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Financial Planning

Spanish EURO mortgage interest rates -

now more expensive even though Interbank rates fall!

But why?

Euribor (European Inter Bank Offer Rate) is the interest rate index which reflects the rates that banks provide loans to one another. Banks which borrow money from other banks can then use these funds to provide loans to other parties, in the main via mortgages.

The general rule is that, when the Euribor rate increases, the interest rate applicable to variable based loans and mortgages increases, and vice versa. There is a direct relationship between the rate at which the lender borrows from the Money Markets and then how much they charge for lending, the difference being referred to as the bank 'margin'.

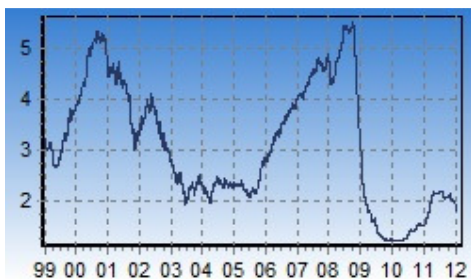
At its peak in the autumn of 2008, the Euribor annual rate hit a high of 5.6%. When the banks margin (profit) for lending was added this brought some mortgage rates up to well in excess of 6%. Since then, following the European Central Bank's decision to drive the cost of borrowing down to stimulate lending, we have seen rates fall dramatically. The ECB's base rate now stands at 1% and the annual Euribor just 1.80% and this has fallen steadily, month by month, of late since the 'Euro Crisis' began.

However, Spanish banks are becoming more defensive and cautious so, whilst there is the potential for cheaper loans and mortgages, the reality is far different!

Lenders, in order to protect their profitability and balance sheets, have not passed the market rate reductions on. On the contrary! In very recent months their margins have increased substantially so, whilst i) the base rate is low and will remain as is ii) the 12 Month Euribor (the basis on which the mortgage rate is set and reviewed), the actual pay rate on mortgages is rising! The average margin a year ago was 1% to 1.5%. Now that range is from 2% to 3.5% meaning that the 'pay rate' is higher, perhaps by an average 1%, at say 4.5%.

This in itself is not that high by historical standards and cannot really be considered 'expensive'. It is simply higher than borrowers would want!

Perhaps, once the 'Euro Crisis' has been resolved and Spanish banks feel a little less defensive, we will see the margins lowered and competition for business return.



Euribor 12 months rate – 1999-2012 (Source: <http://www.euribor-rates.eu/euribor-charts.asp>)

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