Research & Strategy

Asia-Pacific property market overview Q3 2020

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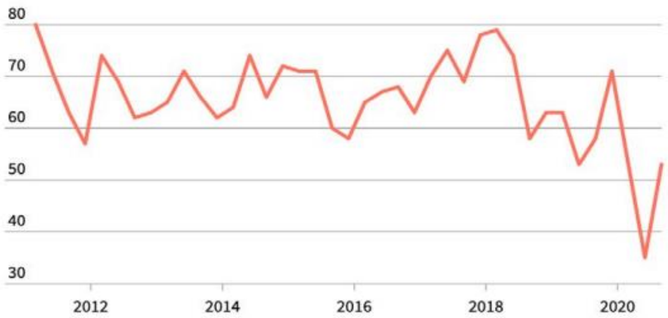
Economy and politics

Leading indicators point towards an improvement in business and consumer sentiment post lockdowns. However, recent resurgence of infections in some countries pose a downside risk to the regional economic recovery. However, news of a successful vaccine trial has somewhat helped to buoy sentiment. Many countries are also pencilling in further fiscal stimulus in the year ahead to support their domestic economies in 2021. Economic recovery across the region will be uneven and will hinge on the extension of public job support schemes.

- Economic sentiment in the region continue to improve in Q3 2020. Business sentiment rebounded in the third quarter as easing coronavirus restrictions lifted sales, but lingering uncertainty over the pandemic remains as a key downside risk, a Thomson Reuters/INSEAD survey showed (figure 1). Based on the survey, Asian firms' outlook for the next six months jumped to 53 in Q3 2020 from an 11-year low of 35 in Q2 2020 and above the 50-point mark, which indicates a positive outlook.

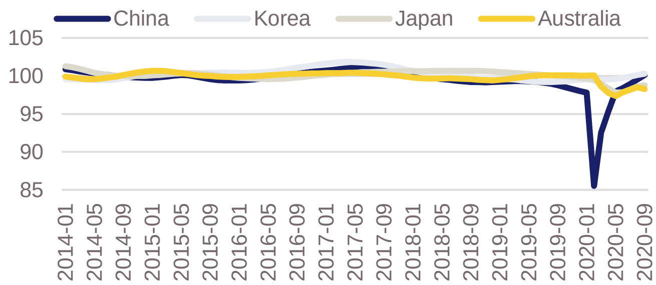
Figure 1: Asian business sentiment index in September 2020



Source: Thomson Reuters/ INSEAD

- While business sentiment and economic recovery is underway, the pace of recovery is uneven across the Asia Pacific region (figure 2). In addition to the pandemic, geopolitical tensions between China and Australia has also dent Australia's economic outlook as China implements tariffs on Australia imports.

Figure 2: Composite leading indicators for major OECD Asia-Pacific economies



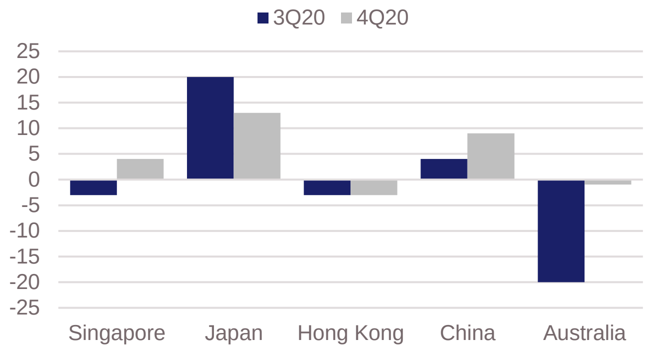
Source: OECD

Note: Numbers above 100 suggest increased confidence in business performance in near future and numbers below 100 indicate pessimism towards future performance.

Sources: OECD, Savills IM

- Unemployment continues to rise across the region. However, the pace of retrenchment has somewhat slowed as more economic activity resumed. Hiring prospects have also improved in Q4 2020 albeit some markets such as Hong Kong and Australia remain dismal (figure 3).

