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PROPERTY TRENDS : US,UK,China, Hong Kong and S.Korea

Summary	Investment Conclusions
The recovery of the US property sector, the chief culprit of the 2008-9 crisis, could be nearing its peak, threatened by higher rates. Similarly, in UK the authorities are quite concerned over house prices and have already taken steps to cap them helped by the impending rate hikes by the BoE. The China property sector has now decelerated quite sharply but its impact on the banking sector has been, and will likely be, muted. In Hong Kong the worse is yet to come when HKD rates will rise in tandem with USD rates. In S.Korea the authorities are supporting the recovery in house prices as part of their overall macro boost drive.	Higher interest rates never seat comfortably with high property prices.The UK may well be the first of the major markets to face rate hikes, followed by Hong Kong where the markets have been oblivious to a series of measures to cap price rises. All this may end when real HKD rates start to rise. The Chinese market may continue to deflate for, perhaps, another year although rates have not been increased.The S.Korea market is being supported by looser policies. The notion that higher USD interest rates will affect the Asian property sectors is plainly not true, with the exception of Hong Kong

To start at the beginning

As the Factbox indicates, the **US property sector** and the bank loans to it, have a lot to answer for in terms of triggering the 2008-9 crisis. But this is history. Prices of property in the US after the long negative dips in 2008-2009 and 2011-12 recovered but now the rises have clearly peaked. (The Case – Shiller composite index, red line in Chart 1).Existing home sales is always a good index of activity as it also illustrates the movements within markets as people sell to move somewhere else or to a better or more affordable home. The index, after its dip at the start of this year, may have peaked again. What matters at this juncture will be the impact of higher UST yields on mortgage costs and house prices. After the major restructure of the US banking system and the progressive elimination of bad property loans, a weaker property sector will not necessarily present a new threat to the financial system but will do so to consumer spending. The **UK property sector** experienced an almost unbroken period of rising prices from the middle of 2012 to now, but there are signs that prices may be peaking. (Chart 1, blue line),The BoE has been threatening to hike rates and is very likely to be the first of the major central banks to do so. But meanwhile it has turned its attention to mortgages, imposing limits on banks. For nearly two years now, the UK government has been imposing taxes on luxury properties, extended the capital gains tax to houses in general and targeted properties owned by non-residents in particular. A flat tax on all properties is being mooted for after the elections in 2015. In all, the UK property sector is in for a rough time.

Chart 1: US Exist.home sales (green),Case-Shiller home prices (red), UK Nat.Home prices (blue)

Source: Bloomberg

The turn of Asian properties

The **China property sector** has attracted a great deal of attention and not just from the Chinese authorities but also from global investors. The latter considered that a crash in Chinese properties would portent a major collapse of the Chinese banking sector to add to the GDP deceleration woes. The red line in Chart 2 shows the impact on house prices of repeated measures taken by the authorities over the last two years including severe restrictions on mortgages. Price declines in Beijing are typical of these seen in other major citiers.However the fears over the Chinese banking sector have been exaggerated. Mortgages accounted for 27% of the total value of all property transactions in 2013 and, at present, loans to property developers account for less than 7.0% of all loans by banks. Hence the bear outlook should be confined to the property sector as opposed to using it as proxy to beat Chinese banks with!

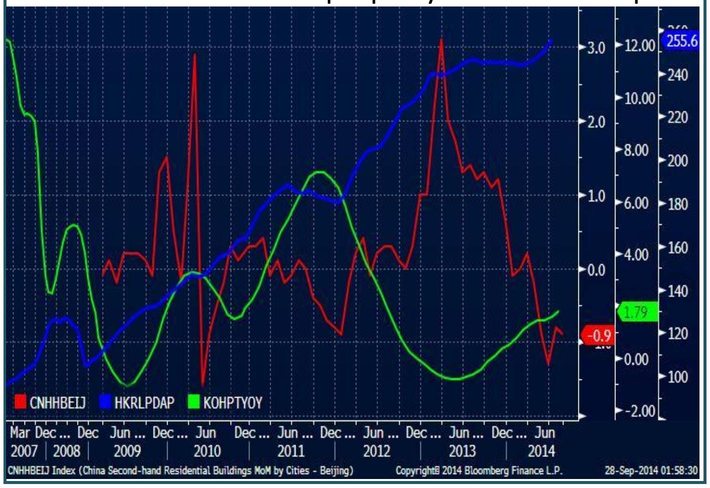
Hong Kong is a different case as the peg to the USD has led to a persistent boom in the housing sector fuelled by negative real rates as well as large inflows from China, where the restrictions on property investment led to capital flows across the border. The authorities in Hong Kong responded with a series of measures including increases in stamp duties and discriminatory taxes to purchases by non-residents, but clearly to no avail. (Blue line in Chart 2). It would be comforting to expect that the property sector has priced- in the impending rate increases in the US and, hence, in Hong Kong, but this is doubtful.

FACTBOX : A brief reminder on US property

The discussion over the Fed ending the period of low interest rates has obscured a key important factor. The 2007-8 US crisis (N.B. US, not global !) was caused by a plain vanilla property bust aided and abated by highly leveraged property bank loans all compounded by poorly priced derivatives.Rather than focus obsessively on unemployment, the Fed could have looked sideways at what caused all this in the first place-the property market. As we show here the US property sector recovery may have peaked and may react negatively to higher interest rates. Just a thought!

Chart 2: China,Beijing home prices (red), HK home prices (blue), S.Korea Home prices (green)

Loans to property developers



Source: Bloomberg

Sweeping in S.Korea and concluding

Although this is hardly a “proof”, the performance of the property sector in S.Korea shows that Asian property markets, just like their domestic interest rates, do not move in synch, let alone with those of the US Fed. The BoK cut rates in August this year and followed these up with a spate of easing rules on mortgages, including looser (loans/value) and (debt/income) limits. The government has also introduced a pure macro boosting budget increasing its deficit spending. All these will continue to support the recovery in housing prices which had started about one year ago.

In sum, US property prices may have peaked and the deceleration could be accentuated by the impeding higher interest rates. Similar considerations apply to the UK where monetary and fiscal policies have been hostile to the booming market, particularly the luxury end. Hong Kong must be a unique case of a slow-motion train crash in action with the market nearly oblivious to the years of higher rates to come after the hiatus of 2008-2014.There is no reason to expect that the HKD peg will be abandoned in order to decouple the property sector from the higher USD rates. Last but not least, S.Korean property prices are now being supported by benign policies.

Andrew Freris (writing completed 28/9/2014)