High correlation between unemployment and house prices could lead to a structural break in the correlation between the HSI and house prices.

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Forecasting Hong Kong house prices

Will unemployment lead to a drop in house prices in 2020?

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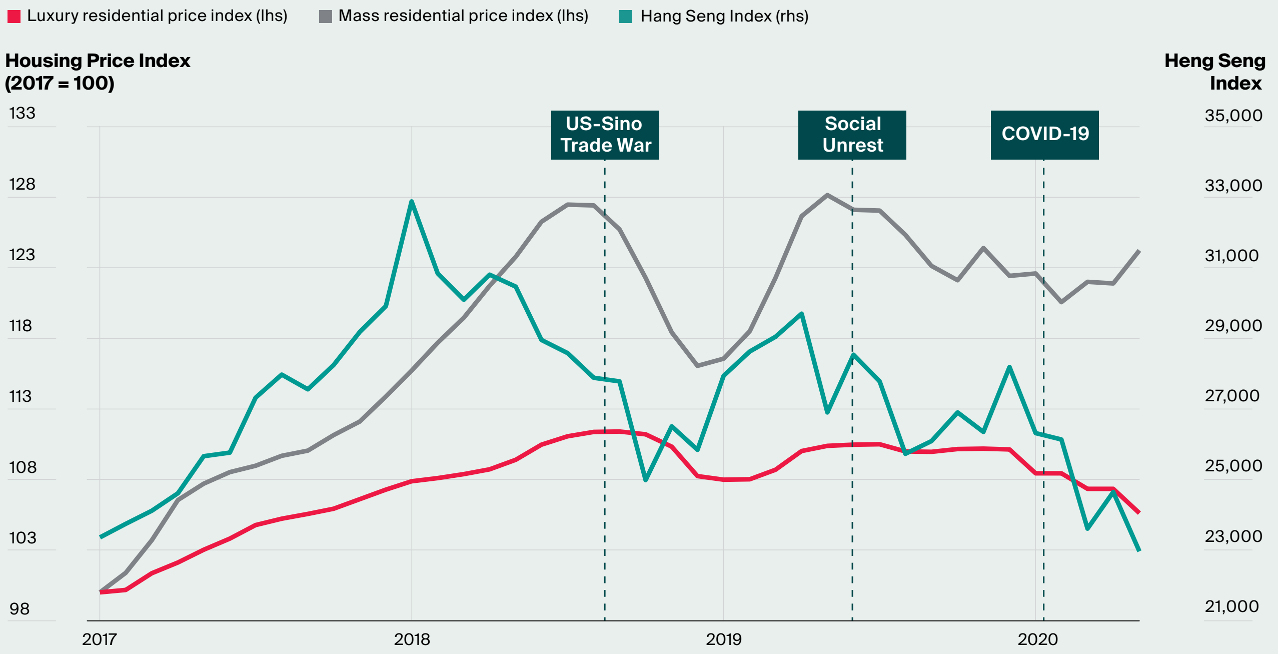
RECAP

Last year, we published Forecasting Hong Kong house prices **January 2019** and **November 2019** papers assessing how Hong Kong housing prices changed according to various factors. We concluded that the Hang Seng index (HSI) has been the most correlated indicator for forecasting home prices in Hong Kong, with the HSI leading house prices, especially mass residential prices, by 3 to 6 months. With Hong Kong witnessing a series of new socio-economic incidents since the second half of 2018, it's a good time to review how the housing market and the HSI evolved during this period.

