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ASIA HOT TOPICS

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HONG KONG: EASING MACROPRUDENTIAL MEASURES TO THE RESCUE OF A TANKING ECONOMY

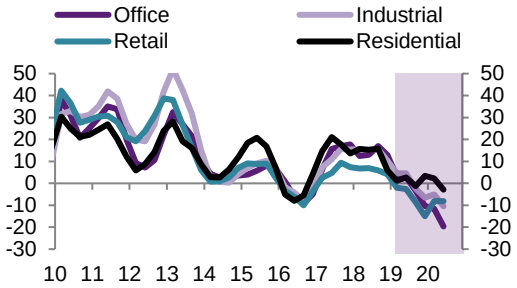
Hong Kong has one of the world's expensive real estate markets. But the highly priced properties have now been put to test, first by the social unrest and then by the prolonged Covid-19 pandemic. In the midst of multiple shocks, the HKMA has relaxed the macroprudential measures for commercial properties with the loan-to-value (LTV) ratio caps adjusting upward by 10 percentage points. The move comes after the previous relaxation to allow higher household leverage and two cuts of the countercyclical capital buffer (CCyB) since October 2019.

The reason for a targeted relaxation towards commercial real estate may be explained by its poor performance versus residential properties. Since the previous peak in June 2019, prices for offices and flatted factories have declined by 16% and 12% respectively. Due to the weak consumer sentiment and spending, retail properties also face pressure and are still stuck in a contraction of 7%. As there is no significant improvement in the related unemployment rate, it could imply further closure of shops and restaurants without more fiscal stimulus. In contrast, home prices have been more resilient with a 2% decline.

The better performance on residential properties may be attributed to the relaxed macroprudential tools earlier. As a consequence, the average LTV ratio for new residential mortgage climbed to 58% in June 2020 from 48% in October 2019, the time when the Mortgage Insurance Programme was updated. The laxer liquidity conditions with lower interest rates after the Covid-19 outbreak have also facilitated mortgage loan growth, which has accelerated from 9.5% YoY in 2019 to 10.6% YoY in June 2020. Furthermore, there has been no relevant increase in land supply, putting a floor to any downfall of home prices.

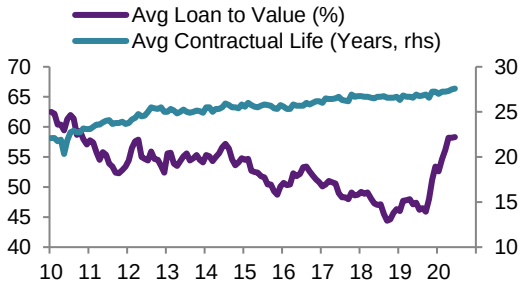
While Hong Kong has suffered its worst decline on GDP growth on record in Q1 2020, the impact on property prices is not yet comparable to the Asian Financial Crisis in 1997-98 and the Global Financial Crisis (GFC) in 2008-09, although still larger than the period of SARS in 2003. But this time around, Hong Kong is facing deeper cyclical and structural economic pressure. The relaxation of macroprudential measures may not necessarily shield further downfall of commercial property prices. One of the reasons is that only the LTV ratio is relaxed but not the stress test requirement. Unless there is a solid improvement in business and consumer sentiment, the easier access to credit alone may not be enough to fuel the rebound of prices in commercial properties, especially when there is no sign of ebbing geopolitics tides.

Hong Kong: Property Price by Type (%YoY)



N.B. Data as of June 2020
Source: Natixis, Hong Kong Rating and Valuation Department

Hong Kong: New Residential Mortgage Approved



N.B. Data as of June 2020.
Source: Natixis, Hong Kong Monetary Authority

Alicia Garcia Herrero
Tel. +852 3900 8680
alicia.garciaherrero@natixis.com

Gary Ng
Tel. +852 3915 1242
gary.ng@natixis.com

RESEARCH BY NATIXIS

Missing tranquility

Hong Kong has one of the world's expensive real estate markets. But the highly priced properties have now been put to test, first by the social unrest and then by the prolonged Covid-19 pandemic. In the midst of multiple shocks, the Hong Kong Monetary Authority (HKMA) has relaxed the countercyclical macroprudential measures for commercial properties with the loan-to-value (LTV) ratio caps adjusting upward by 10 percentage points and raised from 40% to 50% for general cases.. The move comes after the previous relaxation to allow higher household leverage and two cuts of the countercyclical capital buffer (CCyB) since October 2019.

