Singapore & Hong Kong: A Wail Of Two Cities

Two old fellows are out on the golf course. One says to the other: "you know its terrible – I've got AIDS at 80". His friend retorts: "so you think you've got problems do you? Well you may still recover – I've got PCCW at 25".

What the Dickens?

In a city where men who love women more than money are considered sexual deviants, the collapse of Richard Li's Ponzi scheme is a particularly egregious reminder of the widespread angst caused by the ending of the easy money, asset price appreciation years. Singapore too is coming to terms with similar issues and although the peak-to-trough collapse in its property market – at least in local currency terms – has been less severe than that experienced by the SAR, in some ways, the pain has been even more widely spread.

Widespread angst has been caused by the ending of the easy money, asset price appreciation years

Across the region, governments are priming the fiscal pump in response to the likelihood of a further delay to any externally led recovery. This is indeed a correct response. The region's current account surpluses imply excess savings waiting to be deployed yet private sector investment activity, and the ability of financial systems to meet even low-level loan demands, is sorely lacking. In recent weeks we have seen stimulus packages announced by amongst others Japan (a JPY2.7 trillion supplementary budget combined with a backing away from Koizumi's JPY30 trillion JGB issuance pledge), Korea (a KRW2 trillion supplementary, supplementary budget on top of the KRW5 trillion package announced only a month or so ago) and Malaysia (an off-budget MYR4.3 billion of miscellaneous spending measures followed in quick turn by a budget targeting a deficit of 6.5% of GDP for this year and 5% next). The subjects of this article, Singapore and Hong Kong, have also been promising to splash the cash around; in the last week or so, they have come up with SGD11.3 billion and HKD13.9 billion bags of goodies respectively.

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The only real constraint to this collective largesse is the markets' judgement as to the sustainability of fiscal positions should budgets move to prolonged, large-scale deficit. Our recent article, "Fiscal Sustainability and Financial Sector Health in Post-Crisis Asia",[1] addressed such issues and concluded that Indonesia and Philippines have virtually no wiggle room whatsoever; Japan, Thailand and India are flirting at the edges of government debt traps and are therefore limited in their responses; and China, Taiwan, Korea and

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[1] 19th September, 2001

Malaysia all have scope to keep the taps open – for a while anyway. And as for the two City States – well to paraphrase E. Blackadder esq., their wallets have been as capricious as a certain part of an elephant's anatomy, and twice as difficult to get your hands around. In essence, they have both been saving long and hard for rainy days and arguably, this is as wet as it gets.

Singapore has generally shown more flexibility than Hong Kong in its policy responses

Of the two, Singapore has generally shown more flexibility in its policy responses and certainly wins hands down when it comes to long-term vision and planning. We would be the first to admit that we have a Hayekian aversion to central planning but if you are going to do it, you should at least do it well. The Singapore authorities, while recognising that any short-term fiscal policy measures will always be dwarfed in an economy where trade is 2-3 times the size of GDP, have clearly identified society's weaknesses and are making strenuous efforts to social re-engineer the populus. Moreover, they seem somewhat more keenly attuned to the immediate pain of the man on the street – strange the effect of even the limited form of democracy practiced in the Lion City where an election will be held on November 3rd – than their counterparts to the north. 'Singapore Shares' and cutting senior civil servant wages might not lead to a rapid growth surge but certainly suggest that the government empathises with the plight of the common man. For a longer-term discussion of the country's strategic conundrum, we would refer readers to our 24th May 2001 tome "Singapore – A Five Star Hotel in a Ghetto".

Hong Kong's heavenly-mandated mandarins appear to be taking the popular pulse at the local morgue

Hong Kong's heavenly-mandated mandarins, by sad contrast, appear to be taking the popular pulse at the local morgue while at the same time also ducking the difficult strategic decisions that quite frankly, an unaccountable administration can afford to take. For sure they are correct in saying that the SAR's fate is ultimately linked to the wider world. Yet there are plenty of cheapish gimmicks combined with badly needed structural reforms that could be deployed to both ease near term pains and establish the economy on a firmer footing for the future. Many of these were discussed in our article of 3rd October 2001, "Hong Kong's Phantom Fiscal Crisis".

Yet the SAR is still left holding a far superior set of cards

Irrespective of our belief that Singapore will succeed because of its government and Hong Kong will succeed despite, when all is said and done, the SAR is still left holding a far superior set of cards. It all comes down to location, location, and as this article will show, ultimately who owns this location. We frame our argument in terms of the carnage that the property market crash has caused in both places and the potential for the problem to be digested any time soon.

