CHAPTER 3 : DEVELOPMENTS IN SELECTED SECTORS

Summary

- *Amid the continued low interest rate environment and a tight demand-supply balance, the residential property market heated up further in the first two months of 2015. Yet it cooled off somewhat after the Hong Kong Monetary Authority announced its latest round of macro-prudential measures in late February. Overall flat prices were flat in March following an increase in the first two months, though there was still a 5% increase during the quarter. Trading activities also turned quieter.*

- *Raising flat supply through increasing land supply is the Government's top policy priority in ensuring the healthy and stable development of the property market. Reflecting the Government's sustained efforts, total flat supply in the coming three to four years rose to another record high of 78 000 units. In February, the Government announced the 2015-16 Land Sale Programme which is capable of providing a total of about 16 000 flats. Combining the various land supply sources, it is estimated that housing land supply in the coming year could provide for some 28 500 private flats.*

- *The commercial and industrial property markets held relatively steady in the first quarter. Prices and rentals continued to record mild increases. Trading activities generally rose further, though still at low levels by historical standards.*

- *Inbound tourism slowed in the first quarter. Dragged by a marked decline in March, overall visitor arrivals rose by only 4.9% over a year earlier to 15.4 million, marking the slowest pace of growth since the third quarter of 2009.*

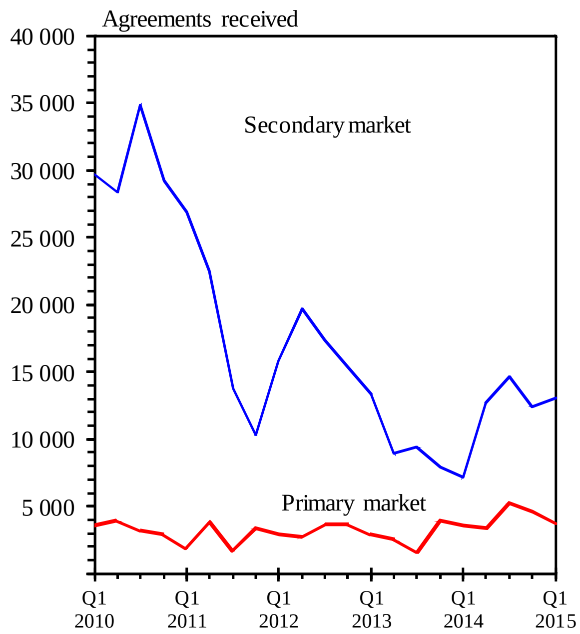
- *The logistics sector saw a mixed performance. Container throughput declined by 8.1% in the first quarter, while air freight throughput fared better, expanding by a mild 2.9%.*

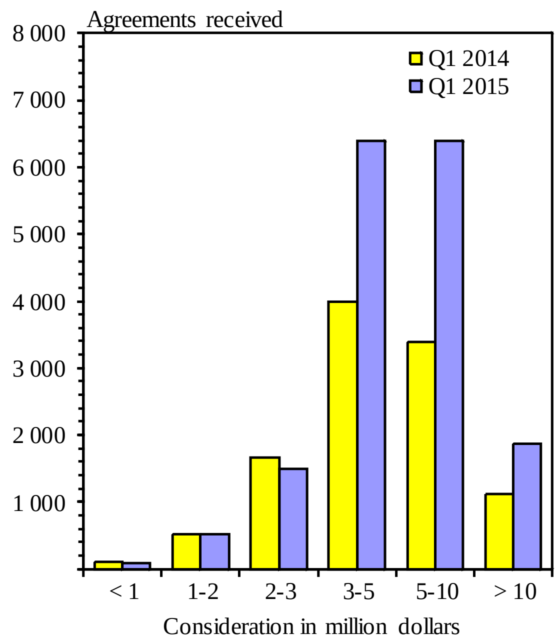
Property

3.1 Amid the continued low interest rate environment and a tight demand-supply balance, the *residential property market* heated up further in the first two months of 2015. Yet it cooled off somewhat after the Hong Kong Monetary Authority (HKMA) announced its latest round of macro-prudential measures in late February (see paragraph 3.7 and ***Box 3.1***). Transactions recorded a notable fall in March, while flat prices stayed flat.

3.2 Trading activities were active in January, but turned less hectic in February during the Chinese New Year season and quietened down even more in March. Taking the quarter as a whole, the number of sale and purchase agreements for residential property received by the Land Registry edged down by 2% from the preceding quarter to 16 768, though representing a leap of 55% over the low base a year earlier. Within the total, primary market transactions fell by 19% from the preceding quarter, while secondary market transactions rose by 5%. In parallel, total consideration shrank by 10% to $115.9 billion.