Figure 3: Hiring intentions, net employment outlook



Sources: Manpower Group, Savills IM

- As oil prices continue to rise on increased economic activity, the resurgence of a second and third wave in Europe and US, respectively, remains as a downside risk to inflation, which is expected to remain low into 2020.

China

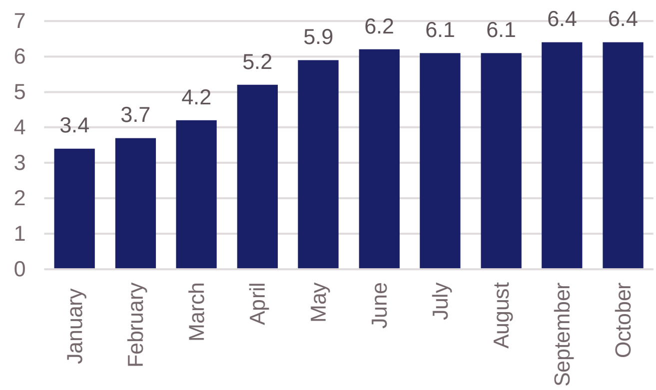
- China's economy continues to recover from the impact of the pandemic. The economy recorded a 4.9% y/y expansion in Q3 2020, up from 3.2% y/y in Q2 2020.
- One of the most encouraging parts of China's recovery has been the recent rebound in consumer spending. Retail sales were up 3.3% y/y in Q3 2020.
- The uptick in domestic travel and spending has helped create jobs for low-skilled workers in the labour market. Unemployment has declined to 5.6% in Q3 2020 from 6.2% in Q1 2020 and 5.9% in Q2 2020.
- China's services sector grew 4.3% this quarter compared with 1.9% in Q2 2020. The sector had struggled to gain traction earlier this year as partial lockdowns and social distancing policies remained in place.
- Industrial production grew 5.8% in the third quarter from a year ago, up from 4.4% in Q2 2020. Technology and new energy vehicle production have been a major driver.
- Nevertheless, there are still major risks facing the Chinese economy, including rising debt and bad bank loans as Beijing relaxed loan approval conditions for small businesses.
- Geopolitical tensions with the U.S. also represent a key downside risk, while more aggressive policy support could spur growth. Consensus Economics upgraded their 2020

forecast from 1.7% in August to 2.3% in October before accelerating to 7.9% in 2021.

Hong Kong

- Hong Kong's economy contracted 3.4% y/y in Q3 2020, an improvement from the 9% y/y contraction in the previous quarter. An improvement in the external environment led by the solid expansion of China's economy, some revival in business sentiment in the latter part of Q3 2020 amid the stabilization of the local epidemic situation, and stronger financial market activity underpin the slower pace of economic contraction.
- On a year-on-year basis, total exports of goods resumed growth on the back of the solid expansion of the Chinese economy. However, exports of services continued to plummet as inbound tourism stagnate. Domestically, both private consumption expenditure and overall investment expenditure declined at narrowed rates according to the Hong Kong government.
- Other encouraging indicators include a moderation in retail sales decline (-13.4% y/y in August from -23.8% y/y in July). Supermarket retail sales have outperformed while the easing of lockdown measures in August should lend support to retail sales going forward according to Consensus Economics.
- Unemployment continues to rise, accelerating to 6.4% in September from 6.2% in June (figure 4). The labour market deteriorated in Q3 2020 amid the third wave of the local epidemic, particularly in July and August, but the pressure faced by the labour market showed signs of stabilisation towards the end of the quarter as the local epidemic situation abated in September. Meanwhile, the Employment Support Scheme continued to provide support.

Figure 4: Hong Kong unemployment rate (%)



Sources: Census and Statistics Department, Savills IM

- GDP is set to plunge this year, as the pandemic weighs on the domestic economy. However, the economy should recover robustly due to a rebound in domestic demand as the impact of lockdown measures and weaker growth in mainland China fade in 2021.
- Nevertheless, the recent anti-subversion law and US–China trade relations pose downside risks to the outlook. Consensus Economics expects GDP to contract -6.8% y/y in 2020 before rebounding in 2021 to 4.4%.

