

The correlation between housing prices and the HSI has been weaker since the beginning of 2020 because of the structural break.



Forecasting Hong Kong house prices

What is the market status in 2021?

September 2021

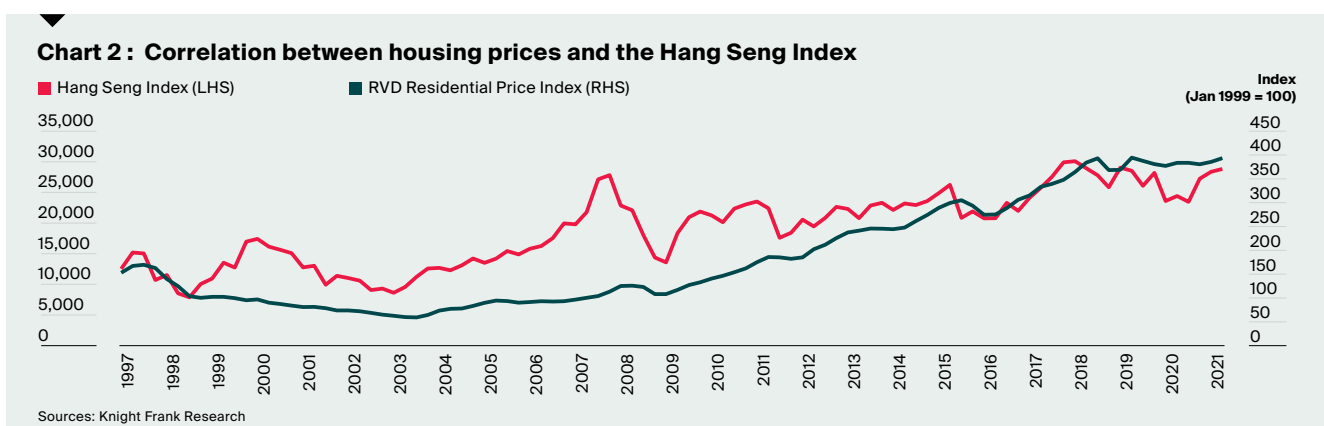
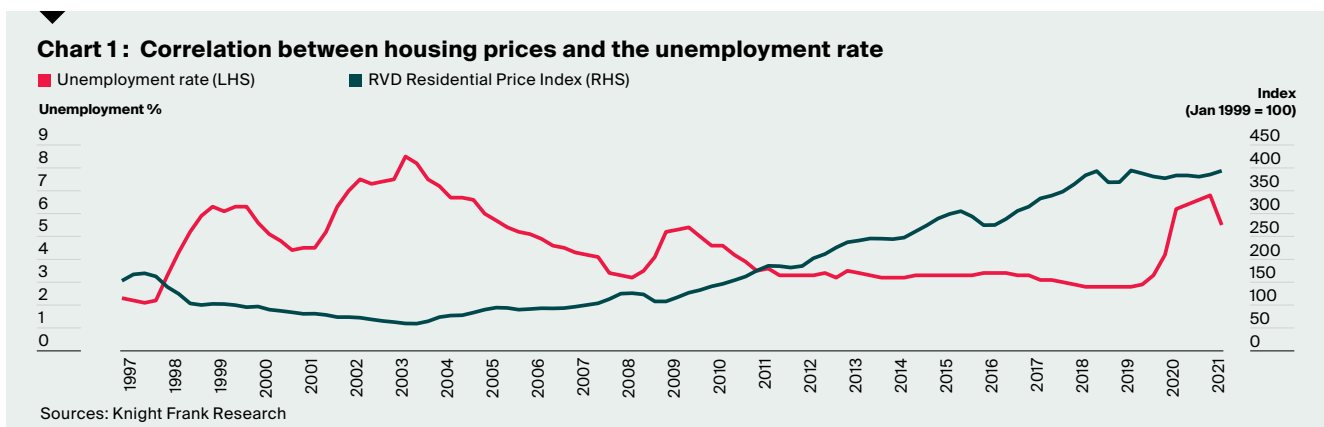
RECAP

We published three papers in 2019 and 2020 to assess how Hong Kong housing prices had changed according to different factors. Previously, we highlighted that the Hang Seng Index (HSI) leads Hong Kong housing prices by one to two quarters over the long term, and that the high correlation between unemployment and housing prices could lead to a structural break in the correlation between the HSI and housing prices in the near term, especially if there is rapid growth in unemployment.

