RESEARCH INSIGHTS

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Property Market in Hong Kong

"To recover or remain as a ticking time bomb?"

Despite being in economic turmoil, we dive into the possible opportunities that lie ahead of Hong Kong's economy, to uncover what fate that lay awaits its housing market

Introduction

The foundation of the Hong Kong special administrative region of the People's Republic of China has been its methodical strength under "one country, two systems". It is particularly notable for propelling its economic development, where its institutional strength and other advantages allow Hong Kong to remain competitive. By positioning itself as a robust city leveraging the aid from Mainland China while engaging with the world, Hong Kong has become an International hub for commerce, finance, and trade, a place for corporate headquarters as well as a major centre for investment, logistics, and transportation. During its reintegration with China in 1978, the economy in Hong Kong became robust and a surge in the business sector take place providing more than 5 million job opportunities at the end of the year. Though most of the business is a labor-intensive assembly for export, there has been an increase in retail trade and financial services from 1997 onwards. Up until recently, Hong Kong started to experience an unprecedented decline in its economy along with the world.

Overview of the economic performance

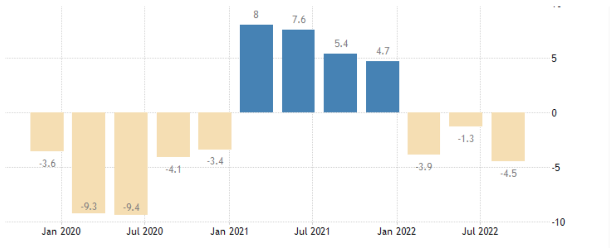
The Hong Kong economy is no exception to the world's economy having a big contraction in the year 2022. The deteriorated external environment and ongoing disruptions to cross-boundary land cargo had dealt a critical blow to Hong Kong's export. Worldwide tightened financial conditions emerged from the steep interest rate hikes by major central banks are significantly dependent on domestic demand, private consumption was supported by improved labor market conditions and the distribution of consumption vouchers in August. Looking ahead, the noticeably deteriorating external situation will continue to place significant pressure on the performance of Hong Kong's exportation. A continued tightening monetary policy to curb elevated inflation in major advanced economies will decelerate global demand.

Where the residential property market softened during a weakened local and global economic outlooks due to a tightened financial phenomenon. Intensified geopolitical tensions coupled with the heightened pandemic situation also contribute to the downside risks. Nevertheless, the loosened quarantine and medical checkup arrangements for incoming visitors should alleviate the condition of the export of services. In Hong Kong, although the Consumption Voucher Scheme and improved circumstances in the labor market will continue to improve consumption demand in the near future, tightening economic conditions and the resulting decline in asset prices will partially offset the positive effects. As a result, a weaken fixed asset investment is caused by the weak economic outlook and soaring borrowing costs. Nevertheless, it was believed that economic activities will recover back to normal at a quicker pace when other restrictive measures are further loosened once the pandemic circumstances are under control. With the aforementioned dire future outlook for the economy ahead, a question surface as to how long will it take for the economy to approach a smooth landing. The real GDP growth for 2022 had contracted to -3.2%, while the underlying consumer price inflation for 2022 is reduced to 1.8%.

Latest Situation

The labor market has shown an indication of improvements coupled with the recovery in domestic economic activities. The quarterly adjusted unemployment rate had fallen from 1.8% to 1.7% from July to September 2022. The total employment increased by 19,700 to 3,648,600, while a decline of unemployment fell from 7,900 to 147,00. Looking ahead, the short-term viewpoint for the labor market will be dependent on the conditions regarding domestic economic activities. The tightened financial situation will foreseeably dampen the economic performance and constrain demand. Nevertheless, it is crucial for significant government intervention on alleviating the anti-pandemic measures to control the epidemic effectively in favour of the economy. Taking into account the aid of the Consumption Voucher Scheme, it would be efficient to accelerate demand for economic activities.

