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The Navigator

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Some reprieve for home owners

By Edward Lim, CFA

What will happen to SORA when Fed starts to cut?

Fun facts: Crazy how 40% of Singapore's mortgages are still a floating and at 3M SORA! Another 30% is linked to deposit rates (so floating with a lag) and only 30% are fixed mortgages and the max you can fixed rate is 3 years.

Why is that so? The nice in me will say there is not enough liquidity in SGD long-term treasuries for banks to hedge. The cynical in me says the banks want best of both worlds. Rates higher, they benefit and when rates lower, their yields will be lowered but so will their cost of deposits. They can massage their NIMs sensitivity better. How? 2/3 of their deposit base reprices quick.

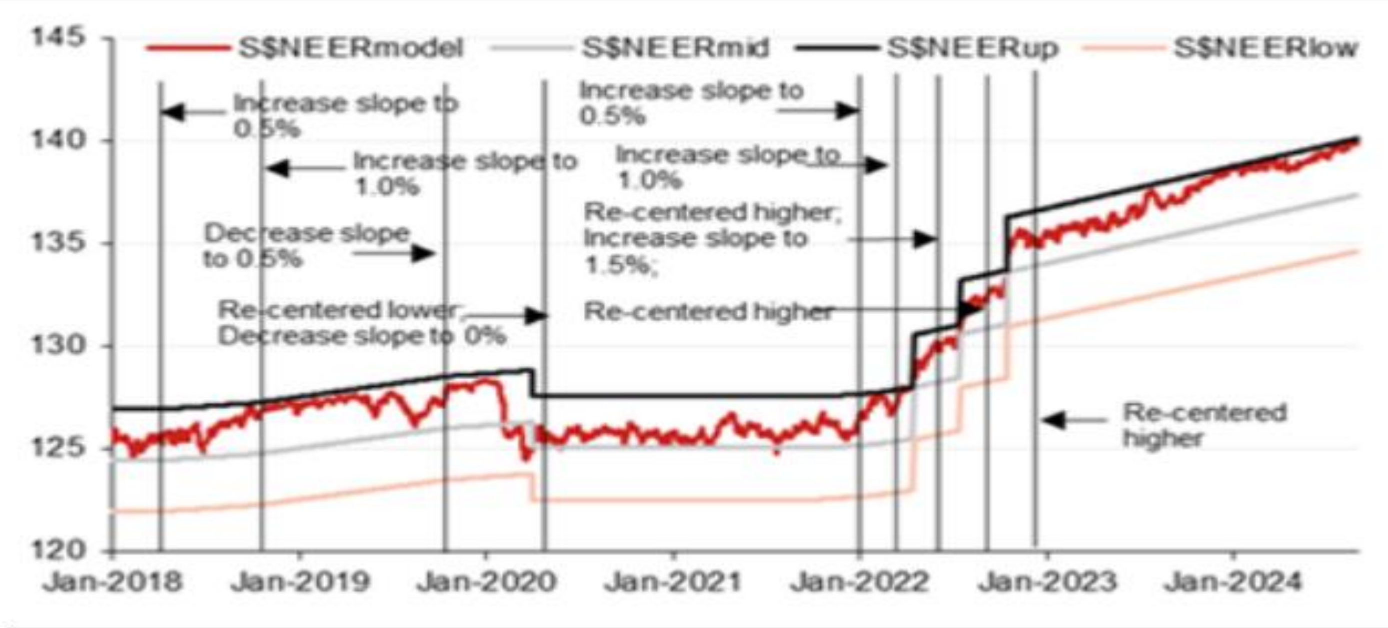
So what is SORA? SORA is the volume weighted average unsecured borrowing rate between banks within the market from 8am and 6.15pm. The data is reported at 9am the following day. The volume on the fix is low relative to the size of the banking market, and the volatility can be high. SORA has now become the benchmark rate since many countries abandon SOR (LIBOR) due to cartel of banks fixing it.

Singapore unlike many countries do not have an interest rate policy because of the genius of Goh Keng Swee arguing it would be futile to control inflation with interest rates given our open economy and open capital account. So, MAS uses exchange rates to control inflation instead.

The SGD NEER therefore determines SGD rates. SGD Neer is a basket of Singapore major trading partners and USD is by far the most significant influence of SGD NEER.

Currently, MAS has allowed the SGD to strengthen, and it has been at the upper band of markets' estimation of NEER band to help combat inflation. Think stronger SGD = cheaper imports = lowering inflation, ideally.

