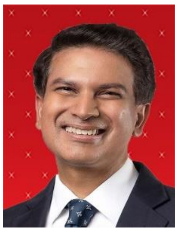
Macro Insights Weekly

High rates and property prices

Group Research

June 24, 2024



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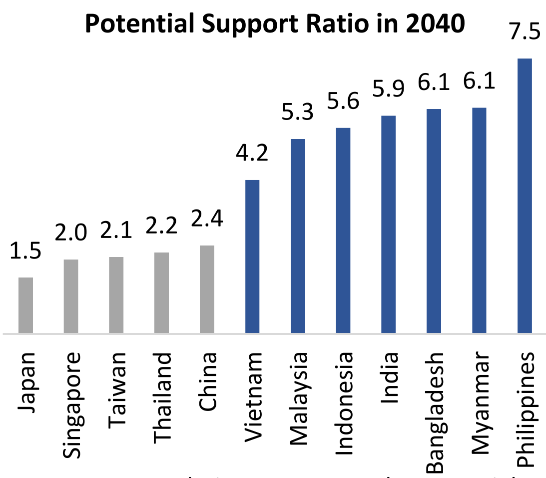
- *From Australia to India to Singapore to the US, the much-feared property market adjustment under the weight of some of the highest rates seen in decades has not materialised. What gives?*
- *In many industrial economies, deleveraging since the GFC has made debt service more manageable.*
- *Strong jobs and wage growth have underpinned affordability and confidence.*
- *Tight housing supply, immigration, and equity market rally have helped property demand as well.*
- *Some economies have property sector stress, especially China, Hong Kong, and South Korea.*
- *But for most markets, favourable dynamics appear here to stay for a while.*

Chart of the Week: Demographics divergence

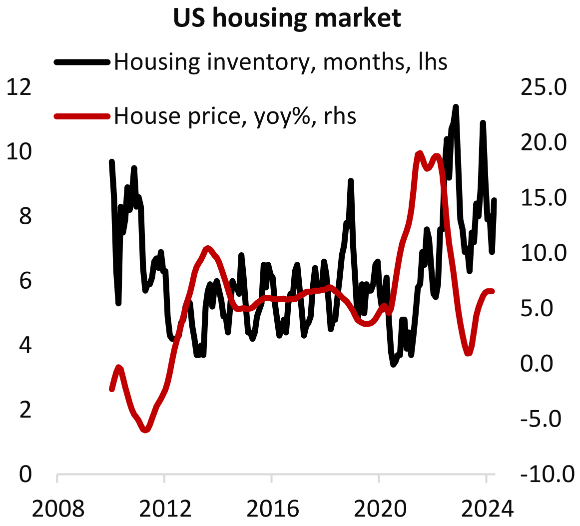
Asia's population dynamics are highly heterogenous. Many nations are aging, and many will remain young for years and decades. As per the projections of UN Population Prospects, more people in Asia will live in countries with favourable dependency ratio in 2040 than with those that don't. Projected support ratio looks worrisome for China, Japan, Singapore, Taiwan, and Thailand. For the rest, there will be plenty of workers per elderly heading into the middle of the century.



Soucrce: UN Population Prospects. The potential support ratio is the number of adults (ages 15–64) per one elderly person (ages 65+)

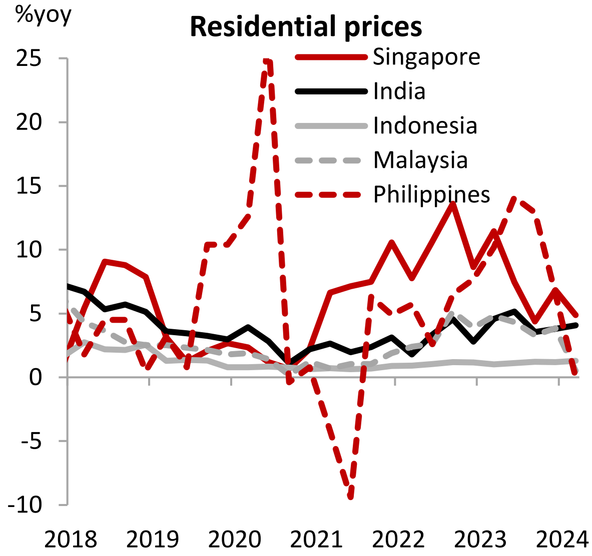
Commentary: High rates and property prices