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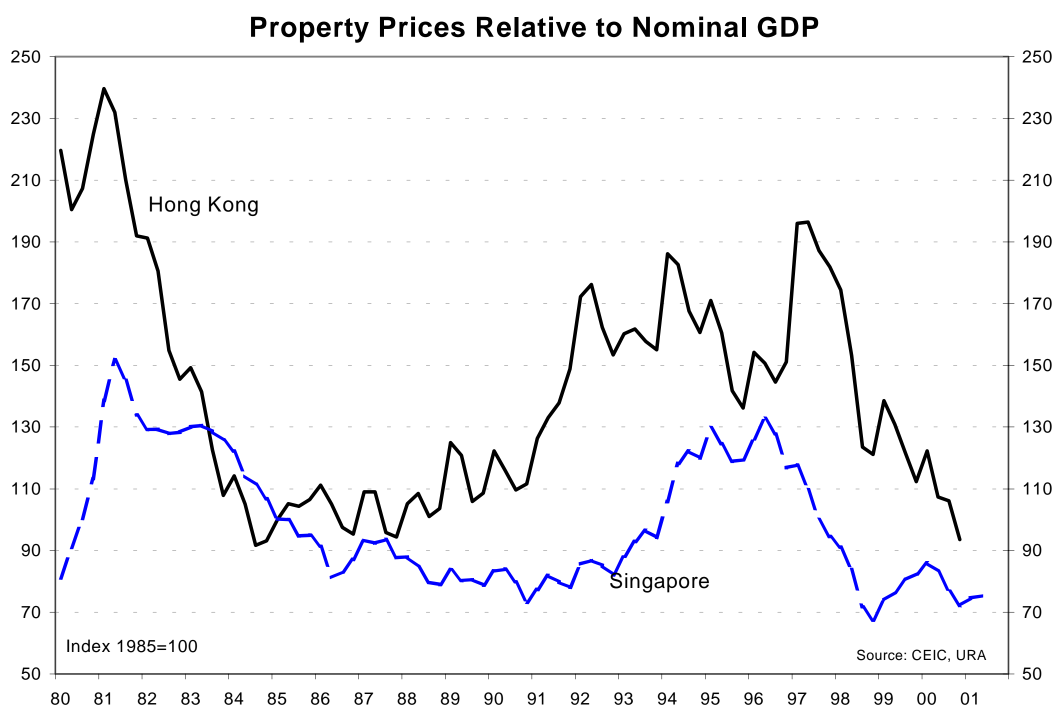
In our recent Hong Kong missive (*ibid.*) we showed a chart illustrating how Hong Kong residential property prices had basically normalised relative to income back to levels last seen in the mid 1980s. As the chart below shows, a comparison with Singapore suggests that the latter's bubble, although not as extreme as that of the SAR, has nonetheless also mean reverted.



In both cases, the wealth created throughout the early to mid-1990s ran well ahead of the total output of the economy in turn providing a balance sheet feel good factor that drove buoyant consumption and investment behaviour. Unfortunately with this ratio going sharply into reverse, the 'sick-as-a-parrot' syndrome has rather taken over.[2]

How widespread and severe is the pain being felt by the property downturn?

And with the downturn has come cacophonies of whingeing. So the questions one needs to ask are a) how widespread and severe is the pain being felt and b) does the economy have the means to overcome its trauma –

[2] We have explained the difference between 'true' savings and asset price appreciation in various pieces in the past, most recently in Tim Lee's 10th October 2001 piece "The Global Financial Adjustment is far from Complete". Tim's seminal book, "Economics for Professional Investors" delves into far greater technical detail.

either by itself or with the help of government intervention – and if so, over what time period?

To answer these questions, we decided to take a radical approach that seems to have eluded the reams of property analysts whose idea of seminal research is to count the number of people queuing at the latest primary launches in Ho Man Tin and Ang Mo Kio. We decided to look at the (copious) data provided by both governments. Our summary findings are tabulated below.

And do the economies have the means to overcome the trauma?

Hong Kong and Singapore Property Comparisons

	Hong Kong	Singapore		
Cost of Average Property (USD)	**Private**	**HDB (Resale)**	**Private**	**Overall Residential**
Current	268,872	180,556	386,839	209,435
June 1997	608,321	386,667	607,549	417,590
% Fall	-56%	-53%	-36%	-50%
Total Housing Equity (USD bn)				
Current	279.3	155.3	75.4	230.7
June 1997	567.4	292.1	93.9	385.9
% Fall	-51%	-47%	-20%	-40%
Total Housing Equity as % of GDP				
Current	177%	178%	86%	264%
June 1997	332%	309%	99%	408%
% Loss	-154%	-131%	-13%	-144%
% of Households Who Own Property	48.8%	91.0%	n/a	92.3%
Total Housing Equity Loss				
Per Capita	41,931	38,416	31,796	37,489
Per Property Owning Household	277,301	139,240	104,928	134,035
Per Years of Income Per Property Owning Household	3.8	2.0	1.5	1.9
Average Amount Borrowed as % of Purchase Price				
Current	27%	39%	55%	34%
June 1997	13%	10%	28%	12%