Diagram 3.1 : Trading activities quietened further in March following the introduction of HKMA's latest macro-prudential measures

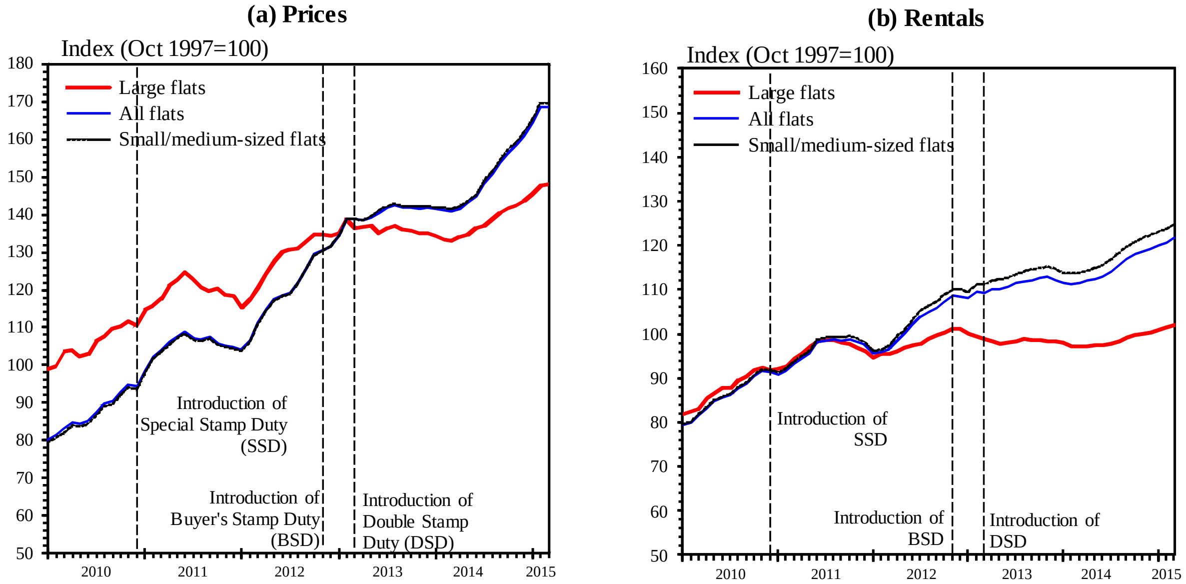




3.3 Overall flat prices were flat in March following an increase of 2.3% per month in January-February, though there was still a 5% increase between December 2014 and March 2015. While the prevailing tight demand-supply balance of flats and market expectation that the US Federal Reserve would only raise interest rates gradually lent support to prices, sentiment has been dampened by the HKMA's latest round of macro-prudential measures more recently. Analysed by size, prices of small/medium-sized flats went up by 5% between December 2014 and March 2015, and those of large flats by 3%.

3.4 Meanwhile, the leasing market held steady in the first quarter of 2015. Overall flat rentals in March 2015 rose by another 2% over December 2014. Analysed by size, rentals of small/medium-sized flats and large flats recorded a similar increase of 2%. Reflecting the relative movements of flat prices and rentals, the average rental yield for residential property stayed at a low level of 2.7% in March 2015, same as in December 2014.

Diagram 3.2 : Flat prices stayed flat in March, while rentals recorded a modest gain during the first quarter



Note : Residential property price index pertains to secondary market transactions only. Large flats refer to those with a saleable area of at least 100 m^2, and small/medium-sized flats with a saleable area of less than 100 m^2.

3.5 Raising flat supply through increasing land supply is the Government's top policy priority in ensuring the healthy and stable development of the property market. In February 2015, the Government announced the 2015-16 Land Sale Programme which includes 29 residential sites capable of providing a total of about 16 000 flats. Combining the various housing land supply sources including the Land Sale Programme, railway property development projects, redevelopment projects of the Urban Renewal Authority, projects subject to lease modification/land exchange and other sources, it is estimated that the total housing land supply in 2015-16 could provide for some 28 500 private flats.

3.6 As a result of the Government's efforts, the *total supply of flats* in the coming few years (comprising unsold flats of completed projects, flats under construction but not yet sold and flats on disposed sites where construction can start any time) rose from 74 000 units as estimated at end-2014 to another record high of 78 000 units as estimated at end-March 2015. In addition, another 11 700 units could be added to the total supply after the conversion of a number of residential sites into "disposed sites".

3.7 As it takes time to increase supply, the Government has also put in significant efforts to manage demand and reduce the possible risks to financial stability arising from an exuberant property market[(1)]. In late February, the HKMA announced the seventh round of macro-prudential measures on property mortgage to strengthen banks' risk management and resilience. The maximum loan-to-value (LTV) ratio for residential properties with value below $7 million was cut, and the maximum debt-servicing ratio (DSR) for borrowers who buy a second residential property or a non-self use property was also lowered (***Box 3.1***).

3.8 These measures have yielded notable results. On *speculative activities*, the number of short-term resale (comprising confirmor transactions and resale within 24 months after assignment) declined further to a record low of 50 cases per month or 0.8% of total transactions in the first quarter of 2015, well below the monthly average of 2 661 cases or 20.0% in January to November 2010 (i.e. the period before the introduction of the Special Stamp Duty). Reflecting the effects of the Buyer's Stamp Duty, *purchases by non-local individuals and non-local companies* stayed low at 93 cases per month or 1.5% of total transactions in the first quarter, much lower than the monthly average of 365 cases or 4.5% in January to October 2012. As to *mortgage lending*, the average LTV ratio of new mortgages in the first quarter, at 54%, was lower than the average of 64% in January to October 2009 before the first round of macro-prudential measures for residential property mortgage lending was introduced by the HKMA.

Box 3.1

HKMA's macro-prudential measures since 2009

To strengthen the banks' risk management and resilience and safeguard the stability of the banking and financial system, the HKMA has introduced seven rounds of macro-prudential measures on property mortgage since October 2009, and the latest round was introduced in late February 2015. The measures are summarised below :

First round (23 October 2009)

- Cap the LTV ratio at 60% for residential properties valued at $20 million or more.
- Cap the loan amount at $12 million for residential properties valued below $20 million.