Singapore

- Singapore's economy rebounded in the third quarter on the back of its manufacturing sector as the city state started a gradual reopening in June. According to advance estimates by the Ministry of Trade and Industry (MTI), GDP rose 7.9% q/q (-7.0% y/y) in Q3 versus a -13.2% q/q (-13.3% y/y) decline in Q2.
- Moving into Q4, the continued reopening of the economy and low number of new daily COVID-19 cases should further support the recovery: High frequency data indicates that retail activity has returned close to its pre-pandemic levels in mid-October, boding well for an uptick in consumer spending in the final quarter of 2020.
- On the other hand, other downside risks to the economic recovery remain. Singapore's unemployment rate rose to 3.6% in September but at a slower rate compared to previous months, as the country reopened from a COVID-19-induced slowdown. Lower disposable income may hold back on domestic consumption.
- GDP is set to rebound strongly next year from the steep contraction projected for 2020. Improving household and capital spending is likely to drive a surge in domestic demand, while a recovery in key regional trading partners should bolster the external sector. Consensus Economics expects GDP to contract -6.2% y/y in 2020 before recovering to 5.4% in 2021.

Japan

- Japan's economy shrank -28.1% year-on-year (y/y) or -7.8% quarter-on-quarter (q/q) in Q2 2020 as the pandemic significantly hampered both the domestic and external sectors.
- External demand, which includes both exports and tourism, pulled down the economy in the second quarter. Private consumption also fell 8.2% from the previous quarter.
- While Japan fare much better compared to other global economies such as the US (-9.1% q/q) and the UK (-29.4% q/q) in Q2 2020, the outlook remains challenging.
- Japan's jobless rate rose in August to its highest in over three years at 3% from 2.9% back in May while job availability fell to a more than six-year low, government data showed. The jobs-to-applicants ratio fell to 1.04, matching a level last seen in January 2014. Worsening conditions in the jobs market is likely to add pressure to the government to offer further support for small and mid-sized firms to help prevent further job losses.
- Stubbornly high Covid-19 case rates throughout August and into September may cloud the outlook. As of October 2020, Oxford Economics expect the Japanese economy to contract by close to 6% in 2020, before growing by 2.5% in 2021, with the now-postponed Tokyo Olympics providing a modest but welcome boost. Significant fiscal and monetary stimulus

should temper the downturn and help to foster a recovery in 2021.

- On a brighter note, Q3 indicators have also posted some green shoots of recovery. The Cabinet Office raised its assessment of the economy from "worsening" to "bottoming out" in August.
- Industrial output in August grew 1.7% m/m, rising for the third consecutive month even though the annualised figures remain largely below last year's levels while PMI readings show an improvement despite still being in negative territory.
- Business sentiment improved in July-September from a 11-year low hit three months ago, the Bank of Japan's Tankan survey showed, in a sign the economy is gradually recovering.
- The headline index for big manufacturers' sentiment improved to -27 in September from -34 in June, which was the lowest level since June 2009 based on the Tankan Survey. Manufacturers and nonmanufacturers expect business conditions to improve three months ahead.
- On the political front, Yoshihide Suga replaced Shinzo Abe as prime minister on 16 September. Economic policy is likely to remain broadly unchanged in the short term with the potential for further stimulus this year to mitigate the effects of the pandemic.
- Japan's inflation-adjusted real wages fell for the sixth straight month in August, reflecting a big drop in overtime pay as the labour market reeled from the impact of COVID-19 pandemic. Real wages dropped 1.4% y/y in August, following a 1.8% y/y decline in July. Wage earners' nominal total cash earnings fell 1.3%, the fifth consecutive month of decline.
- The consumer price index for Japan in September 2020 was 102.0 (2015=100), the same level as the previous year before seasonal adjustment, and down 0.1% from the previous month on a seasonally adjusted basis.
- The Japanese government plans to extend employment adjustment subsidies to support companies that continue to keep employees on their payroll in the wake of the coronavirus. The subsidy was slated to last to the end of September, but the amount may be reduced starting in 2021. The Cabinet plans to use JPY549.2 billion in reserve funds for fiscal 2020 to finance this extension in subsidy programs.
- To promote domestic travel and to help boost local businesses, the Japanese government has set up the Go to Travel campaign, which provides residents with subsidies of up to 50% on transportation, hotels, restaurants, tourist attractions and shopping, all within Japan.