In recent months, we have seen the unemployment rate in Hong Kong continue to decline and gradually return to the long-term

average level, and housing price growth is back in positive territory. The correlation between housing prices and the HSI has been weaker since the beginning of 2020 because of the structural break. These two findings confirm our previous observations.

With the economy now rebounding from the trough and real GDP having grown to 7.8% in the first half of 2021, it is interesting to see how economic growth has driven housing prices. Rather than simply looking at the overall correlation coefficient between these two variables, we developed a model known as the “property-economy-cycle” to provide a deeper analysis.

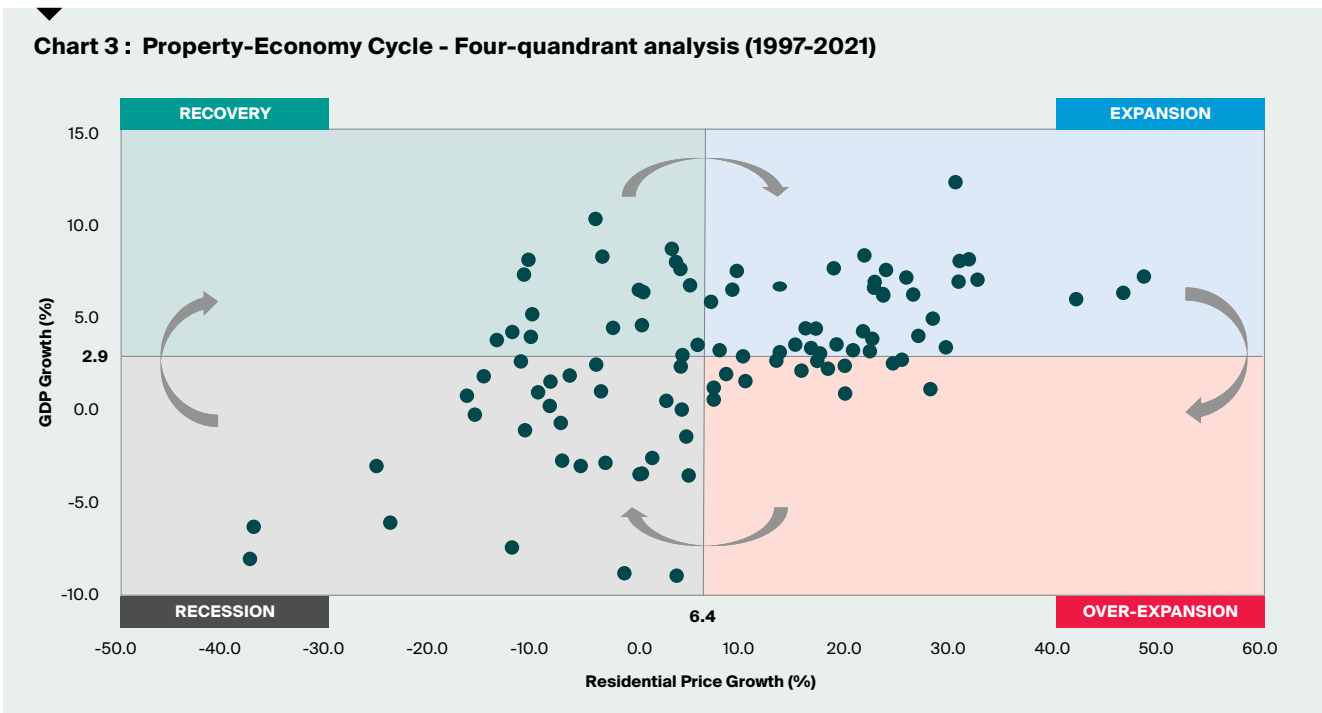


PROPERTY-ECONOMY CYCLE

The property-economy cycle model was constructed to analyse the fundamental relationship between the property market and the overall Hong Kong economy. Between 1997 and Q2 2021, average annual housing price growth was 6.4%, while average real GDP growth was 2.9% per annum. In the model, these average points are used to determine the border of the property-economy cycle quadrants.