Sources: CEIC, Government Statistics, HDB, URA, DSGAsia estimates

We first calculated the peak-to-current (from June 1997) fall in the cost of the average residential property in both cities. In US dollar terms, the drop has been virtually the same though of course, the domestic balance sheet loss has been greater in Hong Kong where the peg has remained firm. The SGD, by contrast has lost roughly 20% in value against the USD over the same period implying a local currency price fall of nearer a third. Note the difference in performance between Housing Development Board (HDB)

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flats and private sector properties. The latter have held up far better – indeed according to Urban Redevelopment Authority (URA) data, prices bounced around 20% from 1999 lows although they have subsequently softened again – but anecdotal evidence suggests that this is because transactions have dried up as developers and sellers have been unwilling to take further mark-downs. (Similar complaints have been aired about Hong Kong developers though with Cheung Kong setting off another round of steep discounting the other week, the justification for such complaints is somewhat lower.) No such luck for the 85% of Singaporeans who live in public housing though. The government has not been shy about continuing to cut the selling prices for new HDB units in line with the economy's travails which has served to raise substantially the hurdle rate for potential upgraders. More on this issue a little later.

Well over a year's worth of national income has been wiped off of the balance sheets of both economies

The next step was to calculate the total amount of housing equity in the economy by multiplying the average cost of a property by the available supply. As a percentage of GDP, the fall has also been similar in both locations though with again the suspicious outlier of private sector Singapore residences. Well over a year's worth of national income has been wiped off of the balance sheets of both economies which translates into a per capita loss of around USD40,000. However, one also needs to take account of both the distribution of this negative wealth effect and the ability of households to absorb the losses. And on these criteria, Hong Kong comes out by far the better.

But in the SAR, only 49% of households own their properties compared to a whopping 92% in Singapore

This is because in the SAR, only 49% of households own their properties compared to a whopping 92% in Singapore. As we argued in our *op cit* "Phantom Fiscal Crisis" article, a combination of cracking down on fraudulent public housing tenants[3] and opening up the border to professional immigrants from the Mainland could do wonders for re-invigorating property demand in more central locations. Moreover, property is becoming ever more affordable for the half of the population that does not already own. All that is missing is a catalyst to change risk appetites. By contrast, in Singapore, it is a struggle to see where the marginal buyer is going to come from.[4] Moreover, the combination of reduced household equity and the

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[3] Execution of the first born of cheating families and placing their heads on spikes in public places should do the trick in our opinion. *Si ji jing hou….*

[4] The potential is there for a large influx of people from Indonesia though whether they would bother with the niceties of using an estate agent and paying for any transfer of ownership is a moot point.

much-widened gap between public and private housing prices has destroyed the upgrading dreams of many. Granted, the wedge is likely to narrow again over time but for now, large swathes of the population are mobility constrained.

In Singapore, it is a struggle to see where the marginal buyer is going to come from

An alternative way of looking at this issue is to weight the total economy housing equity loss according to home ownership ratios. On this basis, the average home-owning Hong Kong household has suffered a balance sheet hit equivalent to almost four years of income. The figure for Singapore is a far lower two years yet such losses have been taken by almost the entire population. There are signs that the Singapore authorities recognise the danger such a situation poses to their social contract[5] – in essence you shut up and we will make you rich. Hence the increasingly innovative ways they are exploring to try to return parts of the accumulated fiscal surplus to the population without raiding the sacrosanct pot of Central Provident Fund. The 'Singapore Shares' scheme – actually not shares at all but rather bonds with a minimum 3% coupon plus a top up bonus based on real GDP performance – is one such measure though the maximum initial allocation of SGD4,000 will only make a small dent in the problem for most. Hong Kong could do well to follow suit and hand out free units in the tracker fund. After all, whose money is it anyway?