Chart 1: Housing prices vs. HSI performance



Sources: Ratings and Valuation Department; Knight Frank Research

Chart 2: HSI and residential prices

	HSI	MASS RESIDENTIAL PRICES	LUXURY RESIDENTIAL PRICES
The US imposed a 25% tariff on a list of Chinese imports in August 2018	↓ 10.4% (Aug 2018 – Oct 2018)	↓ 5.1% (Oct 2018 – Dec 2018)	↓ 2.7% (Aug 2018 – Dec 2018)
Outbreak of social unrest related to the anti-extradition bill in June 2019	↓ 9.9% (Jun 2018 – Aug 2018)	↓ 2.5% (Aug 2019 – Oct 2019)	↓ 0.3% (Aug 2019 – Oct 2019)
COVID-19 outbreak in Hong Kong in January 2020	↓ 13.7% (Jan 2020 – Jun 2020)	↓ 5% (Jan 2020 – Dec 2020)	↓ 5% (Jan 2020 –Dec 2020)

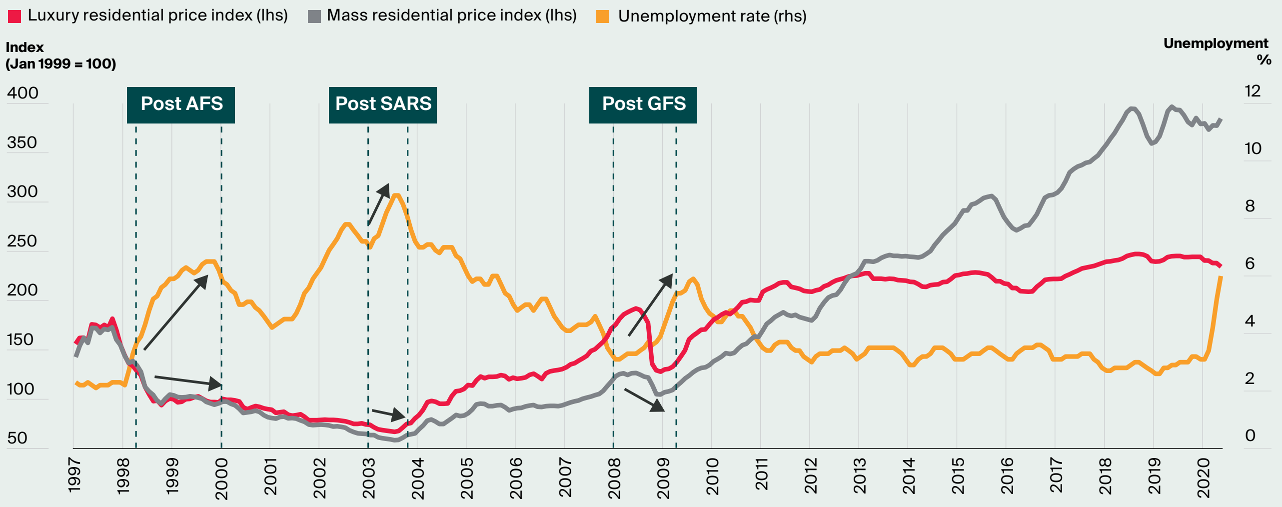
Sources: Ratings and Valuation Department; Knight Frank Research

After the US imposed a 25% tariff on a list of Chinese imports in August 2018, we saw the HSI drop by 10.4% during the three-month period between August and October 2018. Mass residential prices dropped 5.1% in the three months after the HSI tumbled. Similarly, the HSI fell 9.9% between June and August 2019 amid the social unrest in reaction to the anti-extradition bill, and residential prices followed suit, dropping 2.7% in the following three months. This again shows that our previous conclusion on the correlation between HSI and housing prices still holds.

In the first half of 2020, we saw the HSI fall by 13.7% against the backdrop of Sino-US trade war, protracted social unrest, and the COVID-19 pandemic, while housing prices have remained firm so far. However, it is too early to conclude whether there is a structural break in the correlation between the HSI and housing prices, as our analysis has confirmed that housing prices lag behind HSI movement by 3 to 6 months.

WHAT ABOUT UNEMPLOYMENT?