Second round (13 August 2010)

- Cap the LTV ratio at 60% for residential properties valued at or above $12 million and non-owner occupied residential properties.
- Cap the loan amount at $7.2 million for residential properties valued below $12 million.
- Standardise the limit on DSR of mortgage applicants to 50%, from the previous range of 50% to 60%.
- Require banks to stress-test mortgage applicants' repayment ability with an assumed increase in mortgage rates of at least two percentage points, and cap the stressed DSR at 60%.

Third round (19 November 2010)

- Lower the maximum LTV ratio for residential properties with a value at $12 million or above from 60% to 50%.
- Lower the maximum LTV ratio for residential properties with a value at or above $8 million and below $12 million from 70% to 60%, with the loan amount capped at $6 million.
- Cap the loan amount at $4.8 million for residential properties valued below $8 million.
- Lower the maximum LTV ratio for all non-owner-occupied residential properties, properties held by a company, industrial and commercial properties, and properties under net worth-based mortgage to 50%.

Fourth round (10 June 2011)

- Lower the maximum LTV ratio for residential properties with a value at or above $10 million and below $12 million to 50%.
- Lower the maximum LTV ratio for residential properties with a value at or above $7 million and below $10 million to 60%, with the loan amount capped at $5 million.
- Cap the loan amount at $4.2 million for residential properties valued below $7 million.
- If the principal income of the mortgage loan applicants is not derived from Hong Kong, the applicable maximum LTV ratio would be lowered by at least 10 percentage points regardless of property types or values.
- Lower the maximum LTV ratio for properties under the net worth-based mortgage from 50% to 40%.

Box 3.1 (Cont'd)

Fifth round (14 September 2012)

For all mortgage loan applicants

- ➢ Standardise the maximum loan tenor for all new property mortgage loans to 30 years.

For mortgage loan applicants with outstanding mortgage loans

- ➢ Lower the maximum DSR from 50% to 40% and the maximum stressed DSR from 60% to 50%.
- ➢ Reduce the maximum LTV ratio from 40% to 30% for mortgage loans assessed based on applicants' net worth.
- ➢ Lower the applicable maximum LTV ratio by 20 percentage points, instead of the previous 10 percentage points, for applicants whose principal income is not derived from Hong Kong.

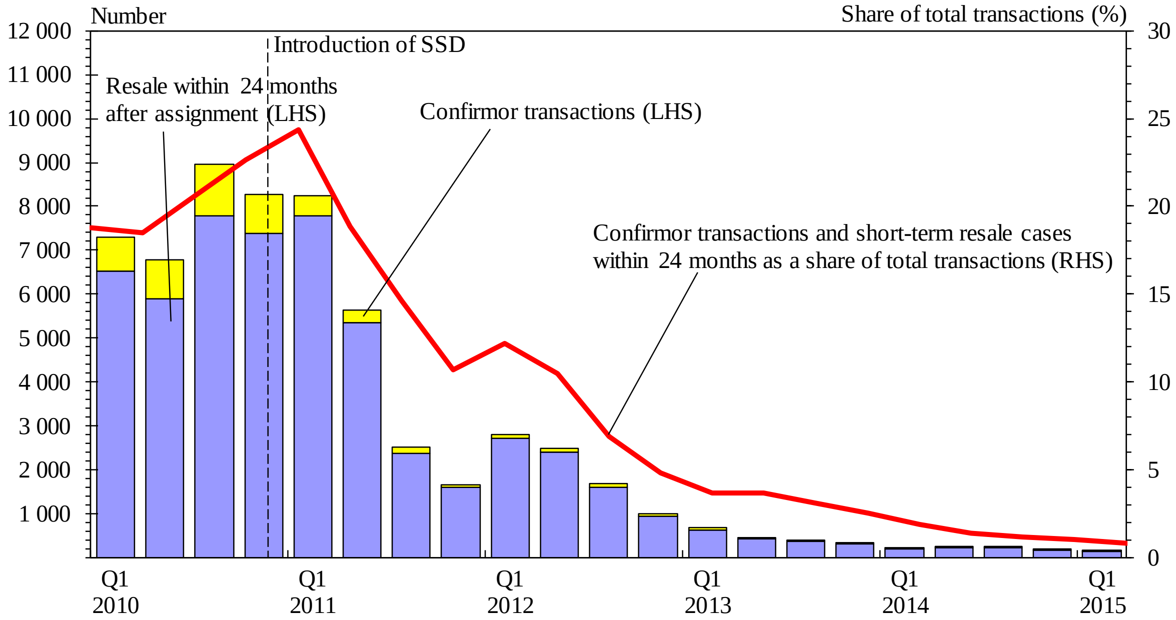
Sixth round (22 February 2013)

- ➢ Require banks to assume a mortgage rate increase of 300 basis points, instead of the previous 200 basis points, in stress-testing the repayment ability of mortgage loan applicants for both residential and non-residential properties.
- ➢ Lower the maximum LTV ratios of mortgage loans for all non-residential properties, whether or not for self-use, from the previous applicable levels by 10 percentage points.
- ➢ Set the maximum LTV ratio of mortgage loans for standalone car park spaces at 40% and the maximum loan tenor at 15 years. Other requirements on maximum LTV ratio and DSR applicable to non-residential property mortgage loans also apply to standalone car park space mortgage loans.
- ➢ Introduce a risk-weight floor of 15% for all new residential mortgages granted by banks using the internal ratings-based approach.