Contrary to popular perception, the average amount borrowed relative to the equity embedded in the property market has been and remains surprisingly low

A final consideration is the extent of negative equity in the more commonly understood sense of people with outstanding mortgages greater than property values. In essence one needs to consider the residual wealth still contained in household balance sheets after the falls seen in recent years. To examine this issue we compared the value of outstanding mortgage loans as reported by financial institutions with the total equity value of the housing stock. In the case of Hong Kong this data was also able to be cross-referenced against mortgage values and numbers provided by the Land Registry. Contrary to popular perception, the average amount borrowed relative to the equity embedded in the property market has been and remains surprisingly low. At the height of the property bubbles, only just over a tenth of the value of the property stock was matched by loans implying that

[5] Hong Kong's social contract has been similar at a political participation level but far less socialist and more tolerant of inequality. In essence, the property owning public has tacitly agreed to subsidise the poor out of property transaction levies, in return for a minimal level of income tax. The issue of free-riders versus the need to explore alternative sources of revenue has the potential to become increasingly socially divisive in the coming years. Legalising soccer betting before the World Cup seems a no-brainer in our opinion.

household wealth, although significantly reduced, is far from wiped out. Indeed, even after the falls of recent years, mortgages only account for a quarter and a third of property values in Hong Kong and Singapore respectively. In fact, the only owners who appear to be under any major pressure are Singapore private property residents who are now 55% geared.

Though these numbers are skewed towards capital gains that have accrued in the past to owners who bought a decade or more ago

Naturally these numbers are skewed towards capital gains that have accrued in the past to owners who bought a decade or more ago. And it is probably fair to say that the older Chinese generation had more of an aversion to debt even if they were able to access credit in the first place. These factors in turn imply that the cohort of younger buyers who made their first purchases in the mid-1990s is suffering disproportionately. But how big is this cohort?

Negative equity is doubtless painful but not that widespread in our estimation

Because Hong Kong provides both volume and value data for residential mortgages one can make a decent stab at an estimate. It should first be noted that whichever way one tries to calculate the average size of mortgages taken out during the period June 1996-June 1998, one still struggles to come up with a figure much in excess of 12% of purchase value. Nevertheless, we can calculate some sensitivities to much higher percentages borrowed, by summing the total number of mortgages taken out in 1996-98 that are greater than current property values. In extremis, assuming a 65% loan-to-value ratio, it is conceivable that around 470,000 mortgages are under water. This would be equivalent to one in four households being in negative equity or one in two that own. However, drop the amount borrowed to 50% and the number of negative equity mortgages plunges to 200,000 while a 40% figure puts the problem at sub 50,000. As for Singapore, the data is more sparse making even broad estimates more problematic. However, the data that we do have suggest that even if one plugs in a 65% loan-to-value ratio, it is impossible to generate even a small amount of mortgagees with loans above the value of their properties.

The Hong Kong problem is maximum a one in ten owning household one

By way of comparison, a recent survey by the HKMA estimated the number of negative equity mortgages to be around 65,000 borrowers or just over 6% of owner households. The HKMA admits its survey was quite narrow based – only 7 banks – and did not include top up loans from developers and other housing loans masquerading under other categories. However, the monetary authority's findings seem pretty consistent with our general conclusion that the problem is maximum a one in ten owning household one. Our recollection is that the equivalent figure for the UK in the late 1980s was nearer 20%.

If one allows for multiple ownership, the problem shrinks further

A further point to note concerns that most Hong Kong of habits, that of multiple ownership. The sheer audacity of the forlorn demonstrator interviewed on TV recently admitting he had three flats and asking for a government handout beggars belief. Maybe we missed something but we do not recall him offering to share his previous capital gains with society at large. The government has hitherto taken an extremely draconian line with those calling for help for the negative equity-impaired. The HKMA has relaxed its guidelines for banks and has said they can consider departing from their normal 70% loan-to-value criterion when re-financing negative equity mortgages. However, if the authorities are to subsequently soften their line, they must ensure that a) multiple owners are excluded from any scheme and b) any relief is limited to providing insurance against banks rolling out repayment terms. And finally, when all is said and done, if an individual has negative equity in his sole residence but is still able to service his mortgage – a function most likely of his ability to hold down a job – then so what? So he may not feel as rich and might spend a little less at the jockey club or in hostess bars but he can hardly claim to be destitute. This would argue for further limiting relief to those who had lost their jobs in a similar vein to the UK providing temporary mortgage assistance to homeowners who lose their jobs.

Demographic and immigration trends do not suggest a repeat of the Japan experience is in the making

We come to two major conclusions from all of the above. First we would note that the negative equity problem, although being trumpeted by a small but noisy and not wholly disinterested minority, can hardly be considered endemic. Governments are right to resist the moral hazard that would be created by underwriting such losses. Second, even though a huge chunk of wealth has been wiped off household balance sheets in recent years, like Japan, the household sector in aggregate remains extremely wealthy. Unlike Japan though, demographics and immigration trends are far more conducive to incremental accumulation of both physical assets and consumption goods. This holds especially true for Hong Kong; Singapore's far higher ratio of home ownership suggest that the negative wealth effect may take significantly longer to dissipate.

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