The value of retail sales recorded an upward growth year on year during October as a result of the disbursement of a large number of consumption vouchers. With the increase in sales of consumer durable goods, business from various retail outlets is able to notice improvements registering double-digit increases. In the near future, the labor market is expected to gradually recover while aided by the consumption voucher initiative to continue boosting the retail sector, however, this may be challenging with the continued financial tightening policy. Nonetheless, consumption-related activities will regain momentum once the local epidemic situation remains under the government's control, which is vital for the communities and stakeholders to cooperate to resolve the issue in an effective manner. During the second quarter of 2022, the economy in Hong Kong continue to contract by 1.3%, follow up by a decline of 4.5% year on year in real terms during the third quarter. The GDP growth for the final quarter is no surprise with a contraction of 3.2% in view of the profound deterioration of global economic prospects coupled with the worse-than-expected economic performance throughout the past 3 quarters. The overall consumer price inflation remains at 1.8% for 2022 and is stated to remain relatively controlled, the government forecast Hong Kong's upcoming consumer prices to rise by 0.1% in January.



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Strategic Position

According to the UNCTAD World Investment Report 2022, "Hong Kong ranked 3rd globally for having a global FDI inflow of approximately US140.7 billion during 2021, behind Mainland China (US 181 billion) and the United States (US 367.4 billion)." "Hong Kong ranked 7th globally in terms of FDI outflows with US87.5 billion while being the world's 5th largest host with around 2,000 billion in terms of FDI shock." Based on a triennial survey provided by the Bank for International Settlements, Hong Kong remains the second largest foreign exchange market in Asia while being the 4th largest during 2022, reaching a daily average turnover of forex transactions amounting to US
694.4 billion in April 2022. Research conducted by SWIFT reported that Hong Kong has remained the largest offshore RMB business hub and clearing centre in 2022, amounting to 76% of the world's RMB payment. Hong Kong remains a prominent financial and banking hub in the Asia Pacific. During 2021, Hong Kong manages to rank as the 7th largest stock market in the world by accumulating a whopping US5.4 trillion market capitalisation and being the 4th largest IPO fundraiser in the world with a total of US42.3 billion. Assisted by exceptional connectivity with Mainland China and the world to establish a compelling research and development competency and renowned universities, Hong Kong is in quick pace with technology and innovation. That said, despite the decline in the current economic situation, the future of Hong Kong's economic prospects remains vigour with major opportunities to thrive in various sectors.

Recent Government Initiative

The government recently establish the Hong Kong Investment Corporation to fully optimise the utilisation of fiscal reserves to accelerate the development of various industries and its economy. An HKD 30 billion is withheld from the Future Fund to develop the Co- Investment Fund to entice enterprises to invest in their businesses and set up operations within Hong Kong. Improved the availability of RMB-denominated investment tools and treasury services. Moreover, a Top Talent Pass Scheme is being introduced for a period of two years to effectively attract talents abroad to pursue a career in Hong Kong. Keeping up with the green and sustainable finance initiative, by promoting the establishment of Hong Kong as a green enterprise within the Mainland while being the leading financing platform for the governments. The government will aid HKEX in pursuing cooperation with other financial institutions in Guangzhou in the establishment of a carbon market to be recognised as an international carbon market. In order to promote the commercialisation of R&D outcomes, HKD10 billion is being allocated for 2023 to launch the "Research, Academic and Industry Sectors One-plus Scheme". "The Convention and Exhibition Industry Subsidy Scheme" is being extended to 30 June 2023 with a projected HKD 1.4 billion scheme to be launched with the goal to subsidise around 200 exhibitions and convention industry within Hong Kong for the next three years.

Source: Hong Kong Special Administrative Region

Greatest Urbanisation in History

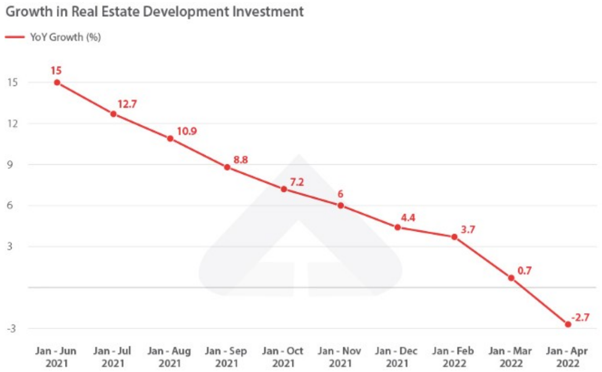
When China embarked on reforms to remake its economy in 1978, only 18% of its citizens lived in cities, in present it boasts an urbanization rate of 64% where more than 900 million Chinese citizens live in major cities and towns. Until 1979, homes could not be bought or sold in the People's Republic of China. Between 1979 and 2021, China built 23 billion square meters of housing where private developers came to dominate the market. By the mid-1990s, Banks started offering 20-year mortgages to alleviate property buyers' spending, meanwhile, China introduced a drastic appraised sales system whereas in countries such as the UK mortgage payments only start after key collection whereas, in China, repayments start much earlier.