Seventh round (27 February 2015 and further guidance on 2 March 2015)

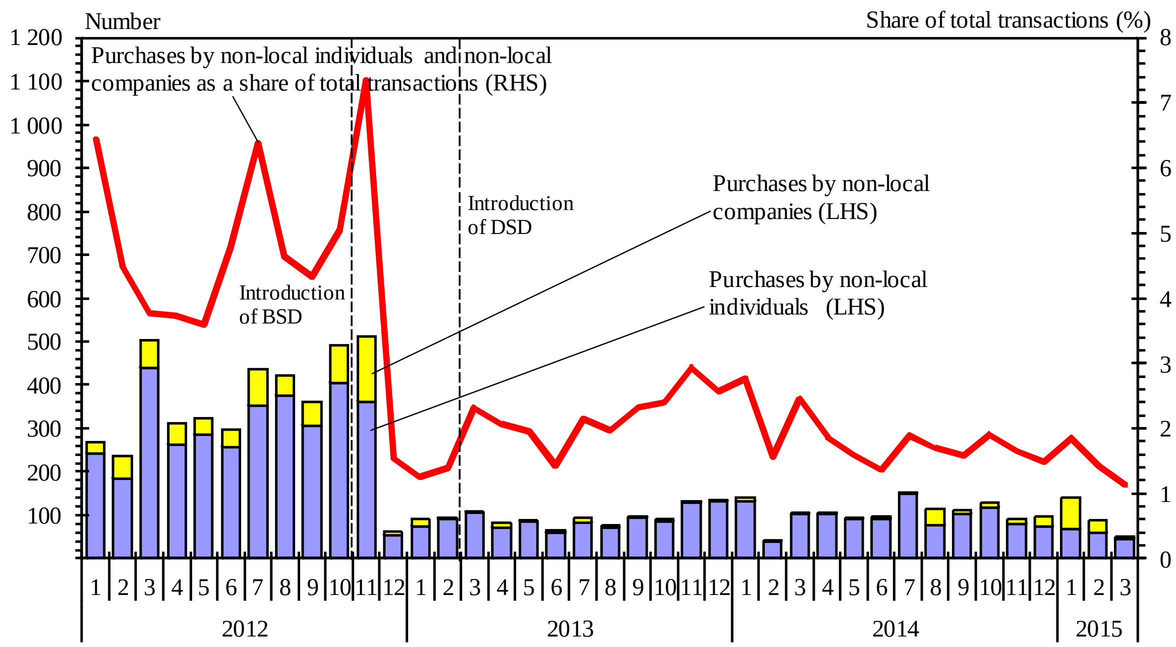
- ➢ Lower the maximum LTV ratio for self-use residential properties with value below $7 million by a maximum of 10 percentage points to 60%.
- ➢ Lower the maximum DSR for borrowers who buy a second residential property for self-use from 50% to 40%, and the stressed-DSR cap from 60% to 50%.
- ➢ Lower the maximum DSR of mortgage loans for all non-self use properties, including residential properties, commercial and industrial properties and car park spaces, from 50% to 40%, and the stressed-DSR cap from 60% to 50%.
- ➢ Require banks adopting the internal ratings-based approach to extend the 15% risk-weight floor to their entire residential mortgage portfolios before end-June 2016, with an interim step of achieving a 10% risk-weight floor by end-June 2015.
- ➢ Require banks to apply a 5-percentage-point knock down on the applicable DSR caps if the total amount of mortgage loans, through any mortgage co-financing or insurance schemes, is 20 percentage points over the normal permissible LTV caps set by the HKMA.

Diagram 3.3 : Speculative activities stayed subdued



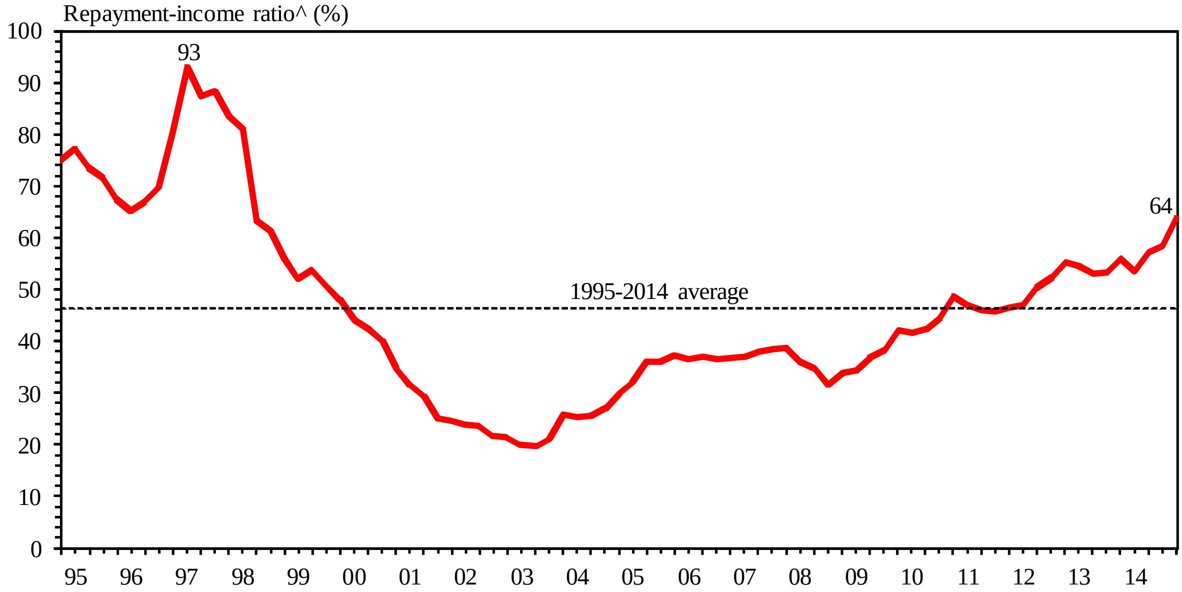
Note : Confirmor transactions refer to resale before assignment.

