Research & Strategy

Asia-Pacific property market overview Q2 2019

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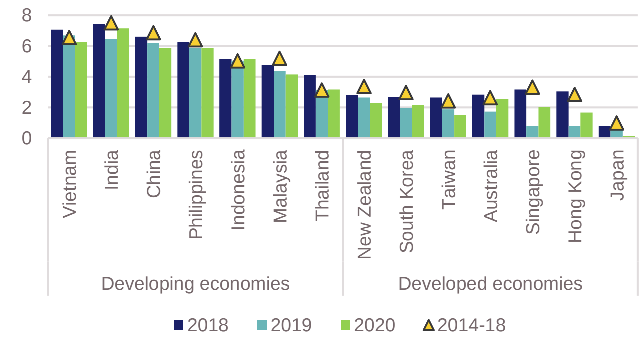
Economy and politics

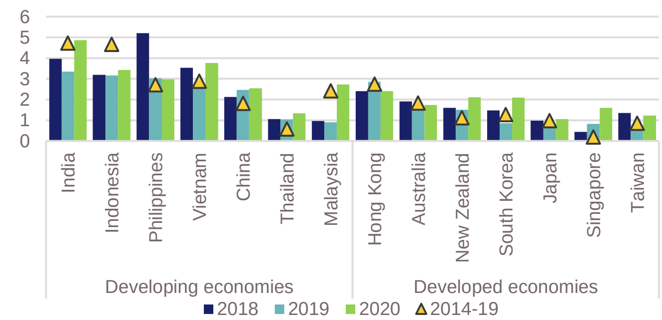
- Asia-Pacific's economic growth remained subdued in Q2 2019 amid a protracted US-China trade conflict. Regional PMIs also reinforced this view, with most markets posting continued monthly declines based on Trading Economics data. Consensus Economics revised down its 2019 Asia-Pacific GDP growth forecast by -0.1% to 4.4% from the previous quarter, with many markets set to record an economic slowdown from 2018 (figure 1).
- In view of the anaemic regional economic performance, a larger-than-expected slowdown in China's economy and its impact on regional trade links, several governments (Australia, New Zealand, Philippines, Malaysia, South Korea, India and Indonesia) have already introduced rate cuts, which preceded the US Federal Reserve cut of 0.25 percentage points in late July 2019.
- As the US-China trade conflict continues to unfold, uncertainty and de-coupling of the global economy remains a key theme for investors. The escalating trade conflict continues to constitute a key downside risk to the economic outlook and, according to Capital Economics, would have a larger impact on trade-dependent countries such as Singapore and Hong Kong.
- Rising populism has led to a backlash against the prevailing world order. Recent large-scale protests in Hong Kong against a proposed bill allowing extradition to China have morphed into a broader pro-democracy uprising that, according to Focus Economics, is poised to hurt business and consumer sentiment as civil unrest could deter private investment. Oxford Economics predicts that Hong Kong's GDP growth will slow to 0.8% in 2019 from 3.1% in 2018.
- Against the backdrop of rising global economic uncertainties and slower economic growth, the second half of 2019 could potentially see further rate cuts. In the absence of an inflationary environment in 2019 (figure 2), Oxford Economics expects two US rate cuts in Q3 2019 and another in Q1 2020 to cushion the impact of escalating trade conflicts while bolstering economic growth in the region.
- The global supply chain is facing disruption, with leading indicators pointing towards a sharp deterioration in economic sentiment (figure 3). In addition to the trade conflict between the US and China, Japan is also embroiled in a trade dispute with South Korea due to a long-standing political disagreement that stems from Japan's conduct during World War II. Global uncertainties have also forced investors to take on a risk-off mentality, with investors rushing for safe-haven assets such as gold and Japanese yen.
- Subsequently, observers expect the Japanese economy to see slower corporate profits on the back of a strong yen as well as slower GDP growth for both Japan and South Korea. To counter this as well as the impact of a scheduled consumption tax hike in October 2019, the Bank of Japan may undertake additional Japanese government bond purchases should the macro outlook deteriorate further.
- In Australia, economic growth appears to have remained subdued in the second quarter after feeble domestic demand weighed on the economy in Q1. Anaemic retail sales, an uptick in the unemployment rate and house prices that continue to fall all point to ongoing weak performance in terms of private consumption, while survey-based data signal downbeat investment activity, according to Focus Economics.

