ARTICLE FOR THE EDGE

SINGAPORE PROPERTY: ARE EXPECTATIONS UNMOORED BY REALITY?

After languishing for many years because of cooling measures enforced by the Government, rising transaction volumes and stabilising property prices are encouraging hopes for a property market revival. The government's tweaks to some of the macroprudential cooling measures have added to these hopes. But are these hopes realistic?

The context: the insidious impact of property prices

Before we look into what might drive property prices in future, it is useful to understand the manifold ways in which the property market affects Singaporeans and the historical context to the current property market.

First, because of the high level of home ownership in Singapore and the relatively large share of real estate-related services in the economy, property prices influence a whole range of factors that determine the welfare of the average Singaporean.

- Fluctuations in property prices can affect macroeconomic stability because a large proportion of bank lending is related to mortgages or loans to developers and because a very high share of household wealth is tied up in property assets.
- The level of property prices also affects Singapore's competitiveness. When property prices are at elevated levels, the cost structure of the economy insidiously creeps upward as workers demand higher salaries to make ends meet in an increasingly expensive society. Also, since landlords usually have a yield objective when they invest in property, higher housing prices will tend to push up rental costs.
- Higher home prices also put a strain on affordability, especially for young couples looking to buy their first home, and lower the consumption of other items that could have added to consumer welfare.
- Elevated property prices can exacerbate wealth inequality in society as existing homeowners, particularly those who are well off enough to own two or more properties, benefit disproportionately compared to younger people who could be priced out of the housing market all together.
- Most critically, remember that a substantial – perhaps even excessive - proportion of retirement savings is allocated to housing. So, property price corrections could undermine retirement adequacy. As of 2016, property assets made up 44.8% of the total household assets while mortgage loans comprised of 75% of total liabilities. This also means that the wealth effect, i.e. the propensity to spend and consume more when asset prices are rising and vice versa, is pronounced and significant.

In short, property prices are a big thing for the economy and high property prices are not necessarily good for it.

Second, the historical trends in the property market have had a strong impact on how Singaporeans look at property prices. Many assume that, since property prices have trended up inexorably through the years, with downturns quickly reversing into yet another upcycle, it is virtually a sure bet that residential property prices will increase with time. Private residential property prices soared by a multiple of 14.4 times from March 1975 to March 2017, or a compound annual growth rate of 6.9% over 42 years.

But trends change and people's expectations do not adjust quickly. The growth in property prices was the fastest in the early years of independence (1975-1980) when breakneck economic progress allowed low-hanging economic fruits to be harvested rapidly. As the years went by, the rate of price appreciation has decelerated and become subject to wider fluctuations. Over the past decade, property prices have actually declined during 2011-2016 due to more desultory global and local economic growth; a slower pace of immigration; and macroprudential curbs to rein in an overheating housing market.

A short-term rebound in property prices is possible – under the right circumstances

We would not be surprised to see a cyclical bounce in property prices – but it would take a confluence of factors:

- First, the government's cooling measures need to be further eased. In March, the Government reduced the Seller's Stamp Duty by four percentage points for each applicable tier and also shortened the window from four years to three years. It also removed the Total Debt Servicing Ratio (TDSR) framework on mortgage equity withdrawal loans with loan-to-value (LTV) ratios of 50% and below. This has led to optimism among homeowners, investors and speculators alike that the cooling measures which have brought down property prices by around 12% since the peak in the third quarter of 2013, might soon be lifted. But this expectation underplays the fact that the broad framework of cooling measures, namely, the Additional Buyer's Stamp Duty, TDSR and LTV limits, remain in place.

- Second, the economy should perform much more strongly. This is likely, at least for the remainder of this year. Global demand is reviving, giving the Singapore economy a welcome boost after difficult years in 2015 and 2016 when trade flows were moribund. Exports have picked up momentum since the end of 2016, and growth should exceed 2% this year. As the benefits of a stronger trade sector feed into the labour market, activity in the property market could begin to pick up further.

If these conditions materialise, we could see a rebound in the property market as pent-up demand is released.

