How well do Singapore homes really hedge against inflation?

They appear to hedge well during high inflation and over long term but caveat is property prices are cyclical

By Fiona Lam
fiolam@sph.com.sg

ALTHOUGH residential properties in Singapore may potentially serve as an inflation hedge in the long run – that is, over at least a decade – investors should still bear in mind the likelihood of shorter-term periods when home prices are falling while inflation soars.

Furthermore, purchasing homes when market prices are at fresh highs can bring mixed results when it comes to real returns, according to an analysis by the Institute of Real Estate and Urban Studies (IREUS).

The research institute took a comprehensive look at longitudinal data to examine how the residential segment has performed vis-a-vis inflation. It compared the movements of price indices of Housing Board (HDB) resale flats and private housing as well as core inflation, which excludes accommodation and private transport costs.

Investors have long viewed residential assets in the Republic as a good hedge against inflation. Given the scarcity of land, many buyers expect real estate prices to rise indefinitely over the long term, buttressed by the premise that home values should outpace inflation, IREUS noted.

Singapore homes have also continued to appeal to investors lately, amid intensifying external inflationary pressures due to the Russia-Ukraine conflict and the regional Covid-19 pandemic situation.

Going by IREUS's analysis, at the macro level, it appears that both the private residential and HDB resale markets hedged well during periods of high inflation and over the long term.

However, the caveat here is that property prices are cyclical. Upticks and plunges can be observed when drilling down into the data.

The picture may not be entirely rosy when inflation continues to trend upwards while the housing market is in a slump.

For instance, from Q3 2013 to Q2 2017, the Urban Redevelopment Authority's (URA) price index for private residential property declined by 11.6 per cent. In contrast, core inflation was 4.4 per cent in the same period.

The downturn for the HDB resale segment stretched from Q2 2013 to Q2 2019, with the price index losing close to 12.5 per cent, whereas core inflation was near 8 per cent.

Lee Nai Jia, deputy director of IREUS at the National University of Singapore, noted that the dynamics of the residential market are determined by many factors, including government policies, and property market prices may diverge from core inflation.

"Hence, we may have a situation where home prices are dropping while inflation continues independently on its upward trajectory. Buyers thus need to have the holding power to wait out till the market recovers," he added.

Holding a property comes with recurrent costs such as taxation, as well as maintenance fees and the cost of vacancy for homes on the rental market.

Inflation in Singapore has been largely stable over the years, barring global economic shocks. Core inflation averaged at about 1.2 per cent every year from 2012 to 2021. Over the same period, the average annual return was roughly 1.7 per cent for private housing and 1.4 per cent for HDB resale flats, according to the respective price indices.

2012

The highest core inflation recorded over 2012 to 2021 was at a new peak of 2.5 per cent in 2012. This came as wages rose, which in turn catalysed inflation, amid strong labour demand to drive business expansion as well as a more restrictive foreign labour policy.

The same year, housing also became pricier – and at a faster pace. The URA private residential price index for Q4 2012 increased by 2.8 per cent year on year, while the HDB resale price index climbed 6.5 per cent.

2007, 2008

A similar build-up in inflation was observed towards the end of 2007 and into 2008. Disruptions in imports from major food sources and higher oil costs had driven inflation up in 2007. On an annual basis, core inflation hit 2.2 per cent in 2007 and jumped to 5.7 per cent in 2008.

Nonetheless, the residential market rose more quickly than inflation. In Q4 2007, private home prices soared 31.1 per cent year on year, and HDB resale flat prices gained 17.5 per cent.

However, in Q4 2008, the private residential index fell by 4.7 per cent year on year due to the global financial crisis, IREUS said.

Buying at historic highs

Properties purchased at the peak of a cycle may not necessarily hedge well against inflation, depending on the market conditions.

Prices of private homes last peaked in Q3 2013, before the total debt servicing ratio framework was introduced. If those who bought in 2013 were to sell their private properties today – with market prices at an all-time high – the URA price index suggests that they would likely make an accumulated return of 13 per cent, IREUS said. That exceeds core inflation of about 10.9 per cent recorded over the same period.

However, HDB flat owners who had bought during the resale price index's previous high in Q2 2013 may not be better off selling today. If those buyers had sold their resale flats in Q1 2022, they would have earned a return of about 6.8 per cent over the period. That did not outpace core inflation, which hit 11.6 per cent, implying that the flat owners' real return would have been negative.

On the other hand, an earlier cycle showed reversed outcomes. HDB flat owners who bought their properties at the peak in Q4 1996 and then sold in Q2 2013 were likely to earn a healthy return after adjusting for inflation.

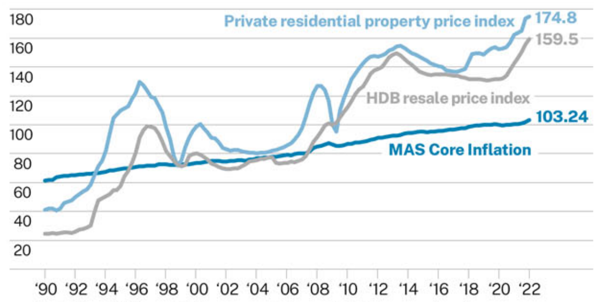
In that cycle, the accumulated return based on the HDB resale price index was 50.9 per cent, surpassing the 29.3 per cent core inflation over the same period.

The private residential market, in contrast, performed poorly. The accumulated return from Q2 1996 to Q3 2013 was 19.2 per cent based on the URA price index, falling behind core inflation of 31 per cent. That said, the returns for owners of private homes may be underestimated in this case, as many could have sold their units en bloc, especially during a collective-sale boom.

Dr Lee noted that while the housing price indices provide a guide to understand how well residential properties can hedge against inflation, they are nonetheless generationalisations that cannot capture all the multifaceted dimensions of property ownership, such as the depreciation from ageing buildings and expiring land leasehold tenures.

"Hence, older residential properties with shorter leases may not hedge as well as a new or freehold property, unless the buyers are anticipating potential gains from en bloc sales," he said.

Housing prices and core inflation



Note: Core inflation excludes accommodation and private transport costs

Sources: HDB, URA, MAS, SingStat