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第一太平戴維斯

Investment

Hong Kong, China



1H / 2009

The Investment Market

Introduction

All property sectors recorded a sustained period of price appreciation from 2003 to mid-2008, in some cases rising by as much as 350 per cent. The financial crisis provided the catalyst for a correction and when export markets began to contract sharply from late 2008 it seemed inevitable that asset prices would follow. As the crisis developed values across most sectors fell by between 10 and 40 per cent peak to trough. At the start of the year, most commentators believed that prices would continue to fall throughout 2009 and into 2010 before finding a floor.

What many had not anticipated was the impact of 'quantitative easing', not just on the property markets, but also equities. Property prices across all sectors lurched upward over the first half of 2009, in the case of luxury residential apartment prices, by as much as 30 per cent. With yields suddenly compressed and a swift economic rebound by no means assured, many are now asking if the turn around is sustainable.

Too Good to be True?

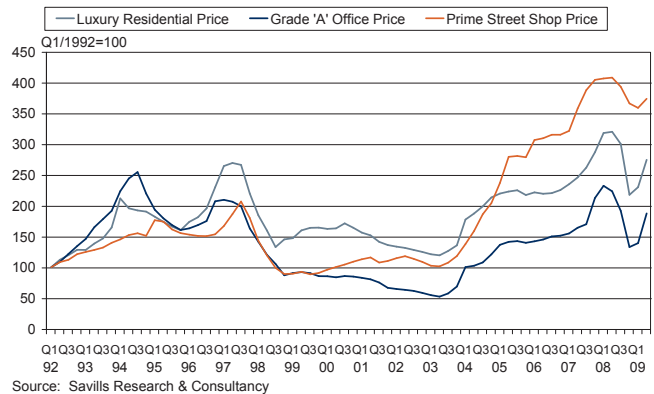
Looking at most conventional indicators of economic health few, if any, are showing signs of a convincing recovery. GDP growth registered -7.8 per cent in the first quarter while unemployment had risen by 2.1 percentage points to 5.3 per cent in May 2009 from August last year. Retail sales to May had posted a 4.4 per cent decline while total exports were down by 19.5 per cent over the same period.

Reflecting the poor fundamentals, rents are continuing to drift down, albeit at a slower pace than earlier in the year. In the office market many financial services firms are still looking for opportunities to surrender or sublet. This so called 'shadow space' could account for around 250,000 sq.ft. in Central alone, which, if it is all given back to the market, could take vacancy to 7.6 per cent. Based on the historical relationship between vacancy and rent, this could take average Grade 'A' rents in Central to below HK\$70 per sq.ft. per month by year end from HK\$80 per sq.ft. per month currently.

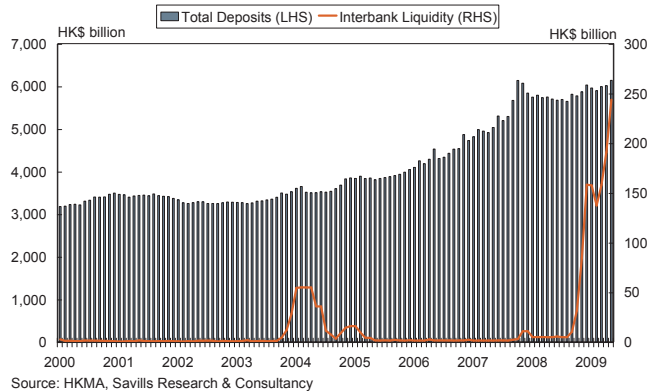
The luxury residential market has also been hit by redundancies from financial and professional services firms although we note some resistance on the part of expatriates to return home to stagnant job markets. Many have had to downsize as housing allowances have been reduced or cut altogether. Luxury rents have fallen by 26 per cent from their peak last year to mid-2009 taking cap rates down to 3.4 per cent on average.

The retail market has seen rents pull back from the world-beating levels recorded mid last year and retailers have been discounting prices in order to maintain sales volumes. As visitor spending now accounts for around 20 per cent of retail sales, the recent slowdown in tourist arrivals is of particular concern for the sector. Mainlanders, hit by the economic slowdown and wary of strict quarantine procedures introduced in response to swine flu infections, are staying away in greater numbers. Luxury retailers in particular are feeling the pinch.