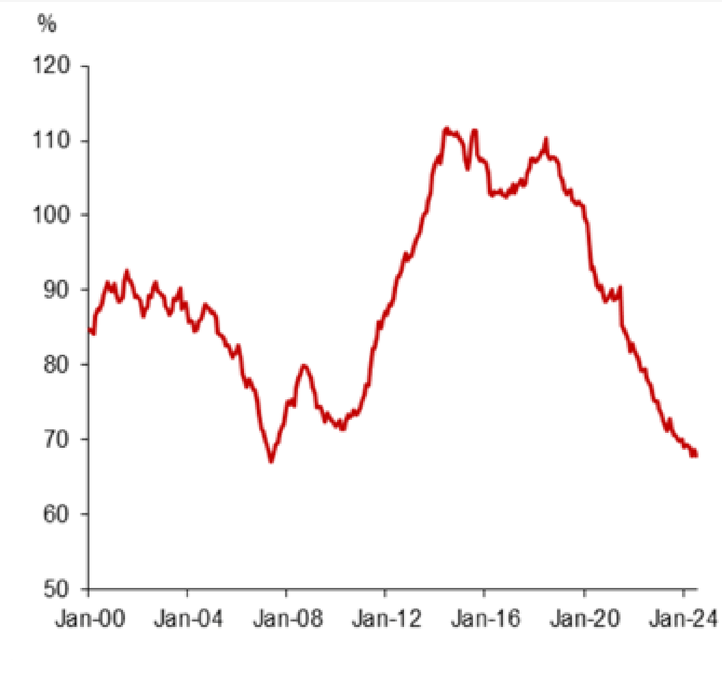
SGD is trading upper end of SGD NEER band to combat inflation



Source: Bloomberg, Nomura

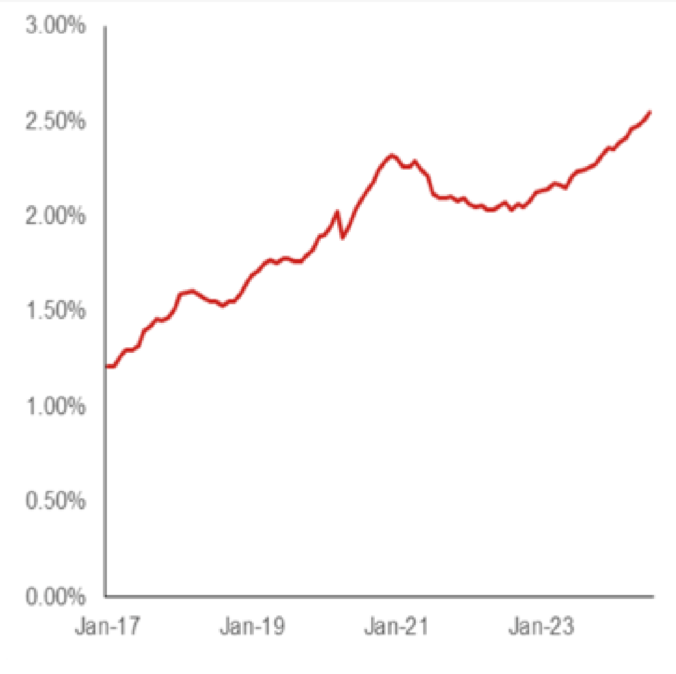
With a stronger SGD coupled with ample liquidity in the systems as evident by the declining Loans-Deposit in the system and the rising Liquidity-Deposit ratio, it explains why despite the US rates (SOFR) have been rising since 2021, the pass through from SOFR to SORA has been less pronounce peaking in 3Q22 and since the start of this year have actually been negative i.e. as SOFR whips around higher for much of last 6-7 months of the year, SORA has been declining.

Loan-deposit in SG is near 25years low



Source: CEIC, Nomura

Plenty of liquidity as % Deposit



Source: CEIC, Nomura

It is given that next week, FOMC will cut 25bps and maybe 50 bps (we have been consistent of the next path. Cuts will happen as soon as September and will be a moderate easing pace i.e. expecting up 100bps cuts in next 12 months absent of a recession in the US), **therefore US rates will fall, so with SORA**. Phew to all home owners!

But how much will SORA fall? It is difficult to precisely determine how much because it involves two massive currents; the state of US economy that will dictate Fed's easing cadence and the state of Singapore's inflation, especially heading into an election period, and MAS' use of SGD to combat that.

Using the forward rates markets on USD and SGD rates, we can guesstimate how much is expected by the market on US and SGD rates and the observed spreads would be the implied the probability of pass through. The market is now expecting the 3mths USD SOFR to fall from 5.33% to 2.95% in the next 12 months, a massive drop of 238bps. Whereas SORA is pricing to decline from 3.45% to 2.10% by only 135bps. Meaning market is expecting only 57% of USD rates decline to translate to drop in the SORA.

