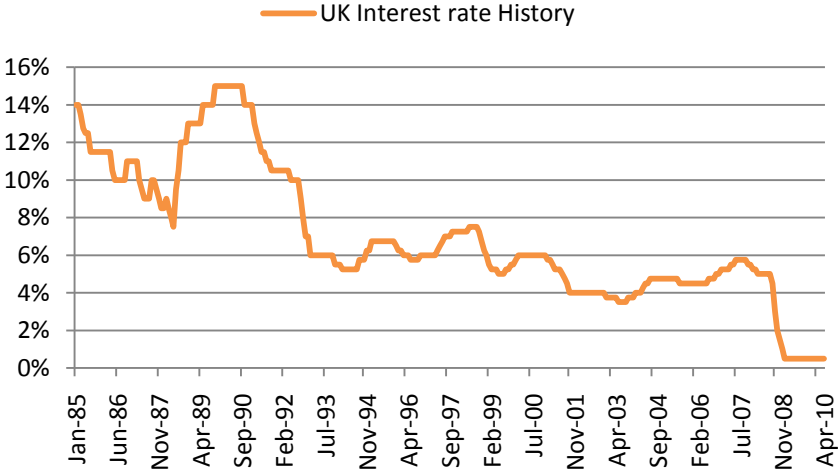
The last time inflation was below the Government's 2% target was in November 2009, forcing economists to believe that the Government will soon have to apply a brake on rising prices by raising interest rates this year. The latest data from the Bank of England revealed that there was an even faster than expected acceleration of 4% during January 2011. Although the Bank of England maintained interest rates at 0.5% during their January meeting, there is a growing consensus within the Monetary Policy Committee that interest rates must rise to combat rising inflation. However, there is a concern that rising interest rates may have a detrimental effect to the UK recovery and this was further exacerbated by negative GDP growth in Q4 2010. Analysts believe that the weather was a major contributing factor of this negative growth. Research suggests that should we get positive GDP growth in Q1 2011 and interest rates may rise by 0.25 – 0.5% during Q2 2011. The GDP figures will be released April so we don't expect a rate rise until May 2011 at the earliest.

After bottoming out not so long ago swap rates rose dramatically in the first half of December and have risen significantly further in January. 5 year swaps have increased from an all time low of 1.99% to the current 2.93%. Swap rates are a good indicator of where fixed rates are going in the future and as such are a key benchmark. Fixed rate mortgages have only increased modestly since the surge in swap rates suggesting an increase in fixed rates could be expected in the short term. A number of the best fixed rates have recently been pulled off the market indicating that banks expect a rate rise.



However as the graph highlights interest rates will still be historically low even with an increase this year. New borrowers are currently using 29% of their disposal income to meet mortgage payments, which is still considerably lower than the near 50% outflow they faced in the middle of 2007. Owners who have chosen variable tracker deals or have stayed with their lender standard variable rate may now want to consider switching to a fixed rate whilst there are still some good fixed rate deals available in the market.

Whilst it's preferable to take a fixed rate mortgage, bank margins and redemption penalties are excessively high on such rates. Prudence and advice is needed before committing to a fixed rate and careful comparison should be done against variable rates before committing. There is still a strong argument to take a variable mortgage as with little or no tie in penalties, these types of mortgages will allow you to take advantage of the expected improvement in the mortgage market over the next 12 – 18 months. We expect bank margins to be lowered and spreads between fixed and variable rates to shorten in the coming year and as such more attractive products should enter the market.





## EUROZONE

Mortgage holders may face a hike in rates in the coming months as concerns grow about inflation in the Eurozone. Inflation hit 2.4% in February 2011 from 2.3% in January 2011, exceeding the European Central Bank's (ECB) target of 2%. More expensive fuel has been said to be the cause along with overall energy prices increasing by 2.3% from November to December last year; the highest annual rate since October 2008.<sup>1</sup>

Despite high inflation, the ECB left benchmark interest rates at 1% after their recent meeting in February 2011, as commodity prices are expected to stabilise in the course of 2011, leading to an estimated inflation rate of 1.9% for the year.<sup>2</sup> This however is never certain. With last year's sovereign debt crisis in Greece and Ireland still weighing on confidence and economic growth still struggling in countries like Spain we expect the ECB to increase interest rates to preserve price stability over the medium term. Research suggests a 0.25% rise to 1.25% looks likely to occur over the Easter period, with a rate hike to 1.75% by the end of 2011.

