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THE HOUSING BOOM IS OVER

2019: likely to see the first full-year negative price growth since 2008

Summary & Recommendations

The subdued stock market, rising interest rates, increasing loan ratios, and a slower economic outlook for 2019 all suggest residential prices will slide further in 2019.

A deceleration of the global economy is a threat, as buyer confidence could be further dampened. However, with steady leasing demand, residential rents should remain firm.

The luxury residential leasing market should be mostly immune to downside risks, as landlords have not aggressively increased rents since 2014. With a sharp correction in luxury rents unlikely, we recommend tenants look into other districts featuring more properties for lease as well as new school campuses.

| | Q4 2018 | Full Year 2019 | 2018-23 Annual Average |
|--|--|--|---|
|  Demand <p>> The total number of transactions declined 38.0% qoq to 8,938. Demand should remain weak in H1 2019 amid an uncertain economic outlook.</p> |  8,938 transactions |  60,000 transactions |  60,000 transactions |
|  Supply <p>> At most, over the next five years, annual completions could reach the government's target of 18,000 units.</p> |  4,000 units |  16,500 units |  17,500 units |
|  Rent <p>> Luxury residential rents should stay the firmest amid the housing market downturn, given their low volatility and slower growth in previous market upswings.</p> | QOQ / End Q4  -0.1% HKD47.2 | YOY / End 2019  -0.9% HKD46.8 | Annual Average Growth 2018-23 / End 2023  0.6% HKD48.6 |
|  Capital Values* <p>> We expect residential prices to decline 3.8% in 2019 with a 15% decline from Q2 2018 to Q2 2019, and a rebound likely in H2 2019.</p> |  -6.0% 366.3 |  -3.8% 348.0 |  1.3% 385.1 |

Source: Colliers International

*Price index by Rating and Valuation Department, 1999 = 100, as of November 2018. 1 USD = 7.84 HKD. 1 sq m = 10.76 sq ft.

A SOFTER OUTLOOK IN 2019

Hong Kong's residential market outlook is murky as buyer sentiment has been hit by the sluggish stock market and the uncertain economic outlook. The US Federal Reserve (the Fed) raised interest rates four times in 2018. The Hong Kong Monetary Authority (HKMA) followed and raised the city's Base Rate by 25 basis points for the fourth time on 20 December 2018.

However, the Fed has trimmed its expectation for rate hikes in 2019 from three to two. The Fed stated it is uncertain about the path of further rate increases due to slower GDP growth and likely tepid inflation in 2019. In December, the Fed cut its median estimates in 2019 for US real GDP growth from 2.5% to 2.3%, and for core PCE (personal consumption expenditures) price inflation from 2.0% to 1.9%. Hong Kong interest rates are effectively tied to US interest rates by the territory's currency peg. Although Hong Kong interest rates may increase more slowly than previously expected in 2019, the turning economic tide is a threat for the residential market.

Norman Chan Tak-lam, Chief Executive of the HKMA, said that the expected interest rate increases, together with the US-China trade war and Brexit, will all add to risks of an economic and property market downturn in Hong Kong. He reiterated that the HKMA would relax mortgage rules if a downturn in Hong Kong's property market is confirmed¹, although Hong Kong's Chief Executive Mrs. Carrie Lam had a strong stance on not relaxing cooling measures despite falling residential prices².