Property prices in most major markets are defying high interest rates. US home prices are up about 6.5%yoy, reaching an all-time high last month. From Australia to Portugal, India to Singapore, the much-feared property market adjustment under the weight of some of the highest rates seen in decades has not materialised. In places like India and Malaysia, the markets appear to be downright buoyant. Even the Philippines, where home price growth has reached 0%yoy lately, there has been no instance of price decline in this cycle.



Source: CEIC, DBS. Data through April 2024

Multiple factors are contributing to the markets' sustained resilience. First, post-GFC deleveraging has pushed down household debt/GDP ratio substantially in a number of industrial economies, ranging from the US to UK to Spain. In these economies, even as interest rates have risen, debt service ratios have been manageable. Second, the rate hike cycle is only in its third year, with many households with existing mortgages yet to feel the pinch of the higher rates thanks to their fixed rate term loans. Third, with a tight labour market and booming equities, income growth has been strong, giving some the confidence to take on higher rates. Finally, in some countries, especially the US, a pick-up in immigration has helped boost demand for housing. Housing inventory is also tight, compounding the supply side of the narrative.



Source: CEIC, DBS

The situation is not comfortable everywhere; here in Asia, China, Hong Kong, and South Korea's real estate markets remain under pressure, with home prices declining through the first quarter. China continues to grapple with a historic boom-bust cycle, with numerous supportive measures implemented so far yet to turn the market around. Hong Kong and South Korea are suffering from high interest rates and high debt burdens. For these two economies, Fed policy rate cuts are keenly awaited, but the wait seems to get longer and longer.

We don't think the still-buoyant property markets around the world can remain oblivious to high rates if monetary policy tightness sustains through next year. For the coming quarter or two though, favourable dynamics appear to continue, much to the frustration of some central banks.

Taimur Baig

FX: US inflation and elections in Europe

We do not rule out the USD's appreciation in the first half of the year reversing in the second half. **Fed** Chair Jerome Powell **may start paving the ground for its first interest rate cut in 3Q24** when he testifies before the US Senate Banking Committee on July 9. More Fed officials see US inflation falling in the second half of the year and do not consider it necessary for inflation to hit the 2% target before removing top level policy restriction. Friday's US PCE deflators should mirror the slower CPI inflation a fortnight ago. Consensus expects headline inflation to slow to 0% MoM (21.6% YoY) in May from 0.3% MoM (2.8% YoY) in April and the core deflator to 0.1% MoM (2.6% YoY) from 0.2% MoM (2.8% YoY).

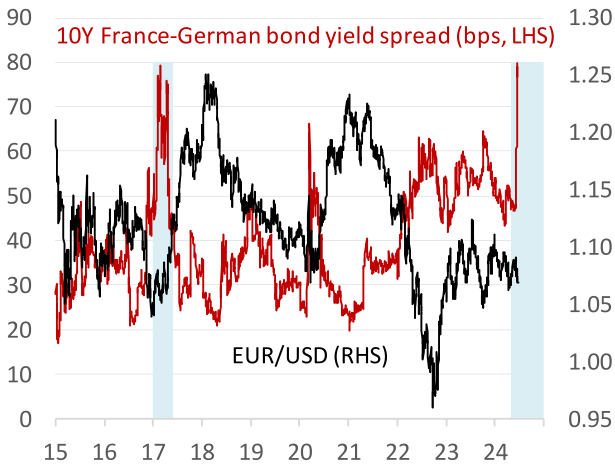
Fed officials were more attentive to the higher unemployment rate at 4% in May. They see monetary policy working to slow consumer spending and forcing retailers to lower prices. Hence, stay alert to a drop in the US Conference Board's Consumer Confidence Index on June 25, especially after the University of Michigan's Consumer Sentiment Index fell a fourth month to a seven-month low of 65.6 in June.