Diagram 3.4 : Purchases by non-local buyers remained low



3.9 Yet following the almost uninterrupted rally in flat prices in the past few years, the risks of a housing market bubble are still prominent. Overall flat prices in March 2015 have surpassed the 1997 peak by a rampant 69%. Home purchase affordability (i.e. the ratio of mortgage payment for a 45-square metre flat to median income of households, excluding those living in public housing) worsened to around 64% in the first quarter, exceeding the long-term average of 46% over 1995-2014. Should interest rates rise by three percentage points to a more normal level, the ratio would soar to 83%.

Diagram 3.5 : The mortgage payment to income ratio rose further



Note : (^) The ratio of mortgage payment for a 45m^2 flat (assuming 70% loan-to-value ratio and tenor of 20 years) to median income of households (excluding those living in public housing).

3.10 Looking ahead, while the US Federal Reserve is expected to gradually normalise interest rates, the exact timing and pace of the rate hike remain uncertain, much contingent on upcoming economic data. In contrast, other major central banks, in particular in the eurozone and Japan, are continuing with their monetary easing measures. The divergent monetary policy stance of the major monetary authorities could lead to increased financial volatilities and abrupt changes in fund flows. The property market may experience considerable fluctuations as market sentiment shifts along with changes in these external factors.

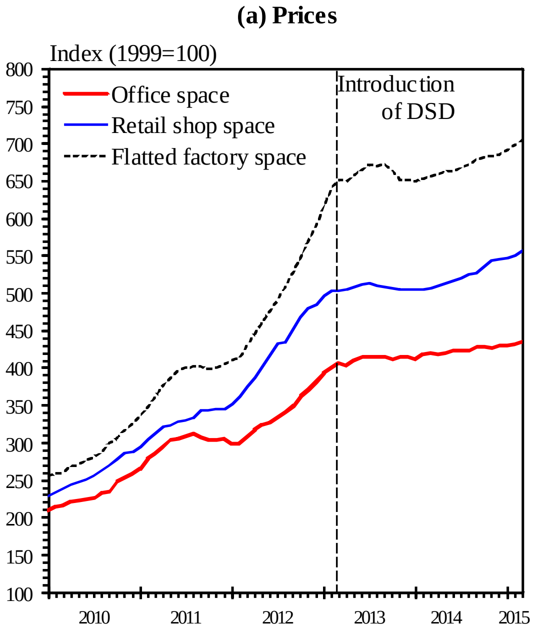
3.11 The *commercial* and *industrial property markets* held relatively steady in the first quarter of 2015. Prices and rentals continued to record mild increases. Trading activities generally rose further, though still at low levels by historical standards.

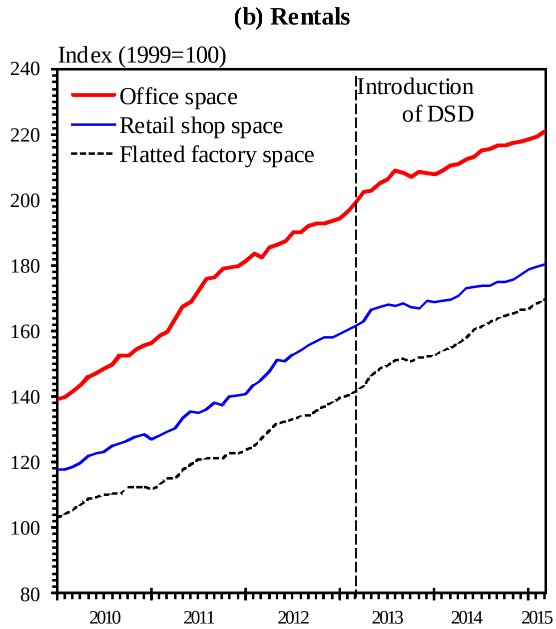
3.12 Overall sale prices of *office space* edged up by 1% between December 2014 and March 2015, with prices of Grade A, B and C office space all rising by a mild 2%. Overall office space rentals also rose by 1% over the period, with rentals of Grade A, B and C office space increasing by 2%, 2% and 1% respectively. The average rental yields for Grade A, B and C office space were 2.9%, 3.0% and 2.9% respectively in March 2015, same as in December 2014. Transactions for office space surged by 23% over the preceding quarter or 95% over the low base a year earlier to 400 cases in the first quarter.

3.13 Both sale prices and rentals of *retail shop space* rose by 2% between December 2014 and March 2015. Meanwhile, the average rental yield for retail shop space edged down from 2.4% to 2.3% over the period. Transactions fell by 22% from the preceding quarter or 18% from a year earlier to 550 cases in the first quarter(2).

3.14 As to *flatted factory space*, sale prices and rentals rose by 3% and 2% between December 2014 and March 2015 respectively. As a result, the average rental yield edged down from 3.0% to 2.9% over the period. Meanwhile, transactions for flatted factory space increased by 14% over the preceding quarter or 57% over the low level a year earlier to 940 cases in the first quarter.