DEMAND REMAINED SUBDUED

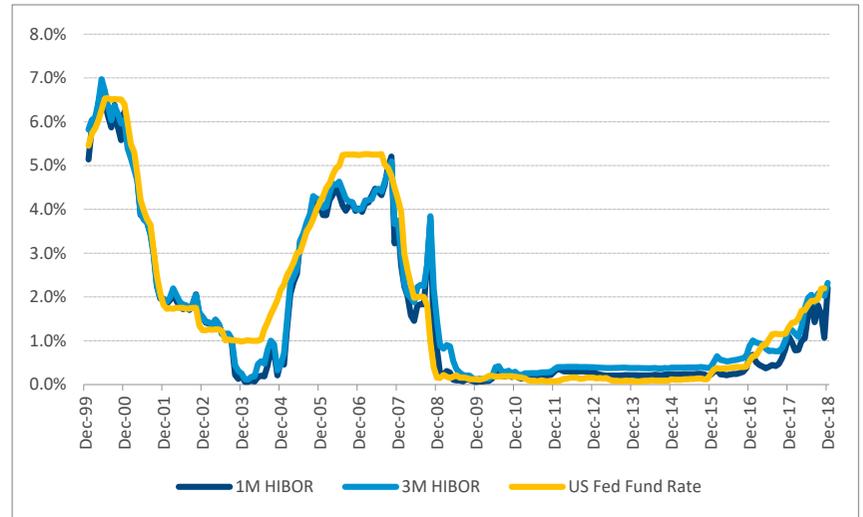
Approaching the end of 2018, buyers' demand weakened significantly, and a wait-and-see attitude seemed prevalent. The total number of transactions of private residential properties declined 38% qoq in Q4, to 8,938. The figure was the lowest quarterly figure since Q1 2016, and was the second lowest over the past two decades.

The volume in the primary market declined further, by 23% qoq, with various new development projects receiving initially low interest from the market. The secondary market remained subdued, with only 5,482 transactions, a decline of 44% qoq, as property owners declined to reinvest in the housing market amid falling prices.

¹ SCMP, 20 December 2018

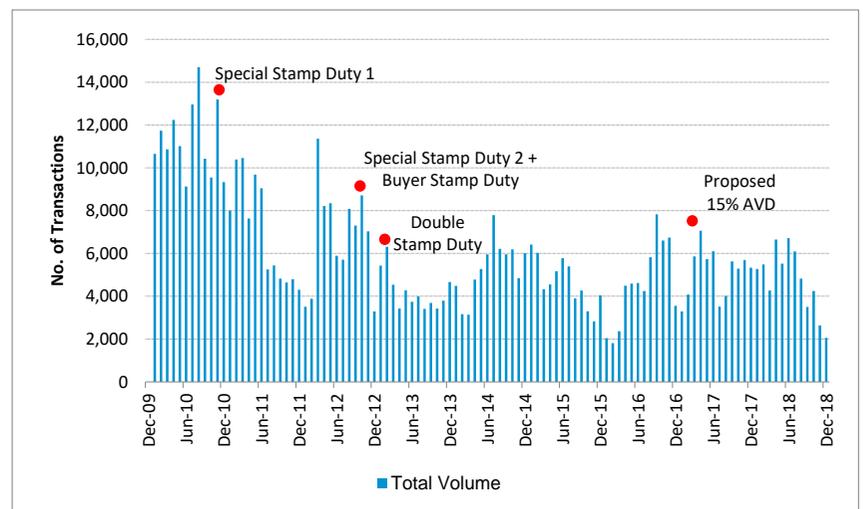
² SCMP, 10 December 2018

US Fed Fund Rate versus Hong Kong interest rates



Source: US Federal Reserve; Hong Kong Monetary Authority

Residential sales and purchase agreements



Source: The Land Registry

PRICE DECLINE ACCELERATES

As investor sentiment was deteriorating, Hong Kong's private residential prices declined with the falling transaction volumes. According to the Rating and Valuation Department, overall residential prices declined 6.0% qoq, led by the decline (-6.0% qoq) of mass residential prices. According to Collier's figure, the luxury market stayed firmer, as owners were not in a rush to sell for cash amid a healthy economic environment.

We expect the dip in residential prices to continue until the market sees a clearer picture of economy and the direction of interest rates, which should emerge by the end of H1. We expect Hong Kong's residential prices to decline up to 15% in total from the end of Q2 2018 to the end of Q2 2019, before rebounding in H2 2019. With buyer confidence potentially improving in the beginning of H2 2019, we expect residential prices to stabilise. However, this stabilisation will not be sufficient to offset the drop in H1, leading to our forecast of negative growth of -3.8% yoy at the end of 2019.