Chart 3: Housing price vs. Unemployment by sectors



Sources: Ratings and Valuation Department; Census and Statistics Department; Knight Frank Research

Due to the COVID-19 outbreak, we have seen the unemployment figure ramp up quickly in recent months. In the first six months of 2020, there were 240,700 unemployed people, which represents an unemployment rate of 6.2%. With both figures reaching new heights since the global financial crisis in 2008–2009, there has been concern in the market that the worsening unemployment situation could lead to a significant drop in Hong Kong home prices, as it could trigger affordability and even lead to bankruptcy and foreclosure. To investigate this possibility, we looked into the correlation between unemployment and property prices, in particular in periods in recent history in which Hong Kong saw fast growth in unemployment, including the periods after the Asian Financial Crisis (1998–1999), SARS (2003) and the Global Financial Crisis (2008–2009).

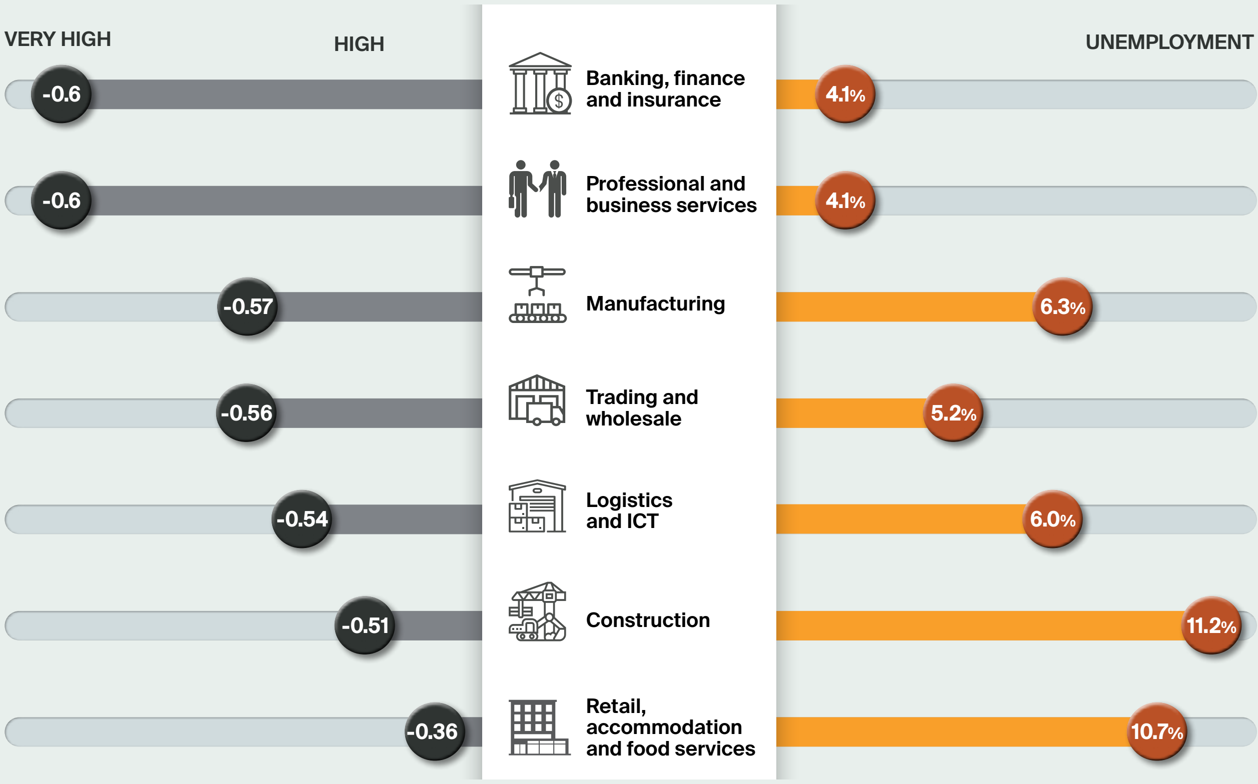
The findings show that mass residential prices were strongly negatively correlated to unemployment in all three periods. Moreover, this negative correlation remained consistent with a lag of 1 to 2 months, implying that property prices have a high chance of falling within 1 to 2 months of a rapidly rising unemployment rate. However, the correlation between unemployment and luxury residential prices was lower, with luxury residential prices remaining relatively stable in the past amid rising unemployment.