Upon signing a contract a property buyer would pay a 40% down payment and take out a bank loan to cover the rest, the banks would start paying the bank right away while the property buyer would service the mortgages sometimes before the bricks are laid. As a result, the pre-sale system allows developers to ease their financial burden by attracting capital before the property completion.

Could the property crisis in China affect the housing market in Hong Kong?

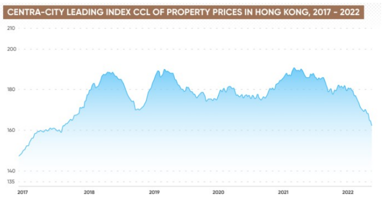
In recent months, A decade-long property boom in China drew to a close as anger erupted among Chinese property owners as property developers held constructions on their property. As a result, the vast population refused to make mortgage payments which caught the attention of the authorities. Close to 9% of housing projects under construction across China have become "rotten tail building", an estimated 2.4 million families can't move into the homes that they paid for affecting a total of 7.3 million people. Their frustration turned to desperation where some have taken to the street demonstration but ended up being quashed with officials citing covid concerns. The incident accelerated the mortgage boycott and affected non-performing loans to soar where banks may hold banks on issuing more loans where the economy might seize up.

Since the boycott emerged, the authorities have cut mortgage interest rates and pledged to support project completion but before that occurs, the mortgage buyers bear the financial stream. According to the rating agency SMP, 40% of Chinese developers are in financial distress and have terminated 20% of their projects. The agency forecast that half of the projects under the developers could potentially become "rotten tails". 12% of China's existing homes are unoccupied, meanwhile, SMP forecast a 7% drop in prices for the nationwide property market for the year. The total value of residential real estate to GDP is typically around 100%, in the US its around 120% whereas in China has 350%, which suggests it has a long way to go before it becomes normal.



Can anything be done to stop the collapse?

A 30% drop in property prices within Hong Kong by the end of 2023 was forecasted by Goldman Sachs as soaring interest rates make properties less affordable while repelling investors from the market.Meanwhile, investors are worried that the decline in China's housing market will trigger an event similar to the 2008 Global Financial Crisis which started when a mortgage meltdown in the US caused American Investment Bank Lehman Brothers to default. However, a real estate crisis in China is handled differently compared to the US where the Chinese financial system would approach long and slow adjustments rather than quick and brutal adjustments. Most of the debt of the distress is within the Chinese institution which has much less risk of financial contagion to the rest of the world including Hong Kong.



Evergrande

According to the economist, China builds about 15 millions of homes a year which is five times the amount America and Europe have combined. Evergrande is the second largest real estate firm that was founded in 1996, at its peak it had more than 1300 projects across China where a total of 12 million families lived in homes it built. In 2021, Evergrande defaulted on its debt and has since disclosed that it owes banks, bondholders, and suppliers a whopping 300 billion US dollars total which is the equivalent of 2% of the Chinese GDP. A "too big to fail" scenario occurs when the end consumers have too much faith in the major property firms. At first, the authorities tried to stamp rising property prices with purchase restrictions, when it didn't work in early 2021 China came out with 3 red lines (liabilities ≤ 70% of assets, net debt ≤ 100% equity, and money reserves ≥ 100% of short-term debt) which was aimed at prohibiting highly indebted developers from borrowing more. Evergrande breaches all 3 red lines which prevent them from continuing to borrow and make interest payments on its debt .