Australia

- Australia's economy recovered 3.3% q/q but was still down 3.8% y/y in Q3, after GDP contracted at a record pace in Q2 amid job losses, business shutdowns and elevated uncertainty. The Australian economy recorded a -7% y/y contraction in Q2 2020, the largest quarterly fall on record according to the Australian Bureau of Statistics.
- There are mixed signs regarding the strength of the economic recovery. Manpower Group's survey on hiring intentions in Q4 2020 shows that employment prospects have improved over the past quarter albeit still negative. Hiring prospects strengthen the strongest in Western Australia, South Australia and Queensland while employers were less positive in New South Wales and Victoria. Unemployment rate has also dipped to 6.8% in August from 7.5% in July.
- Australia consumer sentiment surged to two-year high in October despite of the ongoing pandemic. It is a sign of confidence in the country's fiscal and monetary authorities for their handling of the coronavirus pandemic which bodes well for consumption.
- Quarterly retail volumes advanced 6.5% in the three months through September, after declining 3.5% in the prior quarter, according to the Australian Bureau of Statistics. Growth was partly offset by a 4.2% decline in Victoria state, which remained under lockdown in the quarter, while sales in New South Wales soared 11.6%, leading gains in all states and territories. The quarterly rise was driven by a recovery in industries that saw sharp falls in the June quarter, as well as continued strength in industries such as food retailing, other retailing and household goods
- Business confidence improved considerably in the quarter, hinting at recovering investment activity, although merchandise exports fell at a steeper pace in July-August relative to Q2's average dip, pointing to still-tepid external demand.
- The government unveiled the draft budget for FY 2021 to support economic growth. A further allocation of funds (AUD98 billion) for pandemic response and economic support was announced. The additional stimulus, alongside personal tax cuts, business tax relief and a new hiring credit scheme (JobMaker) should bolster economic growth in 2021.

Malaysia

- The gradual improvement in economic activities in various sectors has given hope that Malaysia's economy will recover in Q3 2020. July's industrial production index has shown positive signs of improvement.
- Unemployment has also seen some improvement as well, declining to 4.7% in August from 5.3% in May. The lifting of restrictions in August led a recovery momentum across all sectors including the tourism industry due to higher demand. Retail trade also improved 2.4% m/m in August.
- However, Malaysia is currently experiencing another a wave of pandemic outbreak, which would likely hinder the economic recovery.
- Consensus Economics expects Malaysia GDP to decline -6.4%% this year before rebounding 6.6% in 2021.
- At the same time, the recently concluded Regional Comprehensive Economic Partnership (RCEP) agreement – the world's largest trade pact - would help boost Malaysia's economic growth prospects.

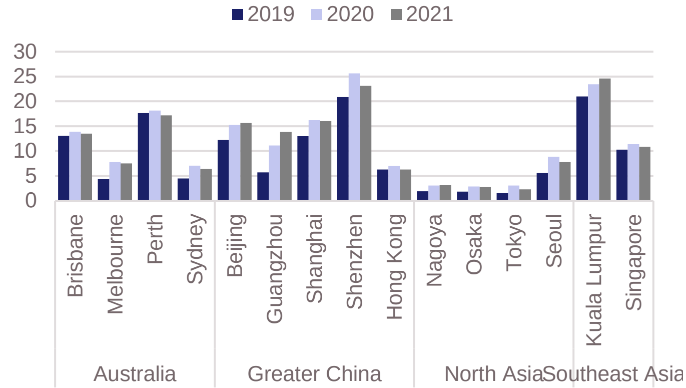
Asia-Pacific commercial real estate market