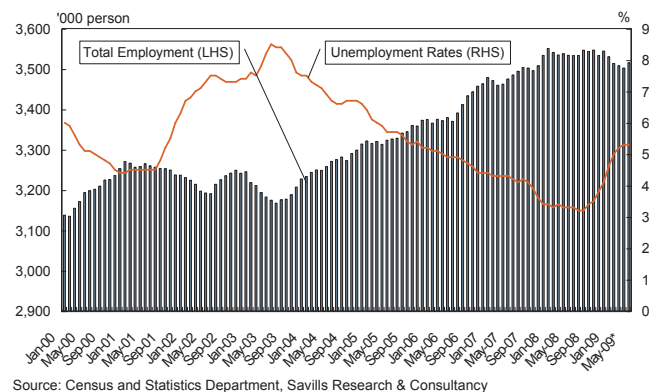
Office, Retail and Luxury Residential Price Indices, Q1/1992 - Q2/2009



HK Deposits vs Interbank Liquidity, Jan 2000 - May 2009



Unemployment Rates, Jan 2000 - May 2009



As values push close to 2008 peak levels policy risk is also likely to increase. Although government will be reluctant to intervene to cool luxury prices, if the mass market shows signs of straining affordability, measures could be introduced. The Mainland government is watching bank lending closely and is wary of local housing market bubbles developing.

Off to the Races?

Despite the grim economic news some early signs of recovery have been evident. Unemployment appears to have stabilized at around 5.3 per cent while the decline in exports has slowed. Consensus GDP forecasts improve from -4.6 per cent this year to positive growth of 2.6 per cent next year as the economy pulls round.

The drivers of the recent rally are still firmly in place. Interest rates are low with deposit rates at near zero while local banks are anxious to lend. Issuance of new mortgages grew by 28 per cent in May alone. The Mainland Government continues to encourage banks to extend loans and Hong Kong is benefitting from the knock-on effects of the surge in liquidity. Mainland buyers have also been more in evidence in the residential market than previously, accounting for a particularly high proportion of sales of some recent residential launches.

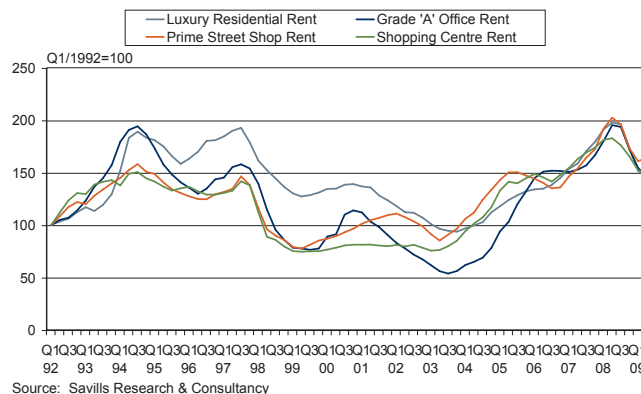
Over the next few years supply levels in most sectors of the property market are modest, the result of almost non-existent government land sales along with a lack of developable sites in core areas. In the residential market, approximately 13,000 units per annum are expected over the next three years, against a 10 year historical average of 26,000 units. In the office sector, new Grade 'A' supply is heavily concentrated in the decentralized Kowloon East area. These low supply volumes should serve to reassure investors in the Hong Kong market, especially as many regional markets face the imminent threat of over supply.

Rates of rental decline are now slowing in most sectors. In the office market, insurance companies have been actively taking up space in Kowloon East while Mainland financial firms, active during the recent boom, are expected to return to Hong Kong once the current crisis abates. There is also early evidence that some international banks have unfrozen headcount, perhaps anticipating the raft of Mainland IPO's scheduled for later this year. Reflecting the thawing taking place in the office market, luxury residential rents are declining at a slower rate and we even have reports of some selective increases.

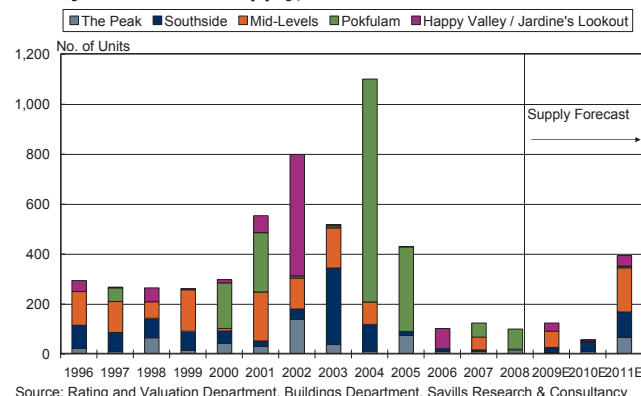
Conclusion

While signs of a full blown economic recovery are scarce, slowing rates of rental decline should help to support values at current levels. If interest rates remain low, which seems likely, and rents find a floor by year-end, then current valuations will be better under-pinned. A buoyant stock market and ample liquidity as well as generally high levels of affordability therefore suggest that it is still too early to call time on the present rally.

Office, Retail and Residential Rental Indices, Q1/1992 - Q2/2009



Luxury Residential Supply, 1996 - 2011E



Grade 'A' Office Vacancy Rates, Jan 2006 - Jun 2009