Those with tracker variable rate mortgages, which account for the majority of mortgages, are likely to face an increase in their monthly repayments. The loan rate for borrowers is directly linked to movements in the ECB rate which as mentioned earlier has not been adjusted since 2008.<sup>3</sup>

---

<sup>1</sup> <http://online.wsj.com/article/SB10001424052748703959104576081314049735784.html>

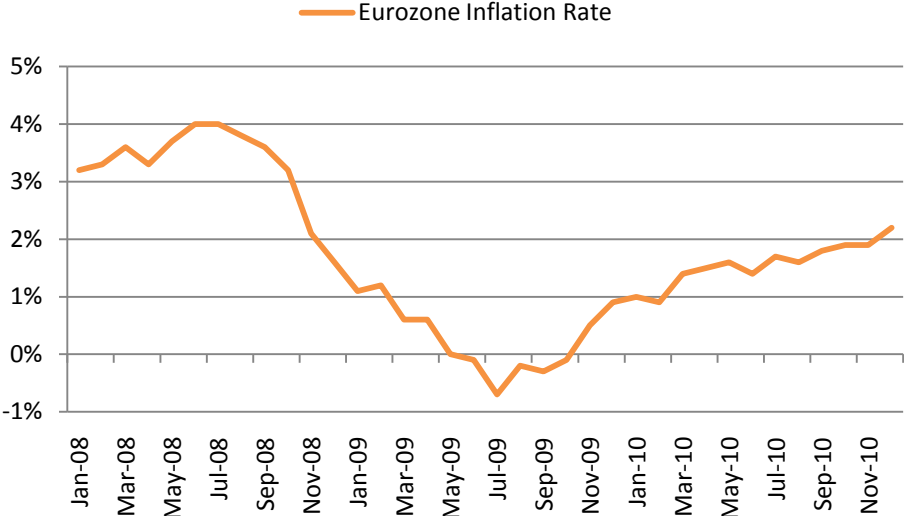
<sup>2</sup> <http://www.marketwatch.com/story/survey-puts-2011-euro-zone-inflation-at-19-ecb-2011-02-10>

<sup>3</sup> <http://www.irishtimes.com/newspaper/opinion/2011/0207/1224289182411.html>



The latest ECB's lending survey showed that banks expect demand for loans to continue to pick up in coming months, a strong sign that the small rebound in the Eurozone economy is beginning to fuel a rehabilitated hunger for credit. However, mortgage loans, an area of lending seen by some economists as the leading indicator of overall trends, is only expected to have a 1% increase in demand, signifying the Eurozone still has a long recovery ahead.<sup>4</sup>

With an expected rate rise in the Eurozone later in 2011, we suggest clients contact their broker to discuss alternative financing options to counter the potential rate rise. As lending in Europe is country specific, greater financial analysis on individual countries is recommended. As lending is still tight, we are still seeing artificially high lending margins and we therefore suggest to only consider switching your mortgage from a variable rate if the fixed rates offer true value.



<sup>4</sup> <http://uk.reuters.com/article/2011/01/27/uk-ecb-idUKTRE70Q3L520110127?pageNumber=1>



## USA

After their January meeting, the Federal Reserve kept its overnight interest rate at 25 basis points and reaffirmed its plan to purchase \$600 billion of Treasury securities by the end of June. According to Freddie Mac the back-up in Treasury rates prompted a similar rise in mortgage rates with average 30 year fixed rate mortgages increasing by 0.6% from October to January 2011. This according to the Mortgage Bankers Association reduced refinancing applications during the start of 2011 to almost half the levels seen in September and October.<sup>5</sup> However, the increase in rates still leaves them historically low. As the graphs shows on page 7, the forecast of 5.2% in 2011 is the third lowest annual average since 1978. The forecast of a low mortgage rate combined with the US house price declines over recent years has put US home price affordability at 184.2, meaning a median income family has 184.2% of the income required to purchase a median price house based on a 20% down payment.<sup>6</sup> This is a clear indication of the current excellent housing affordability conditions.<sup>7</sup>

---

<sup>5</sup> <http://www.forecasts.org/fha.htm>

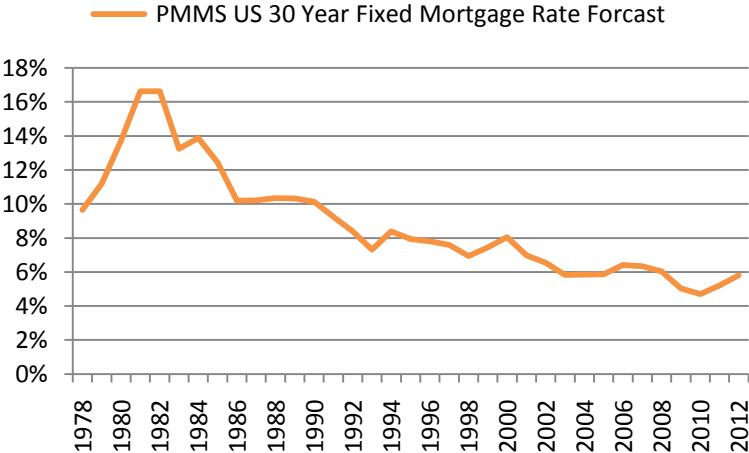
<sup>6</sup> [http://www.mercurynews.com/saratoga/ci\\_17121600?nclick\\_check=1](http://www.mercurynews.com/saratoga/ci_17121600?nclick_check=1)