Diagram 3.6 : Prices and rentals of non-residential properties recorded mild increases





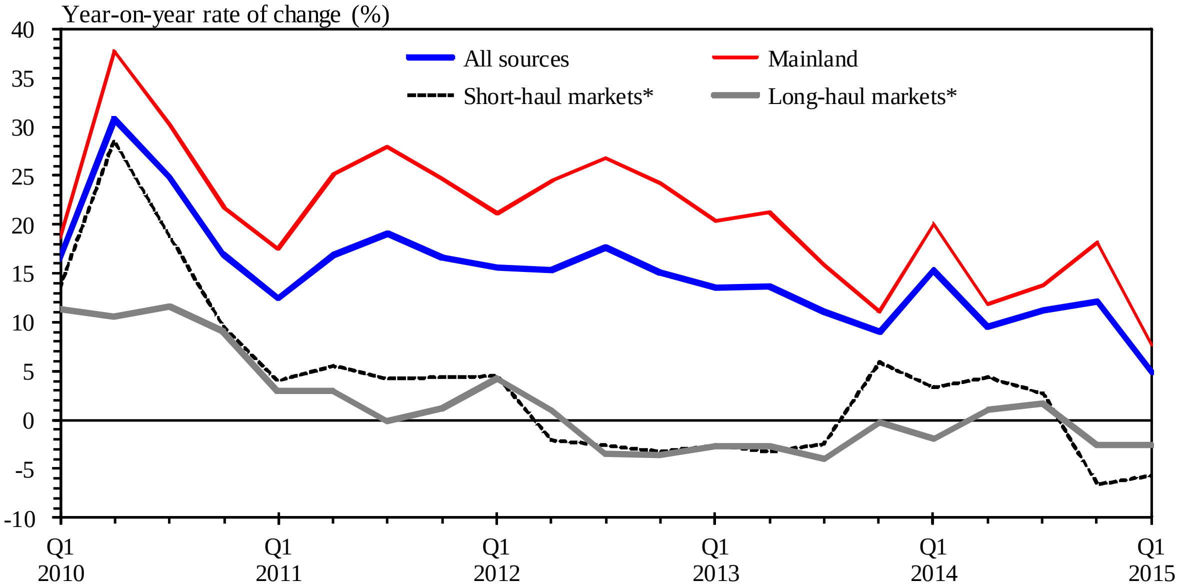
Land

3.15 Reflecting the Government's efforts to increase land supply, five residential sites, one business site, one commercial/office site and one industrial site, with a total area of about 5.5 hectares, were disposed in the first quarter, fetching a land premium of about $14.4 billion. The tender exercises for one commercial/office site and three residential sites also commenced during the first quarter. As to land exchange, there was one land exchange approved in the first quarter. Meanwhile, 15 sites were approved for lease modifications.

Tourism

3.16 Inbound tourism slowed in the first quarter of 2015 after the robust performance in the past five years. While overall *visitor arrivals* still recorded double-digit growth in January-February combined, they turned to a visible fall in March. For the quarter as a whole, overall visitor arrivals rose by only 4.9% over a year earlier to 15.4 million, marking the slowest pace of growth since the third quarter of 2009 when the sector was hit by concerns over human swine flu. Within the total, Mainland visitors rose by a decelerated 7.7% to 12.3 million, while visitors from short-haul markets and long-haul markets[(3)] fell by 5.7% and 2.6% respectively.

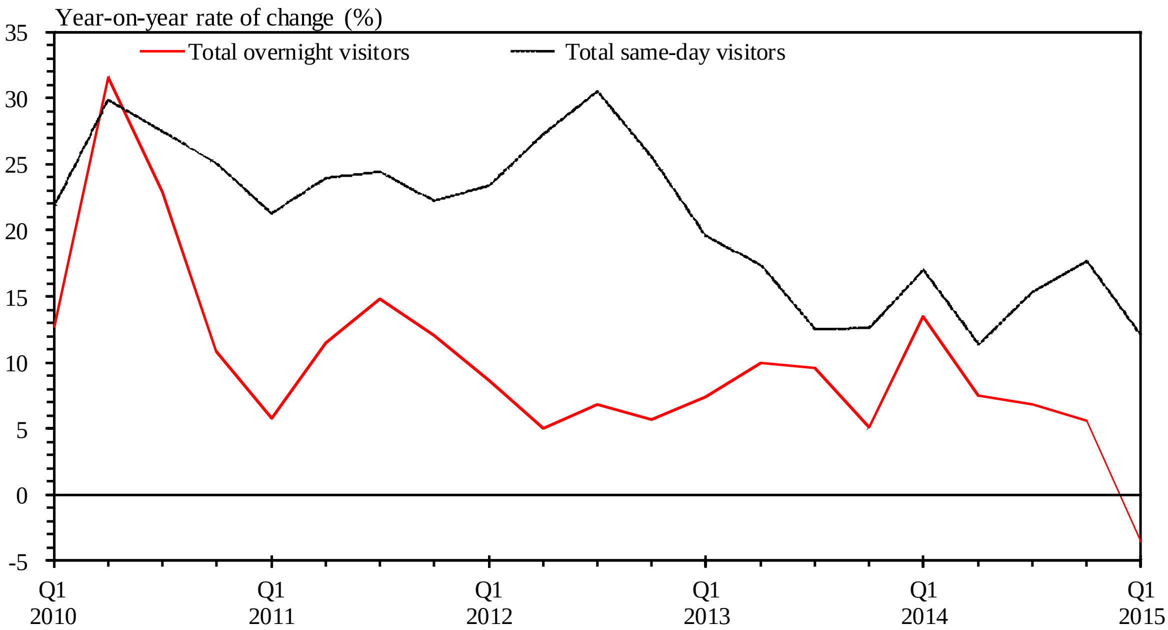
Diagram 3.7 : Inbound tourism slowed in the first quarter



Note : (*) See note (3) at the end of this chapter for the definition of short-haul and long-haul markets.