Figure 1: GDP growth (% per annum)



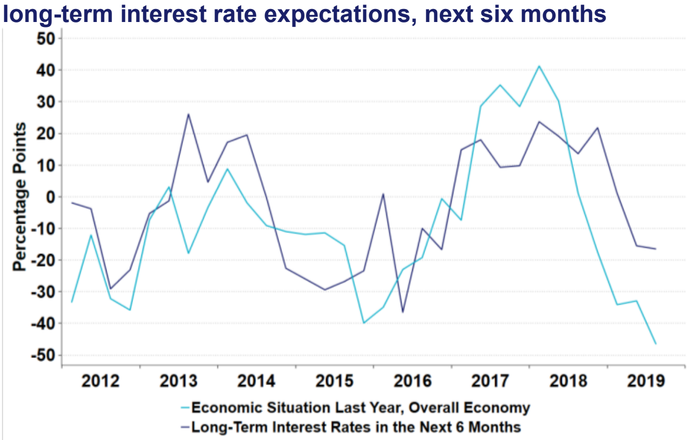
Source: Oxford Economics
Note: 2019 and 2020 values are forecasts as of August 2019.

Figure 2: Inflation (% per annum)



Source: Oxford Economics
Note: Forecast figures are CPI; 2019 and 2020 values are forecasts as of August 2019.

Figure 3: Asia-Pacific Economic sentiment index and long-term interest rate expectations, next six months



Source: Macrobond

Property demand drivers

Office

- Amid heightened tensions, solid fundamentals are still supporting office demand, as the regional aggregate vacancy rate continued to decline in Q2 2019. Based on preliminary PMA data, the regional office vacancy rate for developed markets dropped to 6.9% this quarter from 7.0% in Q1 2019 (7.8% y/y), still below the 10-year average of 8.4%. Meanwhile, the developing markets (Shanghai, Beijing and Kuala Lumpur) continue to post rising vacancy rates (figure 4).
- Looking to the key developed markets, Hong Kong and South Korea posted marginal increases in vacancy rates q/q even though PMA data showed a drop in the annual vacancy rates of these countries. Net absorption in Hong Kong recorded -165,000 sq ft (-15,300 sq m), reflecting negative net absorption for the first time in three years as occupiers look to vacate the central business district (CBD). According to CBRE, weak demand and new office supply resulted in higher vacancy rates in Seoul (+0.2% q/q or -0.3% y/y), and this trend is set to give rise to further increases in vacancy going forward.
- According to JLL, financial services, professional services and tech firms stood out as key demand drivers, while flexible space operators are still a notable source of leasing across the region. The firm predicts sustained occupational demand that will remain broad-based, with continued leasing activity dominated by the tech and the financial services sectors as well as flexible space operators.
- PMA projects that office demand will increase another 4.4% y/y, amounting to 28.3 million sq ft (2.6 million sq m) in take-up by the end of 2019, supported by pre-leasing activity. In quarters to follow, the ongoing escalating trade conflict should have an impact on business sentiment, underpinning a decline in net absorption of 25.5 million sq ft (2.4 million sq m) in 2020 (figure 5).