<sup>7</sup> <http://www.summitdaily.com/article/20110212/REALESTATE/110219942/1078&ParentProfile=1055>



The Federal Reserve’s January meeting highlighted that underlying US inflation has been trending downwards. Whilst headline inflation which includes food and energy costs has picked up rising to 2.2% in February 2011, core inflation remains low enough (1.1% in February 2011) for the central bank to maintain interest rates at near zero and continue with the latest round of quantitative easing.

However, by excluding the cost of volatile fuel and food prices from its core inflation formula, the Fed is ignoring the everyday cost for American consumers. With commodities such as grain reaching two and a half year highs and oil demand rising due to fast growing emerging economies the Fed may be forced to confront these distortions. Economists expect economic growth will force the Federal Reserve to raise its benchmark interest rate to 3% by the end of the year to combat inflation.<sup>8</sup> With US GDP growth expected to improve during 2011, tying in a fixed rate mortgage may be the safe way to hedge against high interest rates.



<sup>8</sup> <http://moneymorning.com/2011/01/16/core-inflation-numbers-will-allow-the-fed-to-stay-the-course-for-now/>



## MALAYSIA

After a decade of capacity building, Malaysia's banking sector looks forward to its next phase of strategic transformation. New long-term directions will emerge when Bank Negara unveils its second 10-year financial services blueprint. In a sector that is increasingly dogged by competition, net interest margins are thinning amid pressure from two ends: loan yields and cost of funds. According to the director of Hong Leong Bank Bhd, "Borrowing costs are much lower, banks are willing to lend, and volumes are up in both consumer and wholesale segments. This is causing margins to narrow and price wars are beginning."<sup>9</sup>

The majority of banks are offering competitive lending and mortgage rates. These rates can be as low as the base lending rate minus 2.2% in some instances.

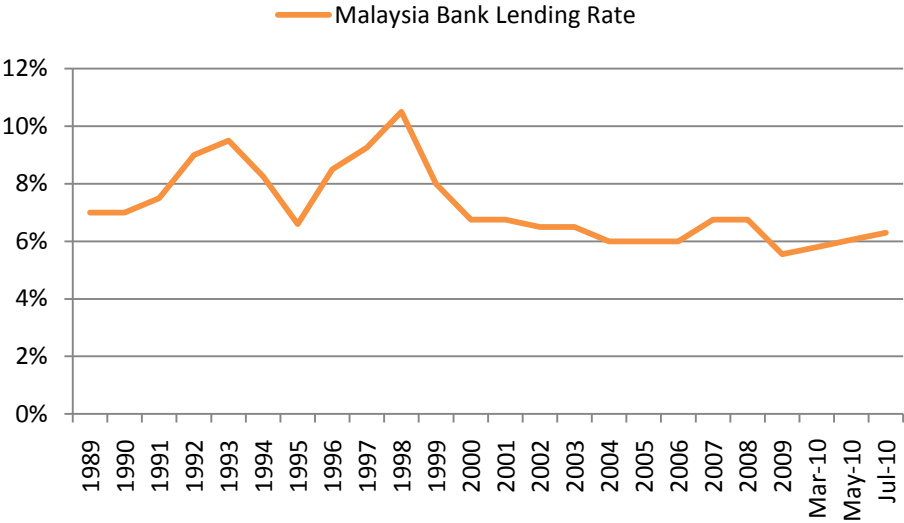
Over the last 12 months Malaysia's central bank has increased rates on 6 separate occasions taking rates to 2.75%. News has suggested that it's likely the central bank will leave rates unchanged for the time being as growth slows off its fastest pace for a decade. However, leading economists have suggested that the uneven global economy could still have an impact on the Malaysian economy and given Malaysia's modest outlook for the 2011 with inflation expected to be 3.4% for the year; analysts have forecast a rate increase of 25 basis points in H1 2011 and 50 basis points during the second half of the year.<sup>10</sup>

<sup>9</sup>[http://biz.thestar.com.my/news/story.asp?file=/2011/1/1/business/7567207&sec=business#12983642020141&if\\_height=566](http://biz.thestar.com.my/news/story.asp?file=/2011/1/1/business/7567207&sec=business#12983642020141&if_height=566)

<sup>10</sup>[http://biz.thestar.com.my/news/story.asp?file=/2011/2/23/business/8115875&sec=business#12984297021641&if\\_height=552](http://biz.thestar.com.my/news/story.asp?file=/2011/2/23/business/8115875&sec=business#12984297021641&if_height=552)



Malaysia is predominantly a variable mortgage market but with property transactions set to surpass RM 100 billion this year more fixed rate options will come onto the market to meet demand levels. Variable base lending rates are likely to increase and we therefore suggest you contact your broker to advise you on the latest refinancing options.