Understanding Hong Kong Housing Market

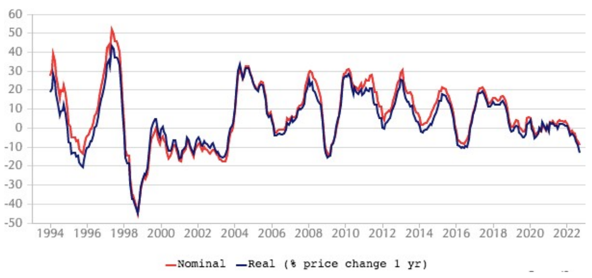
The Housing Market in Hong Kong is famous for being the most expensive throughout the world. However, this may change in the future as a range of factors from the existing Covid-19 restrictions and soaring interest rates, has resulted in a steep decline in the prices of residential properties.

Similar to all assets, property prices rise and fall over time. At some point, property prices may exceed their intrinsic value due to various factors that increase demand rapidly, as a result, a housing bubble surfaces. Several factors that increase property demand include easier access to bank loans, better welfare, and low mortgage rates. When a central bank increases its base interest rate, there will be a decrease in new investors due to a higher cost of mortgage payments. A failure of mortgage payment creates a higher risk of default which could increase the number of available properties. As a result, the housing bubble could burst and cause a collapse in prices if developers constantly build properties even though demand has started to diminish. Furthermore, the overall economy is still in the midst of a recession which causes job losses, reduced savings, and ultimately a decrease in demand for housing. Consequently, Hong Kong remained the least affordable property market with average property prices standing at 23.3 times the average annual income.

Table 4, contd.
HOUSING MARKETS RANKED BY AFFORDABILITY: MOST AFFORDABLE TO LEAST AFFORDABLE
Median Multiple (Median House Price/Median Household Income): 2021: Third Quarter (*revised March 9, 2022*)

Rank	Nation	Metropolitan Market	Median Multiple	Rank	Nation	Metropolitan Market	Median Multiple
36	U.S.	Dallas-Fort Worth, TX	4.8	83	Canada	Toronto, ON	10.5
36	U.S.	San Antonio, TX	4.8	84	U.S.	Los Angeles, CA	10.7
39	U.S.	New Orleans. LA	4.9	85	N.Z.	Auckland	11.2
40	U.K.	Manchester / Greater Manchester	5.0	86	U.S.	San Francisco, CA	11.8
40	U.K.	Nottingham & Nottinghamshire	5.0	87	U.S.	Honolulu, HI	12.0
40	U.S.	Nashville, TN	5.0	88	Australia	Melbourne, VIC	12.1
40	U.S.	Raleigh, NC	5.0	89	U.S.	San Jose, CA	12.6
44	U.S.	Jacksonville, FL	5.1	90	Canada	Vancouver, BC	13.3
44	U.S.	Milwaukee, WI	5.1	91	Australia	Sydney, NSW	15.3
46	U.S.	Richmond, VA	5.2	92	China	Hong Kong	23.2

In the past decades, the housing market in Hong Kong had enjoyed rapid growth according to Global Property Guide's report where housing prices rose to 275%. According to the publication, a remarkable growth of property prices in the Hong Kong real estate market occurred in 2009 (28.5%), 2010 (21%), 2012 (25.7%), 2014 (13.6%), and 2017 (14.7%), which could be an indication of the housing bubble. Hong Kong lies in the Eastern Pearl River Delta in South China and faces a land scarcity issue which explains the intrinsically expensive properties. For instance, the price of a house would be approximately HKD12 million if a Hong Kong resident earns an average of HKD 500 thousand. There was a short decline in the Hong Kong property market's growth momentum when covid peaked but it was swiftly picked up in 2021 as the covid-19 situation stabilised. The economy managed to recover briefly when demand was strong while interest rates remained low, where a total of 74,297 transactions occurred in the primary and secondary housing market, constituting an increase of 24% from the previous year. Although the domestic prices in the property market grew by 3.6% by the end of 2021, the property prices have been downward sloping halfway through 2021.