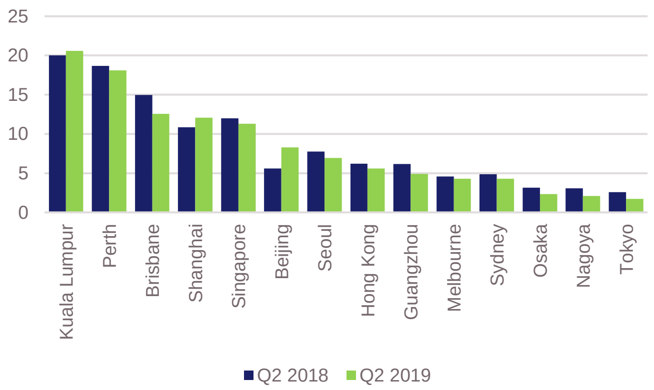
Retail

- The retail market continues to remain challenging on the back of modest retail sales growth in most Asian markets, according to Trading Economics data. The volatility of Asian financial markets has impacted consumer confidence and spending. A cooling housing market in both China and Australia has led to slower retail demand, while the near-term spending outlook in Japan is clouded by the scheduled consumption tax hike in October 2019.
- The food and beverage sector and mass-market retailers are currently driving leasing demand. Luxury retailers by contrast are focused on optimising their current store footage and are not expanding. Tourism remains a key driver of demand for prime retail space in Tokyo, Sydney and Melbourne, while other markets such as Singapore and Hong Kong are still recording lacklustre demand.
- Anecdotal evidence has also shown that some e-commerce companies are merging their online and high street presence by opening physical stores for brand building as part of their omnichannel strategy.

Logistics

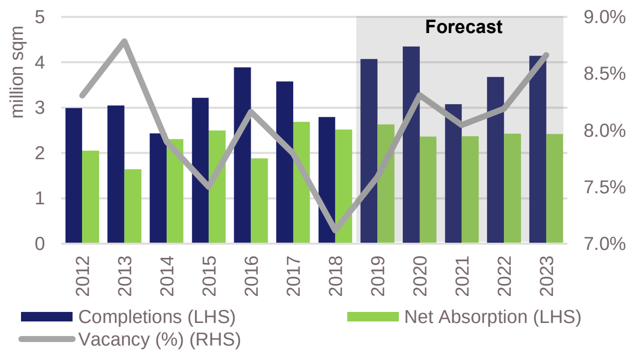
- Occupier demand is strong across Asia as vacancy rates continue to decline. According to PMA, growth in demand is coming from third-party logistics, e-commerce retailers and manufacturers. Nevertheless, a disruption in the global supply chain owing to the trade war between the US and China may result in slower demand for logistics space in the medium term.

Figure 4: Office vacancy rates as at Q2 2019 (%)



Source: PMA

Figure 5: Asia-Pacific prime office demand and supply forecast



Source: PMA

Property supply measures

Office

- In view of healthy office occupier demand, PMA expects new office completions across the region to increase 46% y/y to a total of 43.8 million sq ft by end-2019. Most new supply will be largely concentrated in the developing markets of Shanghai, Beijing, Guangzhou, Shenzhen and Kuala Lumpur, which account for 67% of the development pipeline.

- Gateway markets in Tokyo, Sydney and Melbourne currently have a significant amount of space under construction, but according to PMA low vacancy rates and favourable demand-side momentum mean conditions will remain reasonably healthy. Based on their data, PMA expects new supply in these gateway markets to fall from 2021 onwards, especially in Tokyo and Melbourne.
- While experts anticipate low levels of new supply in other developed markets such as Brisbane, Perth, Hong Kong and Singapore over the next few years, Seoul is proving an exception, as a strong supply spike is likely in 2020 (figure 5). Much of the new space will have its origin in a particular development (Parc1) in the Yeouido Business District, and PMA has pointed out that this is unlikely to influence conditions in the CBD and Gangnam business district GBD.
- Chinese Tier 1 cities (Shanghai, Beijing, Guangzhou and Shenzhen) will continue to see large quantities of new space hitting the market in the next few years. Construction cycles in Guangzhou and Beijing particularly appear to be accelerating, which does not bode well within the context of slowing national and local economic growth.

Retail

- There are diverging retail market trends across the region as well. Supply tends to be focused on primary locations as retailers are looking to shutter unprofitable outlets. As e-commerce continues to grow, developers across the region are gradually shifting their focus away from new retail projects.
- In Japan, forecasts indicate that national shopping centre completions will remain low to moderate over the next five years, with conversion of underperforming department stores likely. According to PMA, Australian shopping centre vacancies also remain low overall, with larger/suburban occupancy holding up better and indications of modest rates of new development over the next five years (greater than 9% of total stock).

