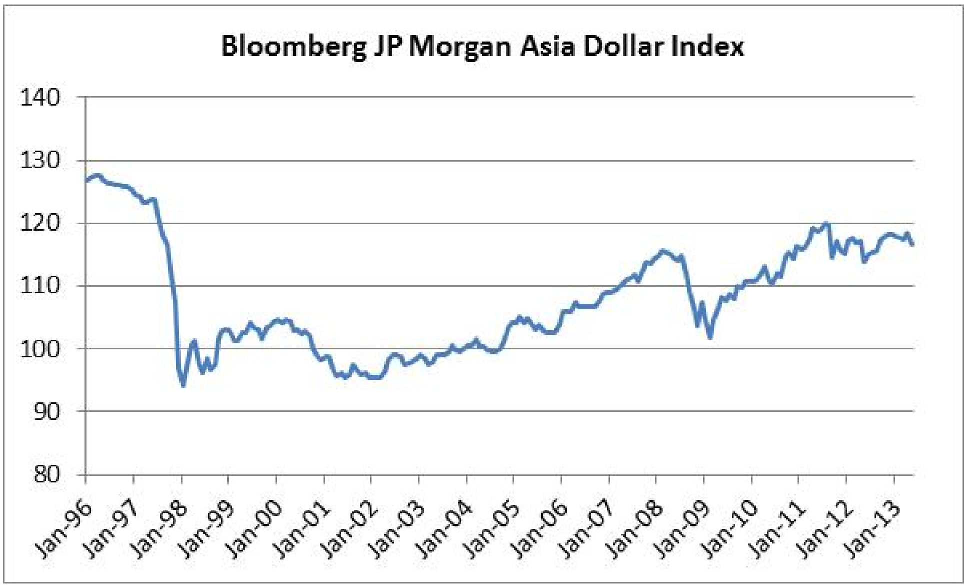
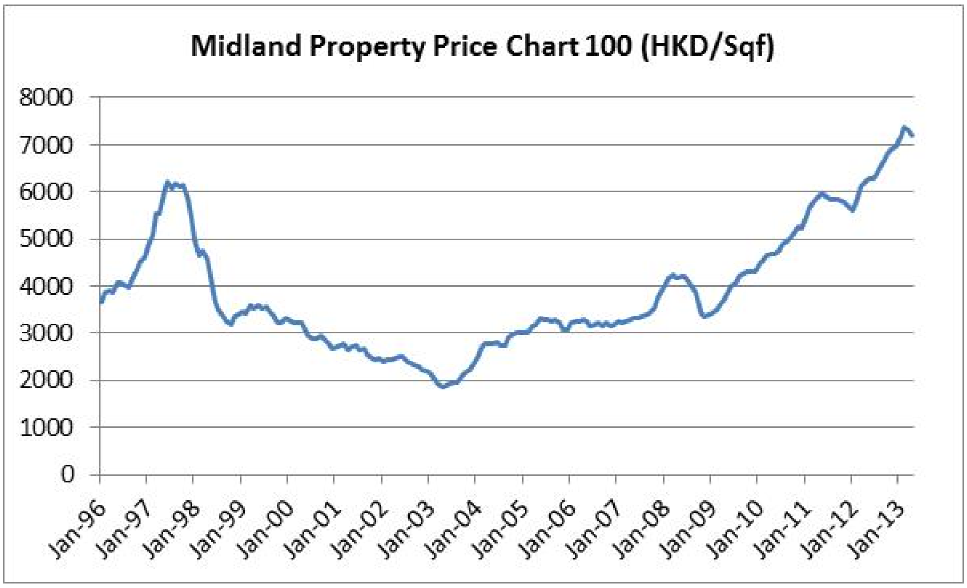
Hong Kong is very unusual in that its currency is explicitly linked to the US dollar. In practical terms, this means that Hong Kong imports the monetary policy of the United States. As can be seen below, 3m Hibor (HK Libor) and 3m Libor (US) generally follow each other.

Intriguingly, we can see that in the late 90s interest rates in Hong Kong moved meaningfully higher than those in the US. This was a period of US dollar strength, and Asian currency weakness and investors were worried that HK may choose to devalue its currency as many other Asian nations did at the time. In the period from 2003 onwards we can see that interest rates in Hong Kong were lower than in the US. This was a period of a weak US dollar and strong Asian currencies and the markets believed it was possible that the HK dollar might revalue upwards its currency (or repeg to the rising Chinese yuan). I was intrigued to note that recently Hong Kong interest rates have moved above US rates again.

I suspect this move in interest rates is reflecting the stagnation in Asian currencies versus the US dollar as reflected in the Bloomberg JP Morgan Asia Dollar Index.



While the US has a large number of home owners in negative equity and still high unemployment, Hong Kong has neither of these problems. In fact Hong Kong property prices have surged off the post financial crisis lows to new highs.



To put this into perspective, the Hong Kong Monetary Authority reports that the average size of a new mortgage loan in HK is now HKD 2.77m (USD 360,000) with an average loan to value of 53.5%. This implies that buyers are also supplying a deposit on average of HKD 2.44m (USD 310,000). On my calculations GDP per capita in HK is roughly USD 35,000. So property prices for new loans are on average 19 times per capita income and the deposit is nearly 9 years of income. This would be suggestive to me that the Hong Kong property market is not driven by first time buyers.

To my mind, the risk reward in Hong Kong property looks poor. Just as the US homebuilder stock prices peaked in 2006, before the housing crash was apparent, the Hong Kong Property index has failed to pass its 2007 high despite strong property prices in HK.

Should the US tighten rates, or the market begins to fear Asian currency weakness and demand a premium from Asian borrowers then Hong Kong property looks very exposed. This area looks good for shorting in my view.

Information

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