Norman T L Chan: Recent economic and financial developments in Hong Kong

Remarks by Mr Norman T L Chan, Chief Executive of the Hong Kong Monetary Authority, Hong Kong, 22 February 2013.

* * *

The property market in Hong Kong moderated briefly after the introduction of the fifth round of prudential measures on property mortgages by the HKMA in September 2012 and the new tax measures by the Government in October 2012. However, activities in the property market picked up again recently, with significant increases in transaction volume and prices of residential properties as well as commercial and industrial properties. The risk of overheating in the property market has, once again, risen sharply.

Moreover, the recent increase in intensity of the quantitative easing by central banks in Europe, the US and Japan has made it more difficult and uncertain for them to "exit" these measures in the future. It will be particularly so when inflationary pressures emerge again in the advanced economies, and the pace and extent of interest rate hike could be greater than originally expected. In fact, in the last quarter of 2012, the HKMA already started requesting local banks to assume a of 300 bps increase in interest rate above the baseline scenario for its mortgage portfolio when conducting stress testing. In order to further enhance banks' risk management in property mortgage lending and to strengthen borrowers' resilience to withstand future interest rate hikes, the HKMA has just issued a set of guidelines to banks, requiring them to adopt an increase of 300 bps instead of 200 bps of interest rate when stress-testing the repayment ability of mortgage applicants. This measure is applicable to all types of mortgages, including residential as well as commercial and industrial property mortgages.

The risk of overheating in the commercial and industrial property market also continues to rise. Our experience shows that the quality of commercial and industrial property mortgages will deteriorate more significantly than that of residential property mortgages during market downturns. In view of these circumstances, our guidelines have also required banks to lower the maximum LTV ratio of mortgage loans for commercial and industrial properties, whether or not for self-use, by 10 percentage points from the existing applicable levels. For example, for mortgage applicants with income mainly derived from Hong Kong, the maximum LTV ratio will be lowered from 50% to 40%. If the applicant's income is mainly derived from outside Hong Kong, the maximum LTV ratio will be lowered from the current 40% to 30%.

The HKMA has also required banks to standardise the maximum LTV ratio of mortgage loans for all standalone carpark spaces at 40% and the maximum loan tenor at 15 years. Other requirements on maximum LTV ratio and debt-servicing ratio applicable to commercial and industrial property mortgage loans also apply to standalone carpark space mortgage loans.

The above measures take effect immediately. However, loan applications in respect of property transactions with provisional sale and purchase agreements signed today or earlier will not be affected.

The HKMA is also aware that the risk weight allocated by Hong Kong banks adopting the Internal Ratings-Based (IRB) Approach under the Basel Capital Accord to residential property exposures is at a relatively low level. This may not fully reflect the existing and future risks of property market volatility. To further enhance the risk management of banks in Hong Kong, the HKMA has decided to introduce a risk weight floor of 15% for residential mortgages approved by banks on or after 23 February 2013 under the IRB Approach.

Mr Arthur Yuen, Deputy Chief Executive of the HKMA, will explain the above-mentioned measures in more details later.

Meanwhile, the Hong Kong Mortgage Corporation will introduce revisions to its Mortgage Insurance Programme in line with the latest developments in the property market and will announce the details later.

I hope the public would understand that Hong Kong is facing an extremely unusual macro-monetary environment. The ongoing quantitative easing by advanced economies is unprecedented in both scale and duration. Interest rates have been artificially maintained at extremely low levels, and we see huge volumes of liquidity flow into emerging markets like Hong Kong. The current unusual circumstances are one of the main drivers for the prolonged boom in the local property sector. The risk of over-heating in the property sector to financial stability in Hong Kong is no smaller than that seen in 1997. We should note in particular that while mortgage rates were generally over 10% in 1997, after the burst of the property bubble, US interest rates have fallen, and mortgage rates in Hong Kong have spiralled down reaching about 2% in 2004. The situation we faced now is just the opposite. Mortgage rates are around 2%. And, even if the low interest rate environment were to remain until 2015 as anticipated by the US Federal Reserve, the US interest rates are bound to head back to more normal levels. Will mortgage borrowers in Hong Kong then be able to withstand the impact of interest rate hikes and property price falls? For example, under a 30-year mortgage, even though the borrower will be able to enjoy a low interest rate in the first two years, the repayment burden could become much heavier as a result of interest rate hikes in the years that follow. This could have serious consequences for the well-being of those families in the coming years. Therefore, I hope that the public will be cautious and should not underestimate the risks that rising interest rate could have on repayment ability, asset prices and the overall economy in Hong Kong.