THE IMPACT OF RENMINBI (RMB) APPRECIATION ON THE HONG KONG PROPERTY MARKET

In this article, I will point out and discuss the effect of the reform of exchange rate institution on the real estate market, and the discussion suggests that the appreciation of RMB leads to the rise of real estate price, but as well as the possible economic bubble in Hong Kong. The influx of capital flows and the real estate price volatility in Hong Kong real estate market shows that the expectation of the appreciation of RMB is one of the elements that inspires investment speculating in the real estate market causing the possible imbalance of demand and supply and various social problems.

RMB appreciation stimulates mainland investors to enter the Hong Kong real estate market

An appreciating RMB will impact the Hong Kong economy and hence the real estate market in direct and indirect ways. Indirectly, it spurs capital inflows into Hong Kong in order to lower the local interest rates, creates an accommodative monetary environment and yields substantial wealth effects from a surging stock market. As a result, such wealth effects are expected to spill over into the property market. Lower interest rates will also provide incentives for increased borrowing and boost asset prices. Under the current currency system, an increase in liquidity would suppress Hong Kong-dollar interest rates. If money supply exceeds the desired money demand, inflationary pressure will rise. The positive outlook for asset prices and expectations of further appreciation of the RMB might attract substantial capital flows into Hong Kong.

Hong Kong – an alternative exit for Chinese hot money

In the long run, it is believed that the reform of RMB exchange rate system and its revaluation will not have any significant adverse effects on China, but is rather one of the steps towards China's strategic goal of gradual appreciation and loosening of capital control for RMB.

The domestic policy tightening in mainland China as well as the appreciation of the RMB causes the China investors to diversify their investment portfolio, Hong Kong is expected to be one of the first spots for it. Chinese investors in search of alternative real estate options, to reduce the overheating of domestic market risk exposures. China on the overseas property market influence eclipsed. China real estate investors are mostly limited to investment in the domestic market, forcing the Government to take vigorous measures to suppress excessive rise in prices of China's domestic policy tightening in real estate, and the appreciation of the RMB will, analysts expect more Chinese people to those high returns and low limit of the overseas market investments such as Hong Kong.

Investment Strategy Consideration

The levels of total return due to the RMB appreciation offered by real estate markets in Hong Kong are likely to be attractive to many Chinese investors. In particular, in an environment when investment in low risk assets in Hong Kong offers very attractive returns, the income return from real estate is likely to be an appealing characteristic for many investors. The key to success is in the speed, scale and timing of the investment. In conclusion, the RMB appreciation presents a cross-border investor with a range of opportunities. It also offers scope for risk diversification within the real estate markets.

How might investors respond? Five trends may be significant:

- **Increasing investment demands**: Firstly increasing allocations to real estate both from traditional institutional investors (pension funds, insurance companies and endowments) but also from sovereign wealth funds and new institutional investors.
- **Favorable risk adjusted return**: Secondly many investors show an elevated degree of China heat effect. After all, if the outlook for returns is strong in Hong Kong many mainland investors still keen to find out the risk adjusted return for their investment?
- **More value-added investment opportunities**: Whilst many risk adverse investors may likely continue to focus purely on prime properties in Hong Kong; I suspect that increasingly some risk accepting investors may start to commit to investments in secondary properties with a value add strategy to reposition the property into a core property as markets continues to grow.
- **Attractive capital flow environment**: Listed real estate tends to anticipate the performance of direct or unlisted real estate. With healthy balance sheets, many listed companies have access to capital to redeploy into the wealthy real estate markets. Many investors might find this a more liquid way to participate in the boosting market environment.
- **Focus on the core segment**: Depending on the risk level the investor is willing to take, investors are suggested to invest in the core segment as part of the overseas portfolio. Hong Kong being a well developed city in the region, the core segment is relative stable in term of price growth and rental income.

So the next question is where are those opportunities? There is not a simple answer to this question, but many would answer using the real estate specific mantra: location, location, location. It will depend on the market, asset type and strategy to adopt. Up to now most investors have taken a 'flight to quality' and have focused on prime markets and assets. Even though this is an understandable choice when the economic is still on the bright side with historic low lending cost and the synchronized move towards prime assets in top markets has caused a 'bidding war' for many opportunities. In some markets the final price has been primarily determined by too much capital chasing the same property, rather than by the outlook for the fundamentals.

Chinese investors convince of the robust prospects of Hong Kong are likely to find this a tempting time to rotate into the more cyclical real estate sectors. Some of the sectors such as hotel and retails are particularly in the strong position due to favorable policies driven by the central government.