3.17 Analysed by the length of stay, same-day visitor arrivals in the first quarter of 2015 rose by a moderated 12.1% over a year earlier, down from the 17.7% growth in the preceding quarter. Overnight visitor arrivals slackened even more abruptly, from an increase of 5.6% to a fall of 3.5%, the first year-on-year decline since the third quarter of 2009. The share of same-day visitors rose further from 53.9% a year earlier to 57.6% in the first quarter, while that of overnight visitors declined from 46.1% to 42.4%.

Diagram 3.8 : Same-day visitors rose at a moderated pace while overnight visitors declined

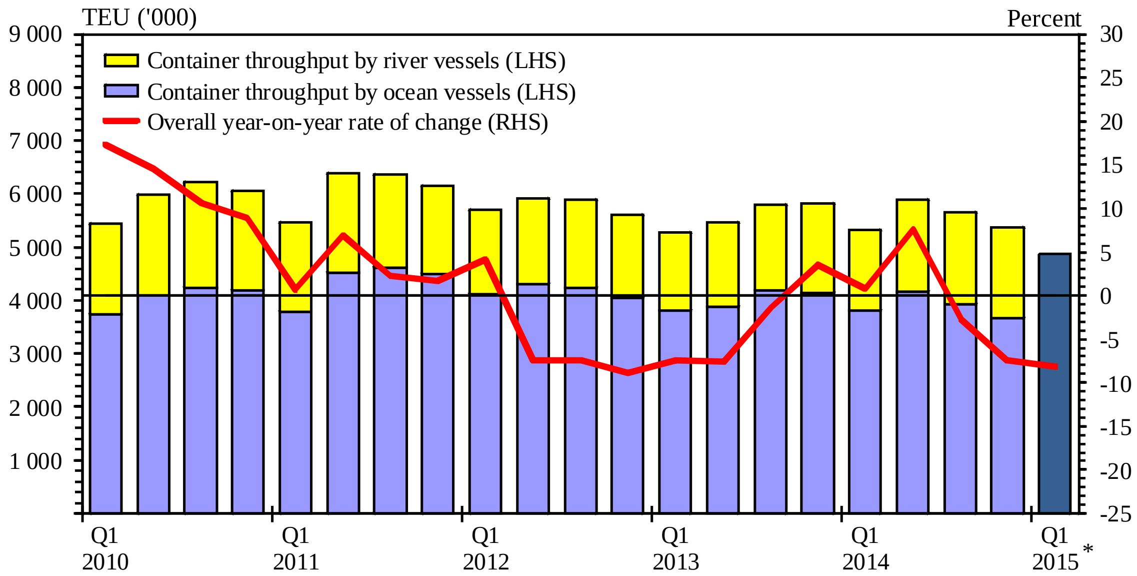


3.18 In tandem with the moderated growth in visitor arrivals, the average hotel room occupancy rate retreated from a high 90% a year earlier to 86% in the first quarter. The average achieved hotel room rate also declined, by 4.9% to $1,422[(4)].

Logistics

3.19 The logistics sector showed a mixed performance in the first quarter of 2015. Amid the still challenging external environment, *total container throughput* declined further by 8.1% from a year earlier to 4.9 million twenty-foot equivalent units (TEUs). The value of trade handled at the Hong Kong port also declined by 4.9% from a year earlier, and its share in total trade down from 23.2% to 21.7%.

Diagram 3.9 : Container throughput declined further in the first quarter

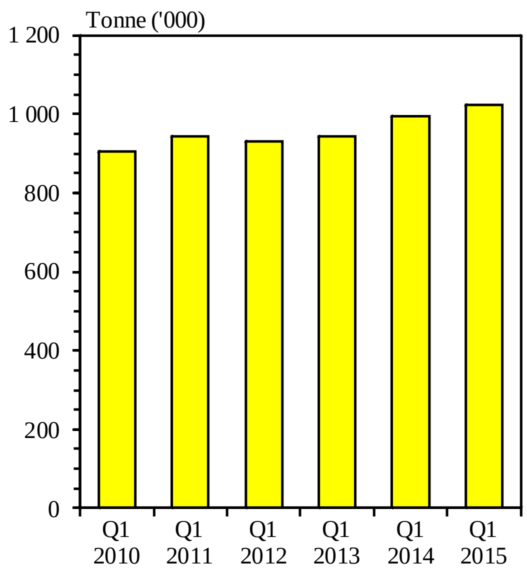


Note : (*) The container throughput figure for the latest quarter is the preliminary estimate by the Hong Kong Port Development Council, for which a breakdown by ocean and river vessels is not yet available.