Table 1: Relaxation of Prudential Measures in Hong Kong

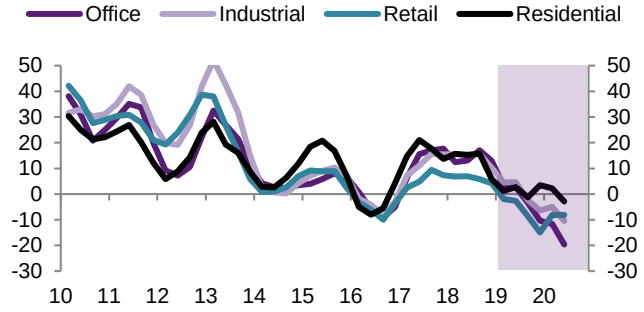
Date	Measure
Oct 2019	Mortgage Insurance Programme is amended to allow leverage as high as 90% of the loan-to-value (LTV) ratio
	The countercyclical capital buffer (CCyB) is reduced to from 2.5% to 2.0%
Mar 2020	The countercyclical capital buffer (CCyB) is reduced from 2.0% to 1.0%
Aug 2020	The loan-to-value (LTV) ratio caps for mortgage loans on non-residential properties are adjusted upward by 10 percentage points.

Source: Natixis, Hong Kong Monetary Authority

Commercial properties facing large pressure

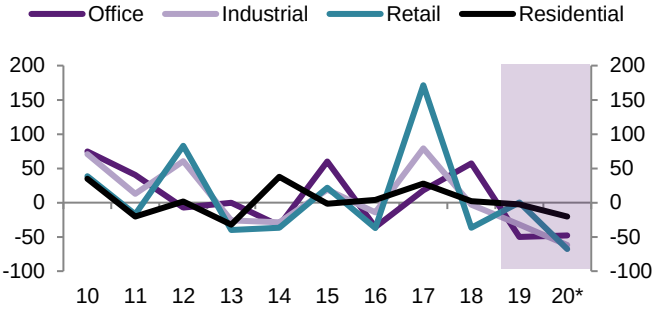
The reason for a targeted relaxation towards commercial real estate may be explained by its poor performance versus residential properties. Offices are facing the toughest headwinds among different property types with sheared prices and transactions (**Chart 1** and **Chart 2**). Since the previous peak in June 2019, prices for offices have declined by 16%, which is a bigger decline than the correction in 2016. Rent for offices have declined 7.9% comparing to a year ago with vacancy rate climbing from 5.1% in June 2019 to 8.1% in June 2020, which may add pressure to cash-flows and profits for office landlords (**Chart 3** and **Chart 4**). Industrial properties, which are mainly measured as flatted factories in Hong Kong, are also facing a price decline of 12% YoY in June 2020.

Chart 1
Hong Kong: Property Price by Type (%YoY)



N.B. Data as of June 2020
Source: Natixis, Hong Kong Rating and Valuation Department

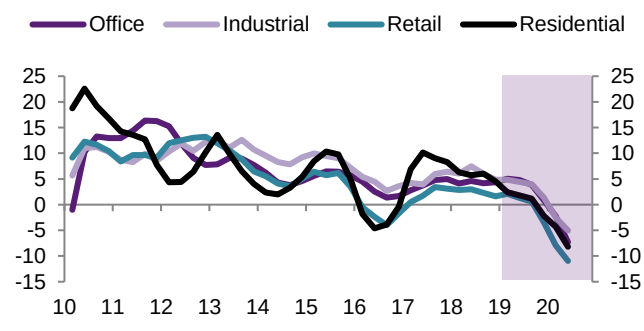
Chart 2
Hong Kong: Agreement for Sales & Purchases (%YoY)



N.B. Data of January to July included for 2020.
Source: Natixis, Hong Kong Rating and Valuation Department