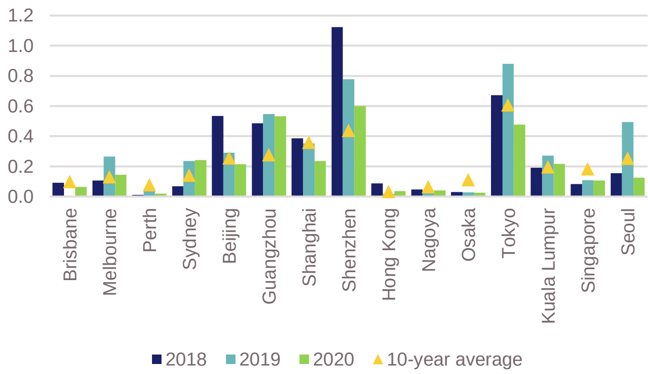
Logistics

- The rapid rise in e-commerce continues to fuel robust demand for logistics facilities, which is being met with high levels of new supply in most markets, according to PMA. Although most of the space is build to suit, speculative supply has also seen a considerable increase, as returns in the other sectors remain modest. PMA predicts a high risk of vacancy upon lease expiries across the region, leading to obsolescence and higher vacancy of secondary space.

Rental levels and growth expectations

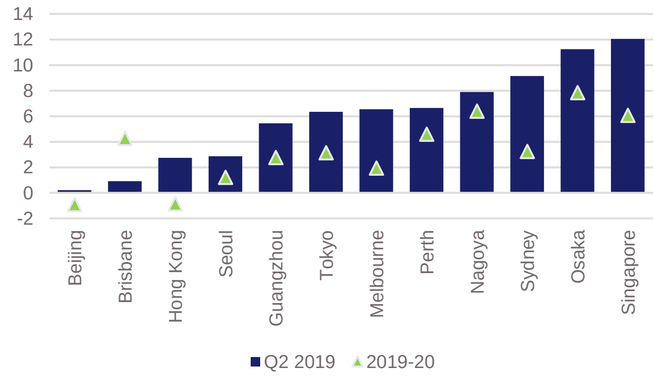
- The JLL Asia-Pacific Office Rental Index rose 3.8% y/y in Q2 2019, down from Q2 2018's 4.4% y/y. According to data provided by PMA, effective prime rental growth was the strongest in Singapore (+12.0% y/y), Osaka (+11.2% y/y) and Sydney (+9.1% y/y) in the second quarter, reflecting the supply-demand imbalances in these markets (figure 7). Nevertheless, PMA projects that prime rental growth will be cut in half, down to 2.3% y/y in 2019 from 4.5% y/y in 2018, on the back of significant new speculative supply in tier 1 Chinese cities and Kuala Lumpur as well as a slowdown in the global economy.
- According to JLL, experienced landlords in the Asia-Pacific retail markets are trying to differentiate themselves from the competition through unique products and services and by targeting niche consumer segments. There has been generally modest rental growth across the region. Observers expect rental growth to remain weak and to fail to keep pace with inflation in most markets.
- Willing occupiers are snapping up new modern logistics space as soon as it hits the market, even though consistent new supply is limiting market rental growth to inflationary levels, according to PMA. In view of the unfolding uncertainty surrounding the external trade environment, PMA projects that prime logistics rental growth will slow to 3.0% y/y by the end of 2019 from 4.6% y/y in 2018.

Figure 6: Office supply across Asia-Pacific markets over the next two years (million sq m)



Source: PMA

Figure 7: Prime office rental growth performance as of Q2 2019 and expectations for 2019-20



Source: PMA

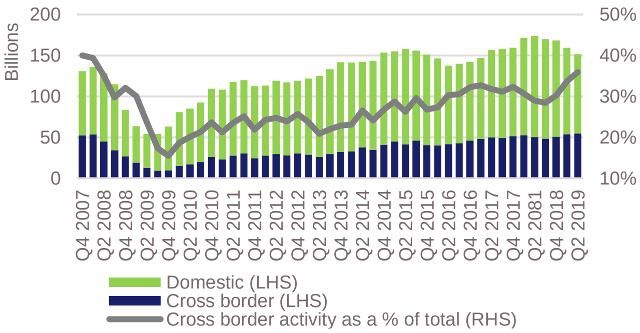
Weight of money and yields

- Data from Real Capital Analytics (RCA) continued to show declining annualised Asia-Pacific investment volumes in Q2 2019 for the second consecutive quarter. Annualised Asia-

Pacific investment volumes for income-producing assets amounted to USD 151 billion, down 4.9% q/q or 12.7% y/y.