Occupier demand is picking up although vacancies are still climbing. While hiring intentions and business sentiment suggest some positivity surrounding the outlook, unemployment remains a key downside risk to office net absorption. Corporates remain cautious and may look to renew and re-evaluate their long-term strategies although tech firms have noticeably been active in expanding despite of fears on permanent work-from-home arrangements. Rents are likely to continue to fall into H2 2020 and even Q1 2021 as waves of new infections arise in some markets such as Malaysia. However, the upside risk is containment of the coronavirus within H1 2021, which may see limited impact on rents with the aid of significant fiscal stimulus support.

Office

- Leasing enquiries and activity have picked up in Q3 after the exit from lockdowns at the end of Q2. However, brokers such as CBRE have not seen a significant translation of actual converted deals. Occupiers remain cost conscious and continue to review their long-term real estate strategies despite improvements in hiring and business sentiment.
- Across the region, China was the only market to record positive leasing sentiment. According to CBRE, net absorption of Grade A office space registered 7.2million sq ft, which is close to its 10-year low. Renewals, downsizing relocations and consolidation underpin occupier trends during the quarter.
- Tech companies remain a key source of demand as they expand or upgrade their spatial requirements. In contrast, financial companies are reducing their office spatial requirements and releasing secondary stock. Sublease space is becoming prevalent in high quality buildings in core CBD locations, which is taken over by tech firms.
- New office completions in Q3 2020 has pushed vacancies higher. Over 1 million sq ft of new office space in Shanghai, Shenzhen and Seoul entered the market, pushing regional total Grade A office stock to 12.2 million sq ft.
- Weak demand coupled with downsizing and a low level of pre-commitments in new projects have pushed up the regional aggregate vacancy to 16.3% in Q3 2020 according to CBRE, up from 15.7% in Q2 2020. Most of the vacancies are largely concentrated in the emerging markets such as China, India and Malaysia.
- 2021 should see vacancy rates remain elevated based on PMA forecasts. As the economic recovery gains momentum, leasing activity in developed markets is likely to outpace those of most emerging markets and vacancy rates are only expected to see a decline in H2 2021 across most markets. (figure 5).

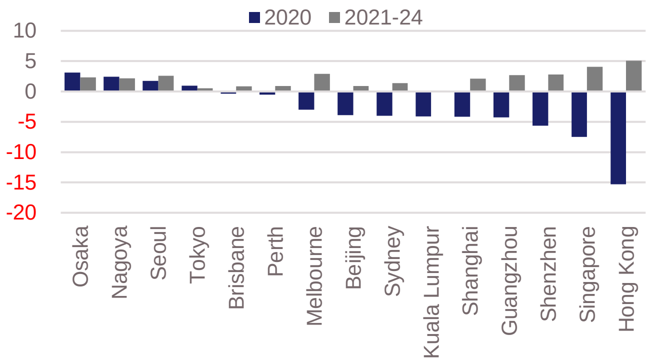
Figure 5: Asia-Pacific CBD office vacancy rate and forecast



Sources: PMA (Autumn 2020, recession scenario), Savills IM

- Average Grade A office rents across the region declined 1.2% q/q amid weak office take-up. Among the key markets, only Seoul reported positive rental growth, which demonstrated its resilience. PMA predicts Seoul to be the only market to achieve positive rental growth by end 2020 (figure 6).
- Healthy pre-commitments in upcoming new office supply in the northern Asian markets of Osaka and Seoul as well as structurally low vacancy rates should help mitigate any sharp increase in vacancy, which will support more modest rental growth according to PMA.
- In contrast, continued weakness in the Hong Kong office market is exerting further downward pressure on Grade A office rents. Hong Kong recorded a -3.4% q/q decline in Q3 2020, a slight improvement versus -3.8% q/q drop in Q2 2020. Against a challenging economic environment and rising unemployment, Savills Research expects a more modest decline in rents (-2.5% to -5%) in 2021.

