Box 4.1

Economic Impact of Competition in Mortgage Interest Rates

Residential mortgage lending, a key market segment for local banks, has experienced fierce competitive pressure over the past few years. According to statistics from HKMA, over 90% of new mortgages was issued at more than 2.5% below the best lending rate (BLR) in the third quarter of 2007; in the first half of 1998, more than 80% of new mortgage loans was issued at more than 0.5% above the BLR.

Mortgagors are obviously the major beneficiaries of this development. The intensified competition in mortgage lending since 1999 had brought about an estimated interest savings of about $90 billion between 2000 and 2006 for these borrowers.

To put the benefit of lower mortgage rates into the perspective of homeownership, if the margin between mortgage rate and BLR has stayed unchanged at the level in early 1999, the latest mortgage repayment-income ratio (which is inversely related to the affordability of homeownership) would have been about 9 percentage points higher. In other words, the “typical” household living in private housing would have to set aside another 9% of their income to pay for a 20-year mortgage on an average residential flat.

In terms of economic impact, the interest savings would have boosted private consumption expenditure and, hence, overall GDP. Nevertheless, the economic impact should have been somewhat dampened by local residents’ high savings rate, their inclination to use part of their discretionary spending on overseas tours and the high ratio of retained imports of goods to support domestic consumption demand.

Looking ahead, while some local banks have already trimmed the negative margin between mortgage rates and BLR, the chance for a drastic reversal of the discount, thereby significantly increasing the repayment burden on mortgagors, is also not likely due to the persistent competitive environment in the local banking market. Besides, the prospects of lower US dollar interest rates and continued positive long-term outlook for the Hong Kong economy should lend support to the residential property market and local consumption demand as well in the near term.