But the longer term fundamentals are weaker than many people think

The era when Singapore property prices rose steadily and predictably is mostly over because the headwinds are significant and intensifying:

- First, economic growth, a key foundation for ever-rising property prices, will slow down structurally and permanently. Singapore will find it hard to outperform its peers as before. Given its weak population growth and even making generous assumptions about productivity, Singapore will be lucky if it grows by 3% a year over the next decade. And, what is more, getting to this 3% will necessarily entail some hard work – restructuring to reduce Singapore's high cost structure and downsizing existing activities so as to move workers and capital into new and more risky areas of growth. This is not really an environment in which one gets a house price boom.
- Second, after almost ten years of near-zero interest rates and extraordinary levels of quantitative easing by central banks all over the world, the next few years will see rising interest rates and tightening liquidity. This monetary scenario is not a friendly one for property prices: asset prices including housing which have soared will recalibrate downward in this new environment of normalising interest rates and a reduced quantity of money.
- Third, it is a stretch to think that the government will allow immigration flows on the scale that boosted the property market prior to 2011. The new economic strategy is focused on reducing our reliance on foreign workers

and boosting productivity while policy makers are sensitive to voters' reluctance to see another surge in the foreigner population. This removes a pillar of demand from the property market.

- Fourth, what about the effects on property prices of an ageing household portfolio? Singaporeans will increasingly realise that they own a 99-year lease on their flats whose value will go to zero within the life times of their children. It will also become more evident that it will not be possible to top up these leases at preferential rates and that the selective en bloc redevelopment that many had banked on to facilitate renewal of their leases will be only available to a limited extent. A "cliff" may form for 99-year leasehold properties that are relatively older as buyers become reluctant to pay good money for an uncertain outcome. As the Singapore society ages, the need to liquidate assets in the savings portfolio to fund retirement becomes more acute. As housing is a large proportion of this savings portfolio, the consequences must be substantial and negative.
- Fifth, what will be the impact of increasing integration with Johor? If access to Iskandar becomes more seamless over time – as seems likely - more Singaporeans could opt to live in more affordable housing developments in Iskandar while commuting to Singapore for work. Iskandar's attractiveness could grow in the near future as development continues – it is assembling more of a diversified economy including manufacturing, transportation, logistics, education, and medical services.

We also need to remember that one reason for high property prices in Singapore is that buyers have been happy to pay the "Singapore premium", a premium that arose out of Singapore's high growth, political stability, superior policy making, high quality of life and a business environment that gave investors a better return on capital than in competing localities. That meant that Singapore assets including property deserved a premium price. But can this premium pricing of Singapore assets last in the context of rising costs eroding competitiveness, weak productivity and innovation efficiency and policymaking made more difficult by a more complex world of technological disruptions?

Much hinges on government policy

Three important dimensions of government policy will affect the property market outlook.

- First, the macroprudential measures imposed on the property market will probably remain in place for some time yet, with occasional tweaks. Substantial easing will only come if property prices fall sharply.

- Second, the Government's immigration policy will play an important role on the demand side. The most likely scenario is that immigration will likely be at a much slower pace than in the 2000s as societal strains stemming from stretched public infrastructure including housing and public transport spill over into political pressures.

- Third, long-term economic policies for the Singapore economy will hold the crux to the sustained prosperity of the island city-state. Singapore needs to stay special in order to preserve its role as a pre-eminent global hub. This means that Singapore needs to play host to new and rising industries while reining in the cost of doing business such that this city-state remains an attractive location for business and investment, as well as to live, play and work in. Maintaining the Singapore "premium" means that infrastructure, efficiency and expertise must be top-notch. If we are able to do so, this "premium" will feed into a "premium" in the housing market too.

The bottom line

Property in land-scarce Singapore will likely remain a good store of value. Cultural norms of owning one's primary residence will also support housing demand. In the short run, Singapore could enjoy a cyclical rebound driven by improving sentiment - especially if the government decides to lift the cooling measures. Pent-up demand and optimistic expectations of a housing boom could drive a cyclical rebound.

That said, it would be prudent to remember that gravity exists: Without sound macroeconomic drivers supporting the recovery, the cyclical upturn in private property prices might be short-lived before reverting to a more subdued path. This is likely to be the long run scenario which we envision, given that economic growth in Singapore would be structurally lower as we grapple with demographic changes and structural constraints.

Prepared by Manu Bhaskaran
Centennial Asia Advisors