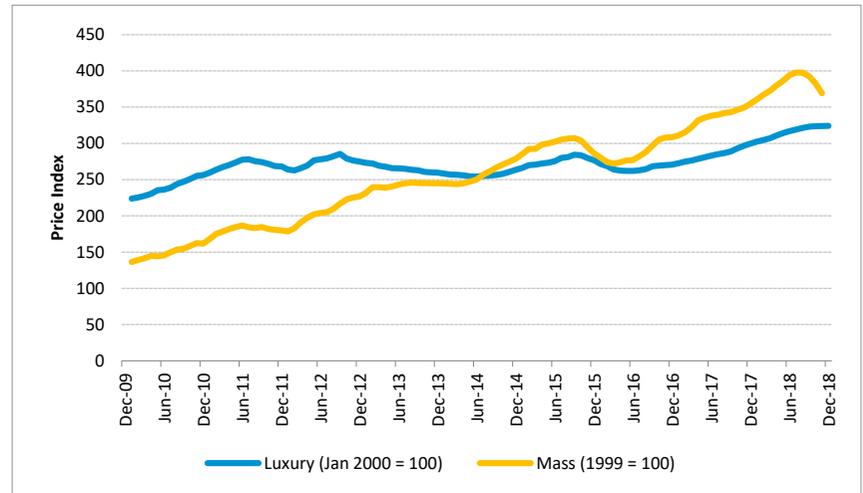
A FIRMER OUTLOOK FOR LEASING

According to the latest Colliers Radar report [Strategies for the Residential Market Turn](#), the luxury residential leasing market should mostly be immune from the downturn. However, luxury residential rents declined by a very moderate 0.1% qoq, as individual owners, who are more sentiment driven, softened their stance. Single landlords held rents for their buildings in view of firm demand amid low vacancies. The Peak and Southside, with the most luxury flats (and houses), were immune to the downturn, with rents edging out a 0.5% increase qoq. The Mid-levels with a more balanced mix of ultra-luxury and mid-range luxury units, slowed with a slight decline of 1.0% qoq.

Although global uncertainties and rising interest rates will probably weigh on business activity and household income in Hong Kong, increasing demand and the lower volatility of the residential leasing market point to only a modest adjustment for the rental market in 2019.

With the opening of new international school campuses concentrated in Kowloon East and Sai Kung District for the 2018/19 school year, tenants may also be able to find new flats offering greater value as rents in decentralised areas are cheaper than in the districts traditionally popular with expatriates.

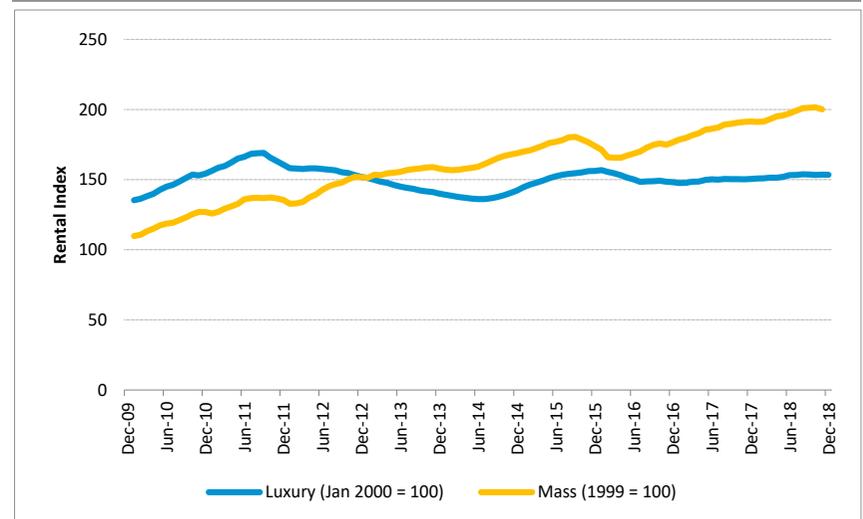
Hong Kong residential price index



Source: Colliers; Rating and Valuation Department

Note: Luxury index represents luxury residential units in The Peak, Mid-levels and Southside; mass refers to the units smaller than 1,076 sq ft

Hong Kong residential rental index



Source: Colliers; Rating and Valuation Department

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