IMPACT OF INTEREST RATES

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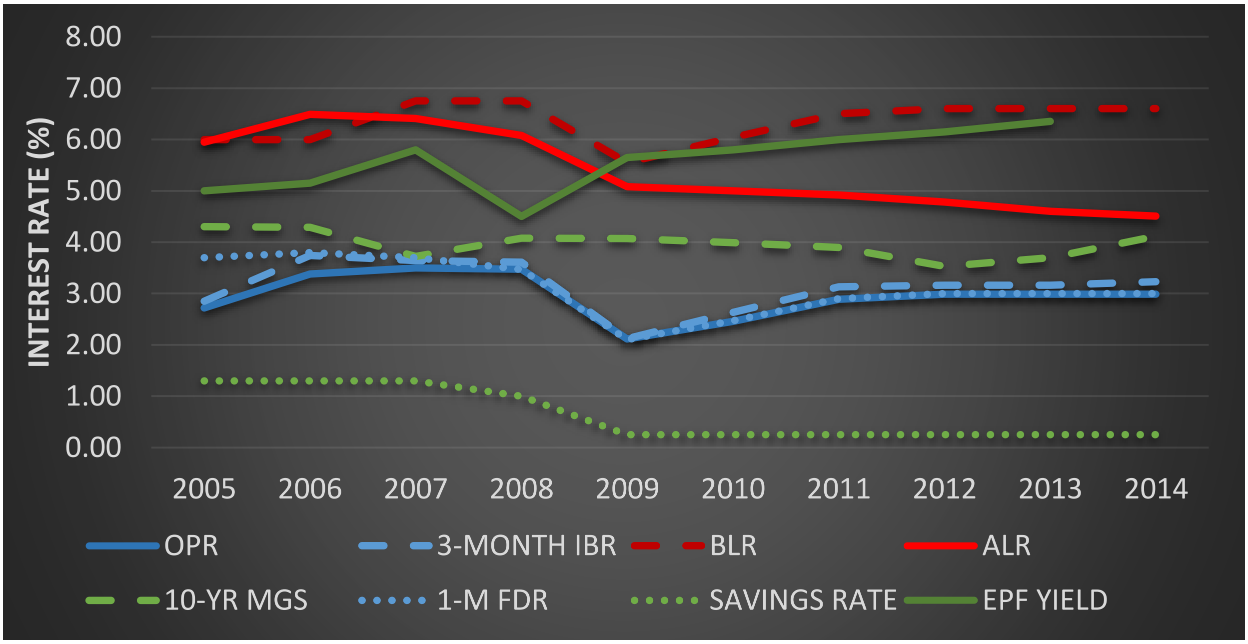
Impact of Interest Rates

.**Interest rates**

In the aftermath of the subprime mortgage crisis which caused financial upheaval across the globe; especially in developed nations, the world is dosed with ample cheap money and ultra easy monetary policies. Thanks to Keynesian practitioners, we now have more liquidity in circulation than any other point in history. As such, assets throughout the world has witnessed spectacular appreciation in value since the last 5 years.

According to Newton's law of gravity, "what goes up must come down"; such implemented policy could not go on forever. The 'New' normal is fast-approaching with slower global growth rates and higher interest rates. The recent hawkish tone by Bank Negara Malaysia coupled with higher creeping inflation rates (causing negative real interest rates), and the emergence of financial imbalances has prompted the central bank to raise interest rates to contain the situation. A strengthening Ringgit and rising 10-year MGS yield are leading indicators of this forthcoming.

The historical data on various interest rates are provided in the chart below. Observe the gradual decline of average lending rate (solid red line) and the rising of 10-year MGS yield (dash green line) in 2014.



OPR = Overnight policy rate, **IBR** = Interbank rate
BLR = Base lending rate, **ALR** = Average lending rate
MGS = Malaysian government securities, **FDR** = Fixed-deposit rate

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.**Higher Mortgage Rates**

It is widely expected that there may be subsequent hike in interest rate; but it will be most modest should the central bank decides to do so. A survey by most economists anticipate a rise of 25 to 50 basis points (0.25% - 0.50%) in the first attempt. The question remains is how exactly will this affect the mortgage payment. In order to address this issue, 2 different scenarios were considered.

Scenario 1: mortgage rate increment at 25 basis points (0.25%)
Scenario 2: mortgage rate increment at 50 basis points (0.50%)

Assumption:

HOUSE PRICE (RM)	CURRENT MORTGAGE RATE (%)	LOAN TENURE (YRS)	10% DOWN-PAYMENT (RM)
500,000	4.50	30	50,000

SITUATION	MORTGAGE RATE (%)	MONTHLY PAYMENT (RM)	YEARLY PAYMENT (RM)	TOTAL PAYMENT (RM)
INITIAL (I)	4.50	2,280.08	27,360.96	820,828.80
SCENARIO 1 (S1)	4.75	2,347.41	28,168.92	845,067.60
SCENARIO 2 (S2)	5.00	2,415.70	28,988.40	869,652.00

DIFFERENCE	MORTGAGE RATE (%)	MONTHLY PAYMENT (RM)	YEARLY PAYMENT (RM)	TOTAL PAYMENT (RM)	%
S1 - I	0.25	67.33	807.96	24,238.80	2.95
S2 - I	0.50	135.62	1,627.44	48,823.20	5.95

Therefore, a single hike of **25** basis points in mortgage rates will result in approximately **3%** increase in monthly payment.

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