As the following diagram shows, the property-economy cycle can be divided into four quadrants:

- Recovery:** Housing price growth is below the long-term average, but GDP growth is above average.
- Expansion:** Both housing price growth and GDP growth are above their long-term averages.
- Over-expansion:** Housing price growth is above the long-term average, but GDP growth is below average.
- Recession:** Both housing price growth and GDP growth are below their long-term averages.



FOUR-QUADRANT ANALYSIS

Examining the four-quadrant analysis of the property-economy cycle model, we can see three significant findings:

1. Regular cycle

Over the past 25 years, the property-economy cycle in Hong Kong has mostly followed the “expansion”, “over-expansion”, “recession”, “recovery” order. We have seen only three periods when the cycle skipped a stage and jumped directly to the opposite quadrant. For instance, the cycle moved directly from “expansion” to “recession” in Q1 2012 as a result of external macroeconomic turbulence caused by the Eurozone sovereign debt situation and the decline in the export of services. In Q1 2014, the cycle leaped from “over-expansion” to “recovery”, again due to sluggish global economic performance. Q4 2014 was the only other exceptional moment, when the cycle jumped directly from “recovery” to “over-expansion” as a result of local political uncertainty. There were also only a few counter-cycle moments, in which the cycle did not progress to the next stage and moved back to the previous stage, including the

SARS outbreak in Q1 2003 and after the global financial crisis in late 2009 to early 2010.

2. Shorter cycle

The four-quadrant analysis also shows that the duration of the property-economy cycle tends to become shorter over the years. It took almost seven years between Q3 1997 and Q1 2004 to complete a cycle, i.e. starting from “expansion” and complete all four stages, but it was shortened to five years between Q4 2005 and Q1 2010, and four years between Q4 2011 and Q2 2015. The most recent completed cycle lasted for less than two years between Q2 2015 and Q1 2017. The underlying reason was higher intervention from the government to facilitate the cycle. Imposing various forms of stamp duties is one intervention to suppress demand and housing price growth, while relaxing the loan-to-value ratio is an opposite measure to create demand.

3. Current cycle distorted

Because of two unprecedented incidents, social unrest and the COVID-19 pandemic, the current property-economy cycle has been distorted and is longer-than-expected. It started in Q2 2018 in the “expansion” stage, and has lasted for almost three years, with the latest “recovery” stage starting in Q2 2021. The “recession” stage of the cycle

lasted for nine quarters, from Q4 2018 to Q4 2020 before it turned into “recovery” in 2021, making it the longest “recession” cycle since 1997. Despite the low growth rates in both housing prices and GDP, Hong Kong still recorded a historical peak in housing prices during this period, showing that there is downward rigidity in housing prices.

Property-Economy Cycle - growth rates and status

Since 1997	Housing price growth (%YoY)	GDP growth (% YoY)	Status
97Q1	40.7	6.0	Expansion
97Q2	47.2	7.2	Expansion
97Q3	45.2	6.3	Expansion
97Q4	26.7	1.1	Over-expansion
98Q1	-8.8	-2.8	Recession
98Q2	-25.3	-6.2	Recession
98Q3	-38.8	-8.1	Recession
98Q4	-38.5	-6.4	Recession
99Q1	-26.6	-3.1	Recession
99Q2	-17.9	0.7	Recession
99Q3	-3.9	4.4	Recovery
99Q4	-4.9	8.3	Recovery
00Q1	-5.6	10.3	Recovery
00Q2	-12.0	8.1	Recovery
00Q3	-12.4	7.3	Recovery
00Q4	-11.6	5.1	Recovery
01Q1	-16.3	1.8	Recession
01Q2	-9.9	1.5	Recession
01Q3	-10.0	0.2	Recession
01Q4	-12.4	-1.2	Recession
02Q1	-8.9	-0.8	Recession
02Q2	-11.1	0.9	Recession
02Q3	-12.7	2.6	Recession
02Q4	-11.8	3.9	Recovery
03Q1	-15.0	3.7	Recovery
03Q2	-17.2	-0.3	Recession
03Q3	-13.6	4.2	Recovery
03Q4	-1.1	4.6	Recovery
04Q1	17.4	7.6	Expansion
04Q2	29.1	12.3	Expansion
04Q3	31.2	7.0	Expansion
04Q4	29.5	8.0	Expansion
05Q1	22.1	6.2	Expansion
05Q2	22.4	7.5	Expansion
05Q3	20.3	8.3	Expansion
05Q4	8.0	7.5	Expansion
06Q1	1.8	8.7	Recovery
06Q2	-1.4	6.5	Recovery
06Q3	-1.0	6.3	Recovery
06Q4	3.6	6.7	Recovery
07Q1	5.6	5.8	Recovery
07Q2	7.6	6.5	Expansion
07Q3	12.2	6.7	Expansion
07Q4	21.3	6.9	Expansion
08Q1	29.4	6.9	Expansion
08Q2	25.5	4.0	Expansion
08Q3	18.5	0.8	Over-expansion
08Q4	-4.6	-2.9	Recession
09Q1	-13.6	-7.5	Recession
09Q2	-7.0	-3.1	Recession