## AUSTRALIA

Australian consumer prices rose at a slower-than-expected pace in Q4 2010 despite the nation's mining fuelled economic boom, a development that could keep its central bank from raising interest rates until the second half of the year. At the first meeting for 2011, the Reserve Bank of Australia (RBA) kept the official cash rate at 4.75% and clearly stated that a rise is not needed for some time,<sup>11</sup> with the nation recovering from natural disasters in Queensland and Victoria.

Australia's inflation figure has been revised to increase to 3% by Q2 2011 and economic growth is expected to fall by up to 1% as a result of the impact of floods and Cyclone Yasi. On the back of these forecasts, economists expect the RBA will look to lift interest rates later in 2011. Research suggests the cash rate will rise to 5.25% during the year on the back of Australia's terms of trade being the highest in more than 100 years due to soaring world commodity prices. The terms of trade is a measure of the price other countries pay for Australian exports against the price we pay them for our imports, therefore is a measure of the national profit margin. The 0.5% rate increase could be expected as soon as the next quarter but will be dependable on the recovery of the natural disaster.<sup>12</sup>

The Australian Dollar has continued to be firm with the currency averaging 1.001 during January and February 2011 as strong commodity prices have boded well for the domestic economy. Broad weakness in the US dollar, a stronger Euro and ongoing strength in commodity prices has helped the Australian dollar hover above parity. Australia's commodity exports, which are now at record prices, have added approximately 13% to the country's annual national income.

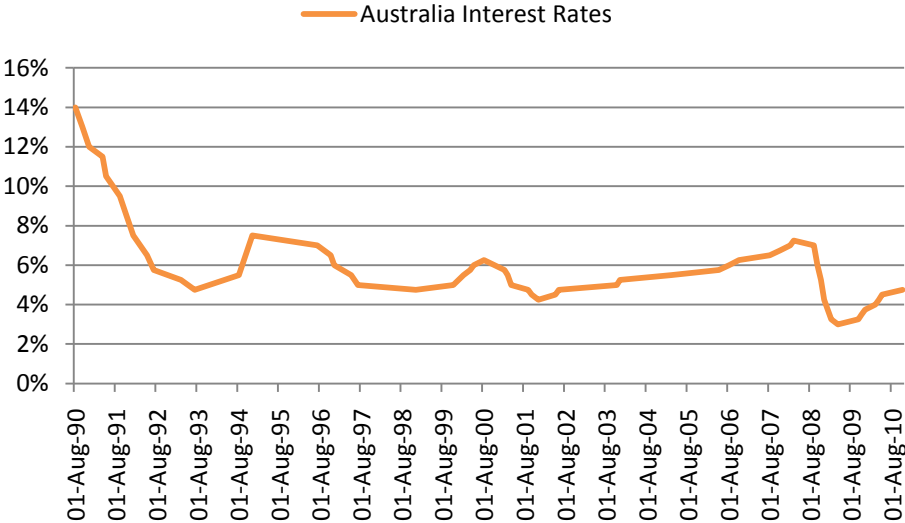
---

<sup>11</sup> <http://www.smh.com.au/business/interest-rates-on-hold-20110201-1ac1b.html>

<sup>12</sup> <http://www.smh.com.au/business/why-mortgages-are-set-to-rise--despite-the-floods-20110122-1a0n8.html>



The Australian Dollar remains the most overvalued currency against its US counterpart, with it currently standing approximately 31.7% above the Purchasing Power Parity fair value and just off record highs according to Bloomberg finance.<sup>13</sup> However, the currency outlook looks uncertain as China (Australia's chief trading partner) attempts to control their inflation and the recent natural disasters could cause a slight downward correlation this year. Whilst the possibility of borrowing in a foreign currency carries much appeal, the risks could out way the benefits. To avoid bearing the risk to cross currency borrowing, we suggest a fixed rate mortgage in the local currency. This will give protection against the impact of a rate rise, the strengthening US economy and the concerns over China's economic stability which with their trade connections could strongly impact the Australian market.



<sup>13</sup> [http://www.dailyfx.com/forex/fundamental/forecast/monthly/aud-usd/2011/02/09/Australian\\_Dollar\\_US\\_Dollar\\_Exchange\\_Rate\\_Forecast.html](http://www.dailyfx.com/forex/fundamental/forecast/monthly/aud-usd/2011/02/09/Australian_Dollar_US_Dollar_Exchange_Rate_Forecast.html)