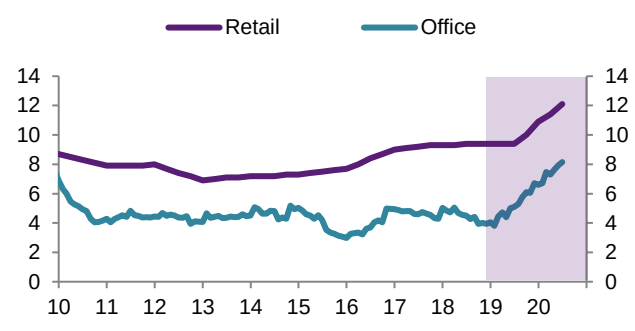
Due to the weak consumer sentiment and spending, retail properties also face pressure and are still stuck in a contraction of 7% as of June 2020. While the immediate price fall is not as larger as offices and industrial buildings, the sharp fall in rent and spike in vacancy rate continues to be worrisome, especially when there is no significant improvement in the related unemployment rate and could imply further closure of shops and restaurants under the existing fiscal stimulus. In contrast, home prices have been more resilient with a 2% decline.

Chart 3
Hong Kong: Property Rent by Type (%YoY)



N.B. Data as of June 2020
Source: Natixis, Hong Kong Rating and Valuation Department

Chart 4
Hong Kong: Vacancy Rate (%)

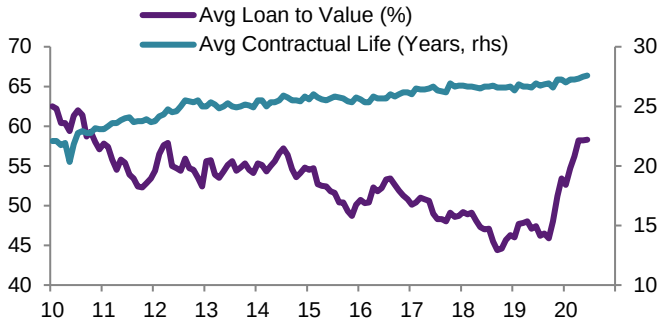


N.B. Data as of June 2020
Source: Natixis, Colliers International, Bloomberg

Home prices are relatively resilient

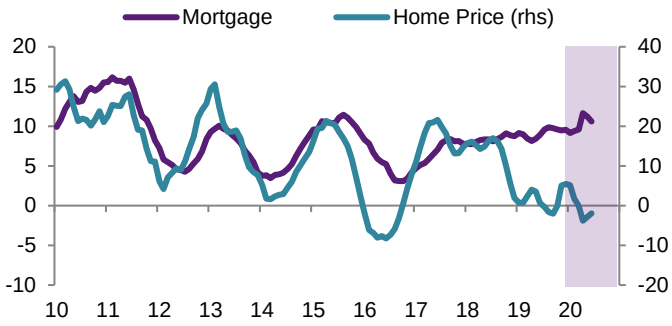
The better performance on residential properties may be attributed to the relaxed macroprudential tools earlier. As a consequence, the average LTV ratio for new residential mortgage climbed to 58% in June 2020 from 48% in October 2019, the time when the Mortgage Insurance Programme was updated (**Chart 5**). The laxer liquidity conditions with lower interest rates after the Covid-19 outbreak have also facilitated mortgage loan growth, which has accelerated from 9.5% YoY in 2019 to 10.6% YoY in June 2020 2020 (**Chart 6**).

Chart 5
Hong Kong: New Residential Mortgage Approved



N.B. Data as of June 2020.
Source: Natixis, Hong Kong Monetary Authority

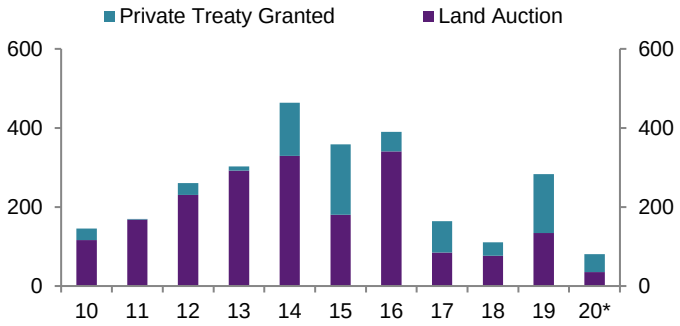
Chart 6
Hong Kong: Mortgage and Home Price (%YoY)



