Economics & Strategy

DBS Focus

Hong Kong: Brakes on the property boom

Economics/Strategy/Rates/FX

Group Research

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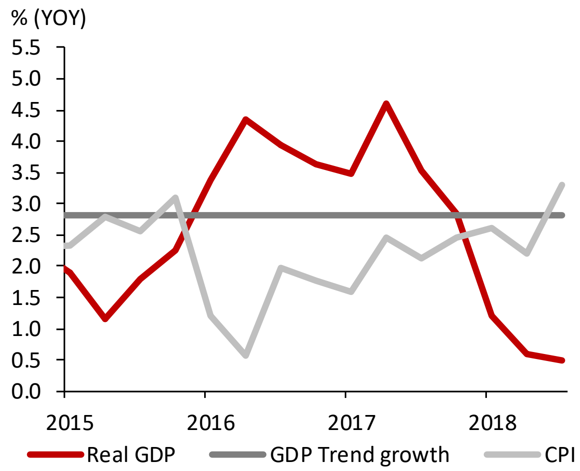
- *Growth slowdown in China and Hong Kong, rising trade tension, equity market selloff, and ongoing political turmoil are sources of property market strain.*
- *Yet a broad market sell-off is unlikely given its solid fundamentals.*
- *The government could remove some demand side management measures if warranted.*
- *We forecast housing prices to rise by 5% in 2019 (to retreat 3% from its June peak) and decline by 0-5% in 2020.*

The fallout from the rapidly escalating anti-government protests is putting Hong Kong's residential property market under strain. The unrest is taking its toll on the economy and financial markets, which have already been impacted by the trade war and the slowdown in China's economy.

Chart 1: GDP and inflation



Source: CEIC and DBS

While HK growth was benign at 0.5% YoY in 2Q19 (**Chart 1**), it contracted 0.4% QoQ. Merchandise exports growth have contracted nine straight months since November 2018; the -5.7% YoY in July after recording the biggest drop since February 2016 last month.

There were negative spillovers from the challenging external environment into the domestic economy. Retail sales value reported the 6th consecutive YoY declines in June (**Chart 2**). Gross domestic fixed capital formation decelerated to a decade low of -11.6% in 2Q19 from 7.0% in 1Q19. Pessimistic business expectation mirrored the weakness in PMIs. We have downgraded Hong Kong's GDP growth forecasts to 0% from 2.5% for 2019, and to 0.5% from 2% in 2020 (see "Hong Kong: Growth downgraded"; August 2, 2019).

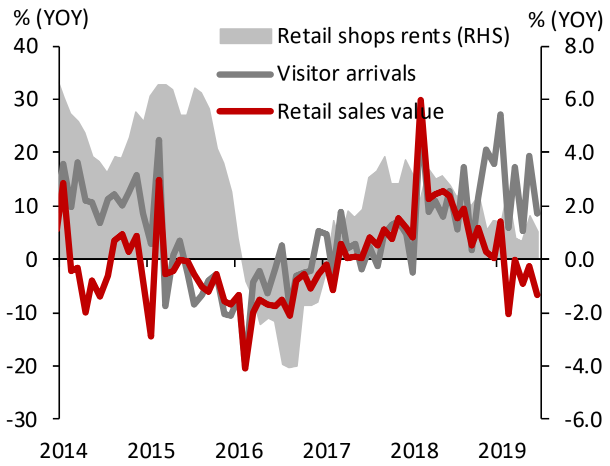
Table 1: Hong Kong property stocks performance

Ticker	Company	Sector	Weighting (%) (Property: 9.8%)	HK segmental revenue (%)	HK segmental revenue (%) by HSI weighting (Property: 6.4%)	Price change Since April 1st (%)	Price change 3M (%)	Price change YTD (%)
101 HK Equity	Hang Lung Properties Ltd	Real Estate	0.4	54.9	0.2	-12.2	0.2	17.3
1113 HK Equity	Ck Asset Holdings Ltd	Real Estate	1.6	49.2	0.8	-24.1	-6.4	-4.9
12 HK Equity	Henderson Land Development	Real Estate	0.6	75.6	0.5	-19.1	-17.2	3.8
16 HK Equity	Sun Hung Kai Properties	Real Estate	1.5	89.1	1.4	-20.8	-17.1	0.5
17 HK Equity	New World Development	Real Estate	0.7	55.0	0.4	-28.1	-18.0	-4.5
19 HK Equity	Swire Pacific Ltd - Cl A	Real Estate	0.5	25.0	0.1	-23.6	-15.2	-5.7
1997 HK Equity	Wharf Real Estate Investment	Real Estate	0.6	98.6	0.6	-28.2	-23.8	-8.5
688 HK Equity	China Overseas Land & Invest	Real Estate	1.1	4.4	0.0	-20.2	-9.4	-8.6
823 HK Equity	Link Reit	Real Estate	2.2	89.8	2.0	-3.0	-7.3	13.2
83 HK Equity	Sino Land Co	Real Estate	0.4	79.7	0.3	-26.7	-12.5	-15.6
HSI index	Hang Seng Index					-13.3	-6.1	-0.9