GBP/USD depreciated for a third week by 0.3% to 1.2645 last week. Although UK CPI inflation hit the 2% target in May, the Bank of England did not lower rates at its meeting on June 20. Core and services inflation remained lofty at 3.5% and 5.7%, respectively. According to the Decision Maker Panel (DMP) survey in the three months to May, UK businesses expected the frequency of services price increases to normalise further over the course of this year.

Polls predict a historic victory by the opposition Labour Party at the UK snap elections on July 4. However, the election appears more about a referendum against the ruling Conservative party than one of popular support for the opposition. Labour needs to overcome the fiscal constraints standing in the way of its promise of a British rebirth and renewal. Labour Party leader Keir Starmer has ruled out reopening the Brexit debate, but Brussels was hopeful of better relations with London under him.

EUR/USD faces downside pressure in the lower half of this quarter's 1.06-1.09 range. The polls do not rule out the far-right National Rally (RN) party winning a majority in the French snap elections that will be held in two rounds on June 30 and July 7. RN leader said he would not become prime minister if his party and allies did not win an absolute majority. The next government is set to clash with the European Commission, which launched an "excessive deficit procedure" against France for breaching fiscal deficit and public debt rules.

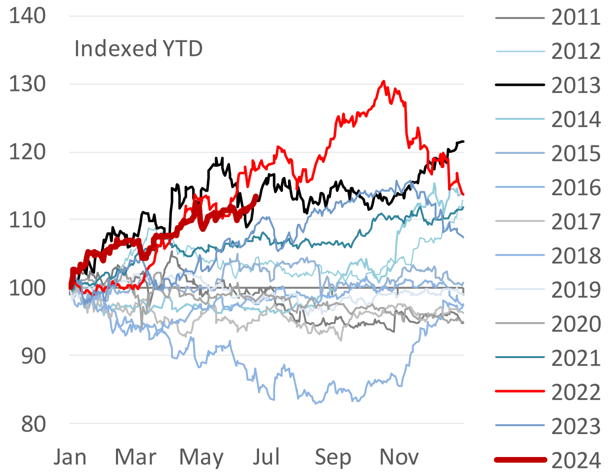
EUR/USD vs. French risk premium



Sources: DBS Research, Bloomberg data

The outcome of the French elections will be of significant interest to the European Central Bank at its forum on central banking in Sintra during the first week of July. Despite fears of France exiting the EU or ending up with a gridlock government, 2017 demonstrated that the EUR could recover quickly if the 10Y yield differential between French and German bonds pulls back after widening to 80 bps.

USD/JPY looks high on a YTD basis



Sources: DBS Research, Bloomberg data

USD/JPY rose 1.5% to 159.80 last week, its highest close since April 1990. On June 20, the US Treasury Department (USTD) added Japan to the currency monitoring list. However, the **USTD clarified that the decision was not attributed to Japan's interventions in April-May to prop up the JPY** but for meeting two of the three mechanical criteria, i.e., a bilateral trade surplus of USD62.4bn (vs. USD20bn criteria) with the US and a current account surplus of 3.5% (vs. 2% criteria) of GDP in 2023. The USTD considered Japan to be transparent in its forex operations, i.e., the recent interventions were carried out after the Washington-Tokyo-Seoul joint statement to consult closely on forex. All said, **USD/JPY looks toppish on a year-to-date basis.** The third quarter could see the Fed paving the way for rate cuts alongside the Bank of Japan hiking rates again and reducing JGB purchases.

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Sources: Data for all charts and tables are from CEIC, Bloomberg and DBS Group Research (forecasts and transformations)

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