Figure 6: Asia-Pacific office prime rental growth forecast (% p.a.)



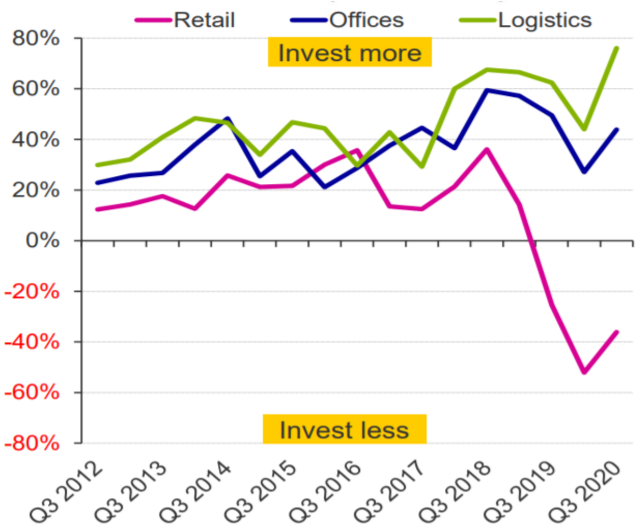
Sources: PMA (Autumn 2020, recession scenario), Savills IM

Retail

- Consumer sentiment has improved from the previous quarter as most markets exit out of lockdowns. According to various brokers including CBRE and Savills, footfalls have seen a substantial increase since Q2 2020.

- Nevertheless, the path to recovery remains long. Retail sales have yet to recover to pre-COVID levels although there were marginal improvements. Retail outlets that are located in CBD areas or those in decentralised office areas remain under pressure due to office employees still adopting a work-from-home arrangement.
- Retails are cautious towards expansions amid the ongoing pandemic. While there was an increase in the number of retailers opening new outlets across the Asia-Pacific region, most of these have been planned prior to COVID-19. Non-discretionary retail such as groceries continue to drive leasing demand while F&B tenants seek to capture domestic consumption, particularly in China where retail leasing activity was very active according to CBRE.
- Not surprisingly, prime retail rents remain under downward pressure although the magnitude of decline may have been more severe had there not been the introduction of significant stimulus and relief measures. Some retailers, who are still performing well, are seeking to capitalise on falling rents to secure prime locations. Until an effective vaccine is found, prime retail rents are almost certain to continue to decline into 2022 as international leisure travel borders remain closed.
- Retailers are increasingly turning towards strengthening their wider omnichannel platform. Physical store pickup services are being introduced more broadly, including fully automated stores, to facilitate a quicker and more efficient process of delivery of purchased goods.
- While the overall retail environment is facing a structural decline, not all formats face the same fate. Grocery anchored suburban malls near residential locations fared better than those retail formats in downtown areas that cater to tourists. This has also prompted a slight improvement in investor interest in the sector (figure 7).
- Investor sentiment has also recorded a slight improvement despite the overall negative trend in the retail sector.