- Accelerating property prices have made for a challenging investment environment during the current cycle. Some buyers' reluctance to acquire assets at current asking prices combined with the slashing of GDP growth forecasts has likely cooled the market.
- According to RCA, quarterly volumes fell to the lowest levels in a decade in both China and Japan in Q2 as domestic and cross-border investments dried up. Australia and Singapore proved more resilient to the pressures of trade war, sluggish exports and weakening global economic growth, which weighed on real estate investment elsewhere in the region.
- Cross-border activity in the region continues to defy falling investment activity, a reflection of investors moving up the risk curve in search of yields outside their domestic markets (figure 8). Cross-border acquisitions rose 1.5% q/q or 8.6% y/y in Q2 2019. In Singapore, volume surged on the back of cross-border capital inflows while Australia recorded 13% y/y growth in investment volume, driven by consolidation of ownership and a handful of large domestic deals.
- Nevertheless, elevated geopolitical tensions, trade protectionism, capital protection measures, populism and economic risk could impair real estate investment decisions in the Asia-Pacific region. JLL forecasts that investment volumes will decline 5%-10% this year.
- RCA has noted that more capital is headed to the key gateway markets in the Asia-Pacific region, which likely indicates more risk aversion on the part of investors. According to RCA, 69% of the capital deployed in the region in Q2 2019 was allocated to eight of the largest Asia-Pacific markets, the highest share since 2011 (figure 9).
- RCA has also observed an upwards shift in office yields in some markets. The RCA Hedonic Series shows that Hong Kong was the first market in which yields began to rise. Office yields have moved out by 35 basis points from a year ago to reach 2.6% in Q2 2019 (figure 10). Yields in Seoul and Melbourne have followed the trend. Office yields in Seoul have increased by 10 basis points and by 15 basis points in Melbourne.
- In view of escalating risks, slower economic growth and regional central banks' potential quantitative easing in order to boost economic growth, yields are set to remain low in the near term in general. However, yields may also rise in markets that are expected to face sharper economic slowdown, such as Hong Kong, as those markets face the risk of further downward repricing.

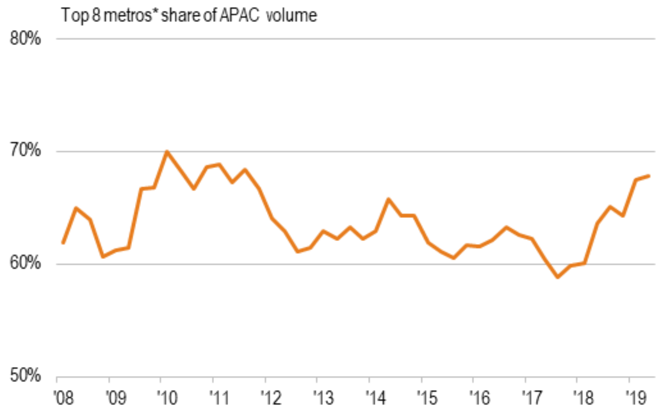
Figure 8: Investment volume and cross-border activity



Source: RCA

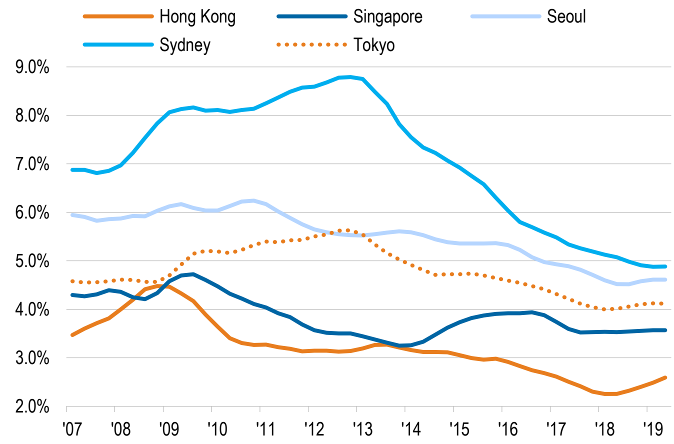
Notes: The chart represents full year to Q2 investment volume and excludes all land deals and entity level deals, i.e. only income-producing assets are included.

Figure 9: Top eight metro cities, share of Asia-Pacific investment volume



Source: RCA

Figure 10: Prime office transaction yields



Source: RCA

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