The current revaluation situation will not be enough to solve the problem of excess capital inflows. On the contrary, it will however further accelerate capital inflows in anticipation of further revaluation, intensifying the harmful stimulus to the economy. On the other hand, the government will set up various measures in order to control the overheat market. The overheat market would disadvantage the interior and could even pose a threat to the city's long term competitiveness. What makes Hong Kong different is that it is an attractive destination for foreign direct investment (FDI). Hong Kong is one the largest recipient of FDI per area in the region, due to its growing dynamic economy and stable political environment . On the other hand, rising incomes and economic growth have also created enormous inflation pressure for the city.

As Mainland China is a major investment source of investment income for Hong Kong, external factor income flows will benefit from the currency revaluation effect. It is particularly helpful for long term investors for purchasing properties for rental income purposes. The market value of investment holdings will also benefit from the currency revaluation, and this could have a positive impact on Hong Kong's aggregate demand, and thus inflation as discussed above, through the wealth effect. The author would like to conclude the following positive impacts on the Hong Kong market:

1. To promote its internal economic growth. The prosperity of fictitious capital, to increase investor wealth, stimulate consumption and growth, changes in short-term marginal propensity to consume and hence increase its internal spending power especially the luxury sectors, the multiplier effect of expanding economic growth
2. To accelerate the concentration of wealth and capital accumulation, the process of promoting social capital. Fictitious capital has changed the way of capital accumulation, capital concentration more quickly, fast, and promote the socialization of capital, for efficient basis for large-scale socialized production.

Property price distortions and market rebalancing

As discussed above, one of the key factors driving the market imbalances has been cheap money, which, together with weak regulation of high-risk investment, led to the potential bubbles in Hong Kong. Many investment funds from developed countries including US and Europe currently make the advantage of extremely low interest-rate policy. It brings capital flows into Asia particularly Hong Kong in anticipation of higher investment return compared to that in their own countries. It therefore further boosts the property price. The appreciation of RMB together with rising Chinese household income and larger official reserves mean that there will be rising demand for diversification by Chinese investors into cross-border assets. Hong Kong is always one of the top destinations for such cross-border capital flow. To facilitate these future cross-border capital flows, it would be helpful for China to maintain a stable exchange rate and large foreign exchange reserves, both of which are critically important in reducing the Chinese and foreign investors' uncertainty that would result from a volatile exchange rate.

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Implication on the Hong Kong society as a whole

The current strong influx of Chinese hot money causing the real estate market in Hong Kong as one of the fastest growing investment tools for the mainland Chinese. However, it has also become an important area of investment, growing its virtual nature, which led to many social problems such as excessive inflation, distortion of the housing market, loss of the city's competitiveness, etc. Virtual capital itself is not value, but the virtual capital to generate profits through circular motion to get some form of "residual value", it can not be directly used as real factors of production or production activities, but only the ownership certificate, the “reality paper copy of the capital”, reflects the debt payment. A lot of money flows from the real economy and financial markets and real estate market, causing economic false prosperity as we have seen before in 1997 and 2008. If the flow of funds into the virtual economy too much, it will cause a lack of real economic sector funding, the development of fatigue, there crowding out productive investment. The fast capital accumulation in the virtual reality of capital accumulation in the case of interest-bearing money capital does not reflect the reality of not only the accumulation of money capital, and self-aggrandizement, which led to bubble economy. Increasing the composition of the bubble economy, people’s pursuit of profit led to the virtual non-normal influx of a lot of money the virtual capital markets, people are keen on playing the stock / property market, futures and other “money game” activities.

The biggest challenge for the Hong Kong policymakers now is how to deal with the property bubbles being formed by the hugh purchasing power caused by the appreciation of RMB and cheap money from China. As asset prices and the consumer price index rise, it is important for China to raise its interest rate. It is therefore necessary for China to improve its capital control mechanisms, to allow orderly cross-border capital flows for more efficient investments.

The author would like to share the following viewpoints:

1. Given the complex institutional and structural limitations in China, the nominal RMB appreciation will become a key policy for China in the near future and the rate of appreciation is likely to be at a stable and controlled pace. One important implication for Hong Kong is that it will be difficult to pursue a weak-dollar policy as Hong Kong dollar pegs with US Dollar.

2. For short term measurement, the Hong Kong Monetary Authority and China Central Bank can cooperate effectively in maintaining the stability of the exchange rate and orderly cross-border flows of capital. A stable RMB-dollar exchange rate seems to fit both parties interest. However, Hong Kong is a free trade port and there is hardly any existing tight regulation on controlling cross-border capital flow. Any additional regulations may damage the reputation of Hong Kong being one of the freest trading places in the world especially China is the biggest trading partner for Hong Kong.

3. The strong cross-border capital flow may cause a sharp change in the Hong Kong property landscape as such influx of money is intensifying demand for office, retail, and apartment spaces. In the world’s most expensive high-rise cities, such as Hong Kong, the free market axiom that real estate should be developed for its “highest and best use” has never been truer.

Notes:

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