Hong Kong Real Estate Market

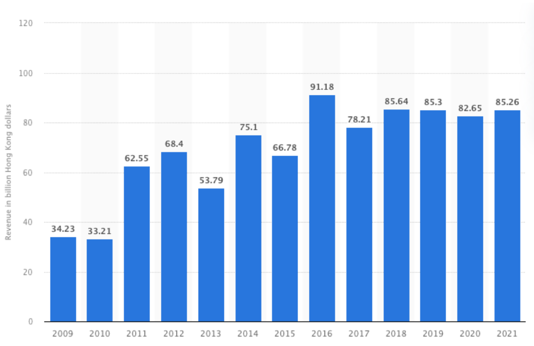
The fed rate in Hong Kong has risen to 4.75% during November, from 0.75% in March to prevent the outflow of Hong Kong dollar to the US dollar, as the outflow of funds could reduce the value of the currency when pegging to the US dollar. In early January, Hong Kong's interbank rate, also known as hibor, was below 1% and has risen to 5.11% within the span of a year. Moreover, most mortgage rates in Hong Kong are linked to hibor, which directly impacts the mortgage market to have a dampened demand for property. According to Bloomberg intelligence, the new home demand has been declining by 10% from the peak. Meanwhile, Saville Research predicted the prices of luxury homes to fall within the range of 5% to 10% during 2023. Recently, Hong Kong has scrapped its 0+3 arrangement which requires travellers to serve 3 days of medical surveillance upon arrival and this comes as the city accelerates its reopening plans amid a sluggish economy, where a new healthcare system with an effective measure in lowering community transmission is being introduced. This could have a positive impact on Hong Kong's commercial leasing and investment markets.

The recovery of the property market had remained stagnant during 2022 with a declining trend amongst all property sectors. According to JJL's market review on the performance of the property market in Hong Kong, the total investment quantity of commercial properties sold for above HKD50 billion had dropped 75.4% year on year to HK11.5 billion in the present. Despite the plummet in the housing market, it is forecasted that there would be a recovery in demand in Hong Kong when the gradual easing of Covid-19 restrictions takes place which opens up a pathway to more efficient overseas travel for Hong Kong while increasing international demand. Additional positive influences include the growth of life sciences and biotech sectors with the near-term potential of "Insurance Connect".

The housing market will result in a positive net absorption, driven by an increase in talented tenants that are incentivised by the opportunities provided within Hong Kong. On the other hand, Senior housing will become a significant focus for investors. Since the average unit price of hotels are the lowest among most property types, hotels are taken into consideration to be converted into senior housing equipped with medical facilities.

Sun Hung Kai

Sun Hung Kai properties is considered one of Asia's largest property developer firm with a revenue stream mainly from the sales of properties in Hong Kong. The firm possesses a market capitalisation of HKD 276.7 billion, similar to most of the firms from its sector, it has a weaker profit compared to the previous year. The firm strongly believes the two largest obstacles and factor that keeps tourists away. Firstly, the increase in interest rates creates a widening interest gap between Hong Kong and the US and has resulted in the outflow of capital and an increase in funding costs from banks within the city. Secondly, a stern covid restriction where a decline in tourism can be crucial to the industry as it is considered a major pull factor that caters to various job opportunities in Hong Kong. Nonetheless, the firm believes in the city's strong fundamentals and increased opportunities from the National 14th five-year plan, these factors fuel their confidence that Hong Kong will continue to thrive and prosper in the future.



Writer's Opinions

Final Thought

Most analyses demonstrates a downtrend of property prices in Hong Kong during 2023. However, the prediction may not always be accurate, past performances do no suggest future performance. Despite the negative circumstances that outweighs the positive ones, housing investors have emerged to a wait-and-see approach despite major uncertainties ahead. This suggests there will be great demand for the housing market as soon as the housing market reaches favourable prices when the economic condition stabilises. With Hong Kong established housing market while remaining one of the largest financial centres in the world, allows it to be resilient and may overcome major financial hurdles.

The authorities are given enough space to stabilises the housing market, provided with the cooling measures in effect. Moreover, long-awaited confidence in the market has recently resurfaced from the recent facilitation of covid police along with the lower-than- expected US inflation. By gradually approaching a stabilising external environment and a full-scale reopening in Hong Kong, the recovery from the economic losses may aid housing demand while facilitating the pace of home price correction.

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