Since 1997	Housing price growth (%YoY)	GDP growth (% YoY)	Status
09Q3	3.2	-1.5	Recession
09Q4	23.1	2.5	Over-expansion
10Q1	30.4	8.1	Expansion
10Q2	25.0	6.2	Expansion
10Q3	21.2	6.6	Expansion
10Q4	22.1	6.2	Expansion
11Q1	24.4	7.1	Expansion
11Q2	26.9	4.9	Expansion
11Q3	20.2	4.2	Expansion
11Q4	12.2	3.1	Expansion
12Q1	5.8	0.5	Recession
12Q2	8.9	1.5	Over-expansion
12Q3	14.3	2.1	Over-expansion
12Q4	23.9	2.7	Over-expansion
13Q1	28.2	3.4	Expansion
13Q2	19.2	3.2	Expansion
13Q3	16.1	3.0	Expansion
13Q4	8.6	2.9	Over-expansion
14Q1	2.8	2.9	Recovery
14Q2	2.7	2.3	Recession
14Q3	6.4	3.2	Recovery
14Q4	11.9	2.6	Over-expansion
15Q1	18.4	2.3	Over-expansion
15Q2	20.8	3.1	Expansion
15Q3	16.8	2.2	Over-expansion
15Q4	7.0	1.9	Over-expansion
16Q1	-5.0	1.0	Recession
16Q2	-8.0	1.8	Recession
16Q3	-5.5	2.4	Recession
16Q4	4.3	3.5	Recovery
17Q1	14.7	4.4	Expansion
17Q2	21.1	3.8	Expansion
17Q3	17.6	3.5	Expansion
17Q4	13.7	3.5	Expansion
18Q1	15.7	4.4	Expansion
18Q2	15.2	3.3	Expansion
18Q3	15.8	2.6	Over-expansion
18Q4	5.8	1.2	Recession
19Q1	1.3	0.4	Recession
19Q2	2.7	0.0	Recession
19Q3	-1.3	-3.5	Recession
19Q4	3.4	-3.6	Recession
20Q1	2.2	-9.0	Recession
20Q2	-2.8	-8.9	Recession
20Q3	-1.1	-3.5	Recession
20Q4	-0.1	-2.7	Recession
21Q1	2.2	8.0	Recovery
21Q2	2.6	7.6	Recovery
Average	6.4	2.9	-

Sources: Rating and Valuation Department; Census and Statistics Department



FORECAST

The Hong Kong Government recently revised its GDP growth forecast to 5.5–6.5% for the whole year, so technically GDP growth in the second half will likely be at least 3.2%, still higher than the 25-year average of 2.9%. With stable economic growth, the property-economy cycle is not likely to fall back to the “recession” stage. Instead, since housing prices have already gone up by 4.3% on a year-to-date basis as at end-July, another increase of about 2% by the end of the year will move the cycle from the “recession” to the “expansion” stage.

Since the low interest rate environment in Hong Kong is expected to remain until at least 2023 when the US may start lifting interest rates, Hong Kong may not necessarily follow suit when

the US interest rate hikes start, as we have seen similar cases in recent years. The low interest rate environment will continue to be the key driver to encourage prospective buyers to climb the property ladder or investors to acquire assets and look for capital appreciation for the next 18 months or so.

Under current market conditions, Hong Kong housing prices are expected to reach new heights before Q3 2021 ends. With the vaccination rate continuing to increase in both the Chinese mainland and Hong Kong, the potential border opening will lead to an influx of purchasing power from the mainland. We forecast that housing prices will increase up to 8% over the whole year, moving into the “expansion” stage of this property-economy cycle.

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

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