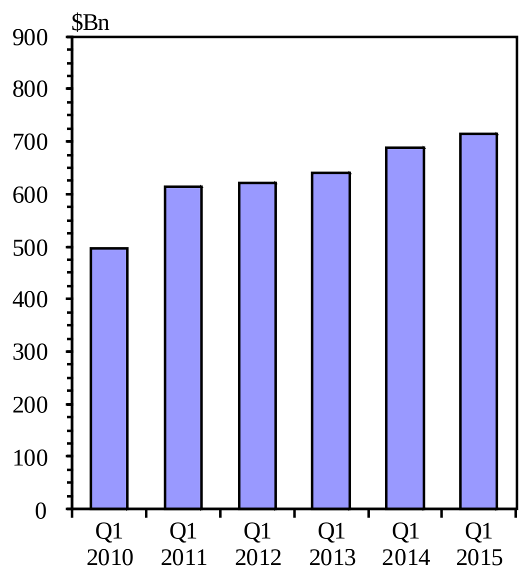
3.20 *Air freight throughput* fared better, expanding by a mild 2.9% over a year earlier to 1.0 million tonnes in the first quarter. The total value of trade by air also increased by 3.9% over a year earlier, and its share in overall trade value rose further from 39.2% to 40.0%.

Diagram 3.10 : Air cargo throughput and value of trade handled by air rose further

(a) Air cargo volume



(b) Value of trade handled by air*



Note : (*) Not including transhipment.

Transport

3.21 Traffic flows for different modes of transport recorded a mixed performance in the first quarter of 2015. Air passenger traffic increased by 8.8% over a year earlier to 16.4 million, while water-borne passenger trips declined by 4.1% to 6.6 million. As to land-based cross-boundary traffic movements, passenger trips went up by 6.5% to 55.7 million, but the average daily vehicular movements edged down by 0.9% to 39 600.

3.22 In March, the Government endorsed the proposal to expand the Hong Kong International Airport from the existing two-runway to a three-runway system. Through significantly expanding the airport's capacity, the three-runway project would help maintain Hong Kong's competitiveness as a global and regional aviation hub and cater for its long-term development and economic needs. The project would be taken forward by the Airport Authority on a self-financing basis, with construction expected to start in 2016 for completion by 2023.

Culture, Creativity and Innovation

3.23 In March, the Working Group on Intellectual Property (IP) Trading released the report on driving the development of Hong Kong as an IP trading hub, which the Government has accepted for implementation. The report sets out 28 recommended measures under four strategic areas, namely enhancing the IP protection regime; supporting IP creation and exploitation; fostering IP intermediary services and manpower capacity; and pursuing promotion, education and external collaboration efforts. Separately, in the 2015-16 Budget $23 million has been earmarked for offering IP consultation, manpower training and other services to small and medium enterprises in the coming three years.

3.24 A number of measures and initiatives were announced in the 2015-16 Budget to support the further development of the cultural and creative industries. An additional $400 million would be injected to the CreateSmart Initiative to support different sectors of the creative industries. To promote the development of the *fashion industry*, existing and new resources totalling $500 million would be devoted to launch a series of measures on a pilot basis, including promotion of Hong Kong's fashion designers and brands. To boost the volume of local production and nurture talent of *the film industry*, a further $200 million would be injected into the Film Development Fund and a subsidy scheme for film productions would also be introduced. As to *art and culture*, a

$300 million Art Development Matching Grants Pilot Scheme would be launched, under which the amount of private donation and sponsorship secured by eligible local arts groups would be matched by grants, with a view to encouraging various sectors of the community to sponsor local art and cultural activities.

Environment

3.25 The Government launched a three-month public consultation on the future development of the electricity market on 31 March. The consultation targets to gather public's view on how to further develop the electricity market having regard to the four energy policy objectives of safety, reliability, affordability and environmental protection, as well as the goal to introduce competition to the market when the requisite conditions are present.

3.26 Separately, plastic shopping bag charging has been fully implemented since 1 April. All sellers engaging in retail sales of goods in Hong Kong are required to charge customers not less than 50 cents for each plastic shopping bag provided, save for situations where there is exemption. The charging scheme would help further reduce the excessive use of plastic bags and promote the green habit of Bring Your Own Bag, thereby conducive to the protection of Hong Kong's environment.

Notes :

(1) For details of the measures promulgated in 2010, see Box 3.1 in the First Quarter Economic Report 2010, Box 3.1 in the Third Quarter Economic Report 2010 and note (2) at the end of Chapter 4 in the 2010 Economic Background and 2011 Prospects. For details of the measures promulgated in 2011, see note (2) at the end of Chapter 3 in the Half-yearly Economic Report 2011 and Box 3.1 in the Third Quarter Economic Report 2011. For details of the measures promulgated in 2012, see Box 3.1 in the Third Quarter Economic Report 2012 and Box 4.1 in the 2012 Economic Background and 2013 Prospects. For details of the measures promulgated in 2013, see Box 4.2 in the 2012 Economic Background and 2013 Prospects and Box 3.1 in the First Quarter Economic Report 2013. For details of the measures promulgated in 2014, see Box 4.1 in the 2013 Economic Background and 2014 Prospects. For details of the measures promulgated in 2015, see Box 3.1 of this report.

(2) The figures on transaction refer to commercial space, which comprises retail premises and other premises designed or adapted for commercial use but excludes purpose-built office space.

(3) Short-haul markets refer to North Asia, South and Southeast Asia, Taiwan and Macao, but excluding the Mainland, while long-haul markets refer to the Americas, Europe, Africa, the Middle East, Australia, New Zealand and South Pacific. In the first quarter

of 2015, visitor arrivals from the Mainland, short-haul and long-haul markets accounted for respective shares of 80%, 13% and 7% of total visitors.

(4) The figures on hotel room occupancy and achieved room rate do not include tourist guesthouses.