Source: Bloomberg and DBS

Adding to the pressure is the volatile stock market. The Hang Seng Index, which has proved a reliable predictor of the city's house prices, has dropped 15% from the April peak. Property developers suffered some of the largest losses, with the Hang Seng Property index falling 18% (**Table 1**). Continued financial market volatility does not bode well for upgrading demand/luxury home demand.

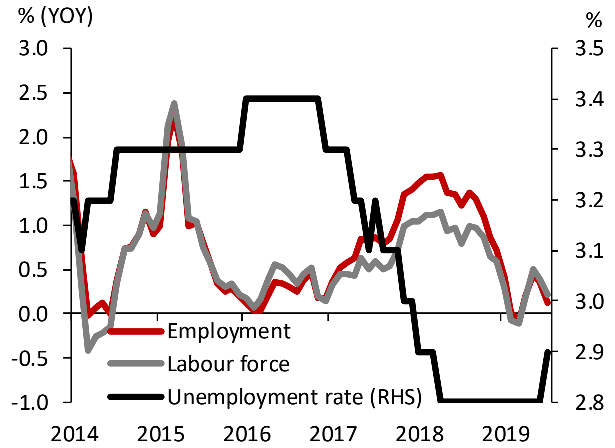
Chart 2: Tourist arrivals, retail sales and rent



Source: CEIC and DBS

In fact, **secondary housing market activity has been dwindling since the escalation of the anti-extradition bill protests in July**. While prospective home buyers have adopted a wait and see approach, existing homeowners are not under strong pressure to sell their properties. The latter have relatively strong holding power given the benign interest rate environment.

Chart 3: Unemployment rate and labour demand-supply



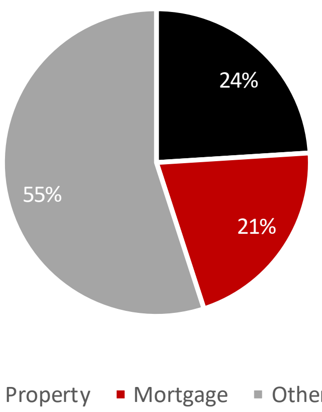
Source: CEIC and DBS

In the primary market, developers have been focused on selling mass market projects while upmarket project launches are on hold due to lukewarm interest. So far, market response for mass market developments has been favourable, reflecting solid end-user demand.

Yet local economic growth has been losing momentum amid the prolonged trade disputes. Tourism numbers are also falling in the wake of the demonstrations, with retailers and hoteliers warning of slowing sales. Political uncertainties, if prolonged, alongside negative wealth effect will further dampen domestic consumption. Such impact will eventually feed through the tight labour market. The unemployment rate rose to 2.9% after staying at its 20-year low of 2.8% for 15 months (**Chart 3**).

Meanwhile, **credit conditions could tighten as banks become more reluctant to lend.** Mortgage lending for residential property purchases amounted to HKD1.39trn at end-March 2019, with lending to property developers accounting for a further HKD1.57trn. This collectively represented 45% of total bank loans (**Chart 4**). This prompted us to forecast a mere 5% growth in housing prices in 2019 (to drop 3% from June peak) and decline of 0-5% in 2020.

Chart 4: Hong Kong Loans



Source: CEIC, DBS

That said, the retreat in housing prices will unlikely trigger a broad market sell-off given its solid fundamentals. The delinquency ratio for residential mortgage loans remained low at 0.02% in June. The risky loans - private co-financing scheme, only accounted for 1.9% of total mortgage value. The outstanding number of mortgages in negative equity also fell from 262 cases in end-2018 to 1 case in June. The loan-to-value ratio stayed low at 47.4%. The US rate cut in July and the dovish global rate environment should also support housing prices ahead.

In 2020-2021, private residential supply should not be excessive. We forecast the average number of new primary units to be completed to be 19,000. The government is aiming to increase public housing supply by raising the allocation of public housing units built on new land to 70% from 60%. This would result in less land sold via government tender for private residential developments.

The land sharing pilot scheme, whereby the government partners with private developers to unlock the development potential of privately-owned agricultural land, and study on land reclamation near Lantau Island are likely to be delayed. Against this backdrop, private housing supply growth is likely to be constrained in the medium term, providing support to residential prices. In the event of any demand shocks, the government could consider removing some demand side management measures including Buyers Stamp Duty to support the market.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations).