NAME: ______________________________ CLASS: ________________

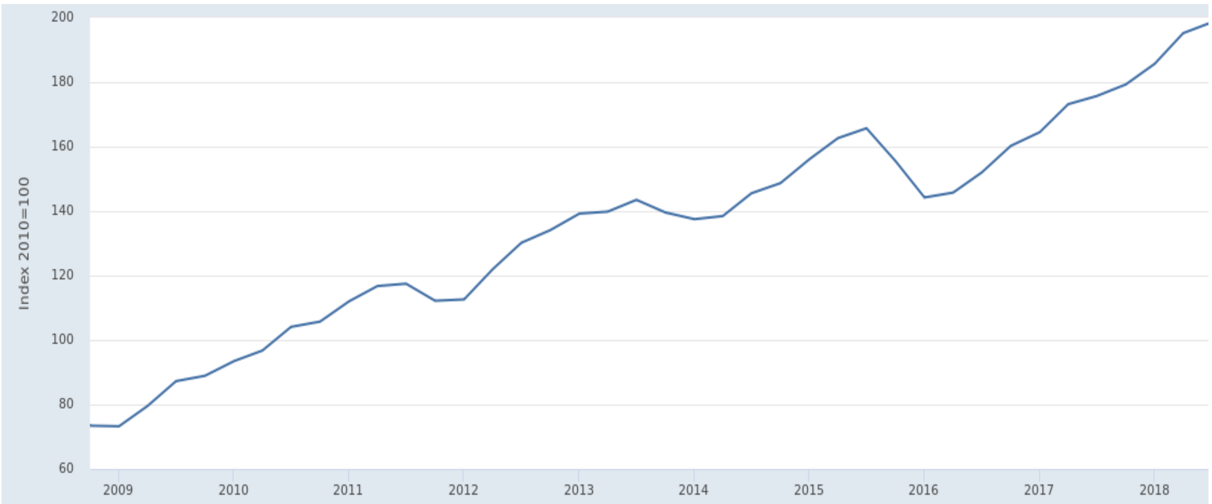
Raffles Institution
Year 5 H2 Economics 2024
T2W8 – Class Test 2 (Tuesday)
Price Mechanism and Firms (Part 1)

/ 20

You have 45 minutes to complete the case study.

Question: The Housing Market in Hong Kong

Figure 1: Hong Kong Private Property Price Index



Source: Federal Reserve Bank (St. Louis)

Extract 1: Key Drivers in Hong Kong's Housing Market

Some of Hong Kong's deplorable living conditions such as "coffin homes" have recently gained much attention in international media. Coffin homes are tiny subdivided units, some so small that a person cannot even fully stretch out their legs.

Despite this, buyers are still enthusiastic about entering the market. Externally, the slowing pace of interest rate rises in the US has benefited Hong Kong's housing market; while internally, strong income growth and low unemployment seem to have raised demand for residential properties. Speculative activities have also contributed to the strong market demand. Many residents consider owning a home a top priority, and are willing to set aside a large chunk of their income to achieve it.

Source: Various

Extract 2: Evolving Market Structure in the Hong Kong Property Market

Some analysts commented that the entry of cash-rich Chinese property developers marks the end of a Hong Kong property market dominated by a few local giants. Raymond Kwok, chairman of Hong Kong-based Sun Hung Kai Properties highlighted that he is not worried about fierce competition from mainland Chinese developers, and many rating agencies agree as these property developers are forecasted to be most able to withstand this competition given their huge market share. One reason is due to their cost advantages over other foreign developers, including the long-term contracts that allow them to purchase materials at lower cost, and the larger land reserves that they hold as collateral.

Source: Various

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Extract 3: Constraints facing Property Developers

Hong Kong property developers are feeling the pinch recently. According to the former head of the Hong Kong Monetary Authority, the government has failed to increase land supply. This has driven up land costs, leading to developers setting unaffordable home prices. The government owns most of the land in Hong Kong and releases sites in phases based on population growth projections.

Skilled construction workers are also in shortage in Hong Kong. The average construction cost in Hong Kong amounted to US$3,704/m^2 in 2017, up 6.2% year-on-year, according to global project manager, Turner and Townsend. Labour was the single largest driver of inflation in building construction costs, with the average hourly wage in Hong Kong rising to US$15 per hour, up 25% year-on-year.

Source: Various

Extract 4: Solutions to escalating prices

Hong Kong's dubious honour of having the world's highest priced property puts private home ownership beyond the reach of many. Instead, public housing is the main choice for young low-income couples, the elderly, and singles hoping to purchase a flat. However, there is a severe shortage of such homes. Public housing is highly subsidised by the government. They currently house about 3.3 million people - 44.7% of Hong Kong's population. There are several schemes to purchase public housing such as price controls or direct subsidies, but with about 268,500 applicants on the waiting list, it can take more than five years to get a flat.

A number of civil servants are against the idea of the proposed schemes to help residents struggling with a booming private housing market, saying they would backfire and only worsen the city's problems. Instead, the government has pledged to increase land supply for the construction of new public flats.

Source: Various

Questions

(a) Using examples from the case material, explain the difference between fixed costs and variable costs. [4]

(b) With reference to **Extract 2**, explain one type of economies of scale experienced by Hong Kong's real estate developers. [2]

(c) With use of relevant elasticity concept(s), account for the sharp increase of housing prices in Hong Kong. [4]

(d) Discuss whether price controls or direct subsidies is a better policy to respond to rising housing prices in Hong Kong for low income households. [10]

[Total: 20 Marks]