SORA declining even as US rates stayed high

Quarter	Avg for Quarter SOFR	Avg for Quarter SORA	Change on Quarter SOFR	Change on Quarter SORA	Pass through
Q121	0.04%	0.19%			
Q221	0.02%	0.12%	-0.03%	-0.07%	
Q321	0.05%	0.12%	0.03%	0.00%	
Q421	0.05%	0.18%	0.00%	0.06%	
Q122	0.09%	0.27%	0.04%	0.08%	
Q222	0.71%	0.74%	0.62%	0.47%	76%
Q322	2.14%	2.00%	1.43%	1.26%	89%
Q422	3.62%	2.96%	1.48%	0.96%	65%
Q123	4.49%	3.51%	0.87%	0.55%	63%
Q223	4.97%	3.62%	0.47%	0.12%	24%
Q323	5.24%	3.66%	0.27%	0.04%	14%
Q423	5.32%	3.67%	0.09%	0.01%	9%
Q124	5.32%	3.66%	-0.01%	-0.01%	
Q224	5.32%	3.61%	0.00%	-0.05%	
Q324	5.34%	3.49%	0.02%	-0.11%	
Total			5.30%	3.30%	62%

Source: Bloomberg, Nomura

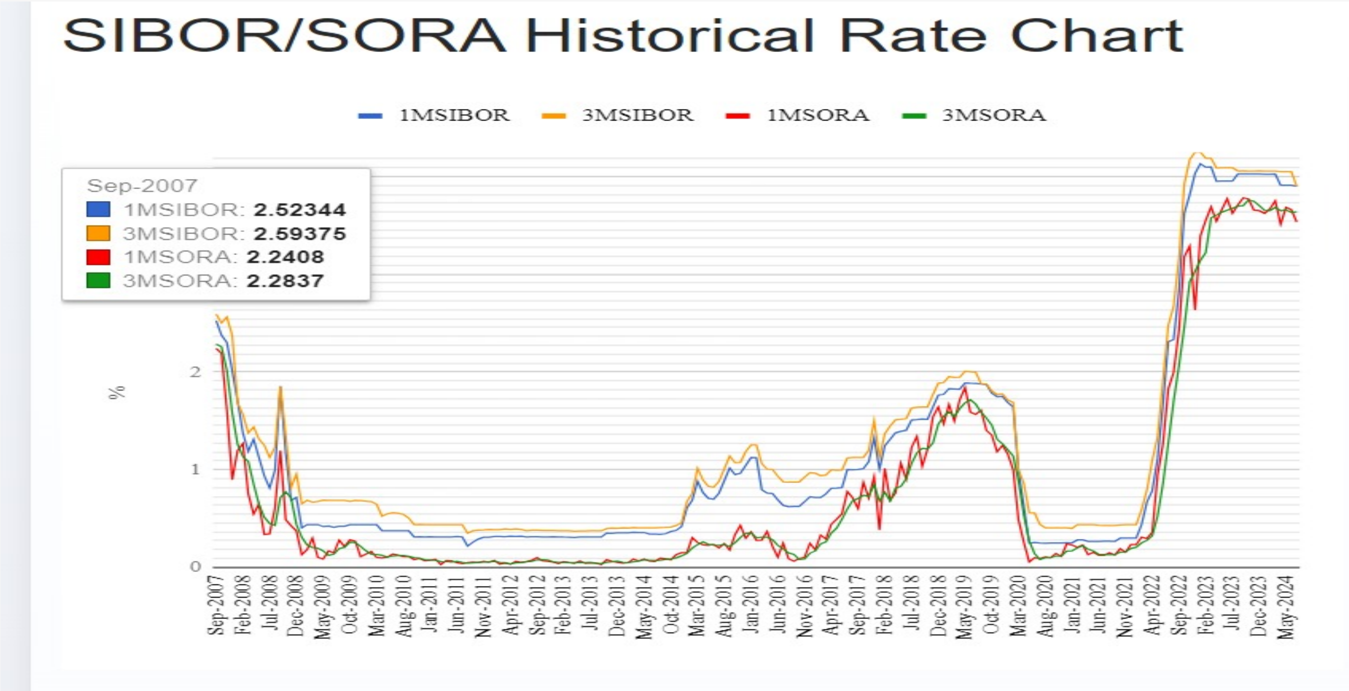
Market pricing only 57% pass through

	SOFR	SORA	Pass-through
20dma Fix	5.33	3.45	
3m	4.96	3.15	
3m3m	4.16	2.64	64%
6m3m	3.53	2.35	56%
9m3m	3.16	2.15	56%
12m3m	2.95	2.10	52%
15m3m	2.95	2.10	52%
18m3m	2.87	1.95	58%
24m3m	2.91	2.08	52%
Total			57%

Source: Bloomberg, Nomura

If we based on our current assumption of 100bps cut by Fed and the fact that SGD is trading at the upper end of the SGD NEER, our guess is that SORA will fall from 57bps to 100bps.

What is my point? Your loan servicing costs will come down. Yeah! But don't expect SORA to drop too much and in tandem with Fed cuts. Lastly, just personal advice. Lock your home mortgage rates for as long as you can. If you can get rates around 2.5 to 2.70, it is actually quite good rates. Don't expect the repeat of NIRP or ZIRP from 2008-2018.



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