N.B. Data as of June 2020. Source: Natixis, Hong Kong Monetary Authority, Hong Kong Rating and Valuation Department

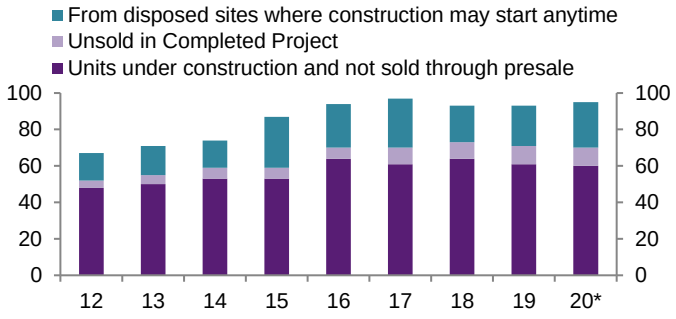
Furthermore, there has been no relevant increase in land supply, putting a floor to any decline of home prices. Although new land supply has increased in 2019, the improvement comes after two years of extremely low land sales (**Chart 7**). There is also no significant increase in the potential unit supply in the coming three to four years according to the government estimates (**Chart 8**).

Chart 7
Hong Kong: New Land Supply (Thousand sq.m)



N.B. 2020 data as of H1.
Source: Natixis, Hong Kong Census and Statistics Department

Chart 8
Hong Kong: Government Estimates on Potential supply in the coming 3 - 4 years (Thousand Units)



N.B. Estimation as of March 2020
Source: Natixis, Hong Kong Transport and Housing Bureau

Not yet as bad as the past

While Hong Kong has suffered its worst decline on GDP growth of 9.1% YoY on record in Q1 2020, the impact on the property sector is not yet comparable to the Asian Financial Crisis in 1997-98 and the Global Financial Crisis (GFC) in 2008-09, although still larger than the period of SARS in 2003 (**Table 2**). But this time around, Hong Kong is facing deeper cyclical and structural economic pressure. The relaxation of macroprudential measures may not necessarily shield further downfall of commercial property prices. One of the reasons is that only the LTV ratio is relaxed but not the stress test requirement. Unless there is a solid improvement in business and consumer sentiment, the easier access to credit alone may not be enough to fuel the rebound of prices in commercial properties, especially when there is no sign of ebbing geopolitics tides.

Table 2: Impact of Shocks on Hong Kong's Real Estate Market

	High	Low	Duartion (No. of Months)	% Change	High	Low	Duartion (No. of Months)	% Change
	Office				Industrial			
Asian Financial Crisis	Sep-97	Nov-98	14	-50	Sep-97	Oct-98	13	-32
SARS	Jan-03	May-03	4	-9	Jan-03	Jul-03	6	-5
Global Financial Crisis	May-08	Mar-09	10	-29	Jul-08	Feb-09	7	-23
Recent peak - Now	**Jun-19**	**Jun-20**	**12**	**-16**	**Jun-19**	**Jun-20**	**12**	**-12**
	Retail				Residential			
Asian Financial Crisis	Sep-97	Oct-98	13	-51	Sep-97	Oct-98	13	-44
SARS	Jan-03	Jul-03	6	-4	Jan-03	Jul-03	6	-8
Global Financial Crisis	Jun-08	Jan-09	7	-21	Jun-08	Dec-08	6	-17
Recent peak - Now	**Nov-18**	**Jun-20**	**19**	**-13**	**May-19**	**Jun-20**	**13**	**-3**

N.B. Data as of June 2020

Source: Natixis, Hong Kong Rating and Valuation Department

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Head of Global Markets Research

Jean-François Robin
+33 1 58 55 13 09
jean-francois.robin@natixis.com

Asia Pacific Research

Chief Economist, Asia Pacific

Alicia Garcia Herrero
+852 3900 8680
alicia.garciaherrero@natixis.com

Emerging Asia

Economist

Trinh Nguyen
+852 3900 8726
trinh.nguyen@natixis.com

Greater China

Economist

Jianwei Xu
+852 3900 8034
jianwei.xu@natixis.com

Japan, Pacific

Economist

Kohei Iwahara
+813 4519 2144
kohei.iwahara@natixis.com

Sectoral Research Asia

Economist

Gary Ng
+852 3915 1242
gary.ng@natixis.com

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