Compared to our previous findings on the correlation between the HSI and property prices (at 0.79, with 1 being a perfect positive correlation), the correlation coefficient between unemployment and home prices with a lag of 1 to 2 months is even higher (at -0.83, with -1 being a perfect negative correlation), despite being conditioned on a rapid rise in the unemployment rate at particular time points. That said, there could a strong correlation with short-term house prices, especially since the jobless rate is expected to continue to rise in the next few months amid the COVID-19 situation and other uncertainties.

WHICH EMPLOYMENT SECTORS ACTUALLY MATTER?

We focused on analysing the impact of unemployment by sector on house prices since 2008, as the Hong Kong economic structure changed significantly after the global financial crisis. By looking further into the correlation between the unemployment rate of individual sectors and property prices, it appears that mass residential prices have been more affected by the unemployment rate (with a coefficient -0.5 ‹ r ‹ -1) in the following sectors:

Chart 4: Correlation between Mass Residential Price and Unemployment



Sources: Census and Statistics Department; Knight Frank Research

Among these sectors, unemployment in the banking, finance and insurance, and professional and business services sectors has the highest correlation with house prices, but the current unemployment rate in these sectors remains low. On the other hand, unemployment in the retail, accommodation and food services sectors has the lowest correlation with house prices, but the current unemployment rate in these sectors is high. One could argue that the manufacturing and construction sectors have a high correlation with house prices and currently have a high unemployment rate, but these do not translate into a fall in house prices. First, the impact of manufacturing is limited in Hong Kong, as the sector is small in scale. Second, employment in the construction sector is highly related to the performance of the property sector, so there could be a statistical technical issue known as multicollinearity problem in this respect.

This explains why property prices have remained firm even though overall unemployment is on the rise. If the employment situation in the finance and professional services sectors worsen later this year, house prices could drop.

With the government implementing the Employment Supporting Scheme (ESS) under the Anti-epidemic Fund in the second half of 2020, the situation could be complicated as companies which have participated the ESS need to take the obligation of not making redundancies during the subsidy period. This discretionary policy will slow down the growth of unemployment rate and create another structural break of the house prices correlation, thus any implication to the house prices could further be delayed. Over a longer term, however, we believe the correlation between unemployment and house prices continues to hold.

CONCLUSIONS

We predict that unemployment will, in 2020, decouple the correlation between the HSI and house prices. Based on our observations below, we expect mass residential price to drop by 5%.

The HSI leads residential prices in Hong Kong by 3 to 6 months continues to hold over the long term.

In the medium term, the high correlation between unemployment and house prices could lead to a structural break in the correlation between the HSI and house prices, especially if there is rapid growth in unemployment.

When unemployment ramps up quickly, it tends to be a leading indicator of mass residential prices in Hong Kong by 1 to 2 months.

Unemployment in the finance and professional services sectors tends to have the highest correlation with house prices; while unemployment in the retail, accommodation and food services sectors tend to have the lowest correlation with home prices.

We like questions, if you've got one about our research, or would like some property advice, we would love to hear from you.

Knight Frank Research

Martin Wong
Associate Director, Research & Consultancy,
Greater China
+852 2846 7184
martin.wong@hk.knightfrank.com

Residential Agency

Maggie Lee (E-076435)
Senior Director,
Head of Residential Agency
+852 2846 9550
maggie.lee@hk.knightfrank.com

Valuation & Advisory

Thomas Lam (S-372521)
Executive Director,
Head of Valuation & Advisory
+852 2846 4819
thomas.lam@hk.knightfrank.com

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