Figure 7: Investor intention survey

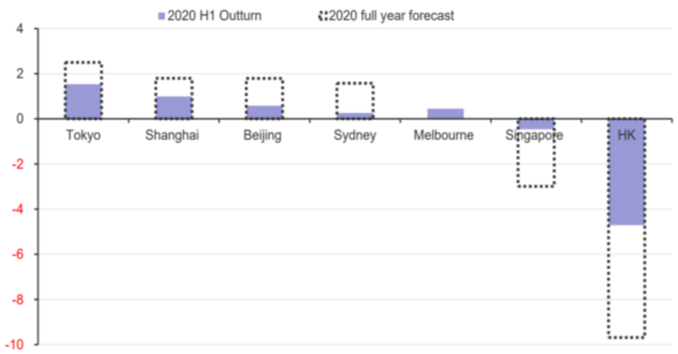


Sources: PMA (Autumn 2020, recession scenario), Savills IM

Logistics

- Despite the reopening of many physical stores, e-commerce continues to be a strong driver of demand for logistics space globally, leading to near-record absorption levels in several major markets including Asia.
- Markets which recorded a resurgence of infections in Q3 2020, such as India and Australia, recorded a surge in warehouse leasing enquiries due to the sharp increase in online orders of necessities such as food.
- Meanwhile, China, one of the first markets in the region to see a successful containment of the pandemic, recorded robust leasing demand. The emergence of new e-commerce platforms in other categories such as group purchases, fresh delivery and cross-border e-commerce is contributing to new demand. As a result, vacancy rates remain low in China, with Beijing and Guangzhou reporting a lack of available and suitable space according to CBRE.
- Aside from China, most of the other regions reported low vacancy rates and with the exception of the smaller trade dependent markets of Hong Kong and Singapore. Hong Kong's political landscape poses the biggest risk to rental growth while the supply overhang in Singapore is likely to dampen any rental growth expectations in the near term (figure 8).
- The logistics 5-year rental outlook across the region is certainly set to benefit from a structural demand change. As more investments in the sector gain traction due to its secure income stream, new supply is also expected to increase significantly, limiting rental growth to a modest rate.

Figure 8: Asia-Pacific 2020 prime logistics rental growth projections, % p.a.



Sources: PMA (Autumn 2020, recession scenario), Savills IM

Investment and capital markets

Commercial transactions remain subdued as cross borders remained close to travellers. So far, there have not been any signs of distress, even though most deals currently involve domestic investors due to travel restrictions. The significant weight of capital and low interest rate environment is however likely to keep yields stable as investors maintain a favourable tilt towards sectors/ assets that have shown resilience amid the pandemic.

■ Asia Pacific commercial real estate investment (excluding development sites) fell further in Q3 2020, down 21% y/y compared to 13% decline in the previous quarter and the third quarter of consecutive decline on an annualised basis. Travel restrictions, compounded by structural trends across all sectors including work-from-home, online retail and supply chain diversification, has led to lower transactions on balance.

■ Industrial property investment remains favourite with investors, notching a 1% y/y gain in Q3 2020 to record USD 7.2 billion of transactions. There is also still strong interest for prime segments of the office market and multifamily apartments, but investment has slowed for other sectors

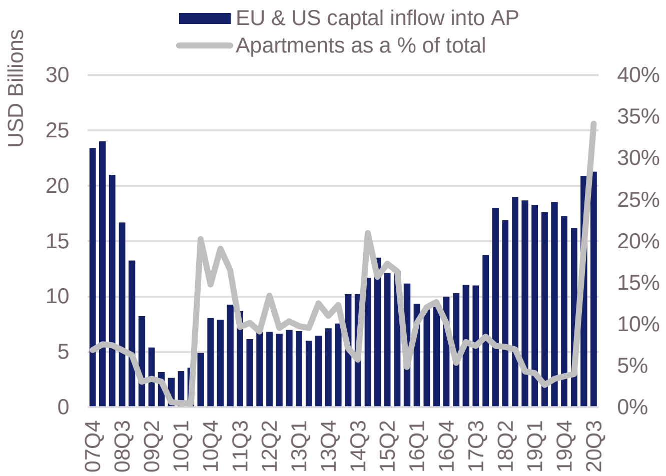
■ Despite the interest in industrial space, not all industrial formats fared the same. Within the industrial space, interest has been skewed towards logistics facilities and data centres. Even then, only logistics facilities within the largest markets have shown growth, while those in geographically smaller countries have seen slower growth.

■ Offices remain the largest asset class despite investment volumes on the decline. In Q3 2020, investment volumes fell 38% y/y to USD 12.6 bn. Despite the decline in volumes and ongoing media regarding increased flexible work from home arrangements, yields have yet to see any expansions.

■ Cross-border investment pulled back sharply in the third quarter with new deals hard to come by as travel restrictions have mostly remained in place for the time being.

■ While cross-border flows in total have dipped, several investorgroups have managed to place capital in Asia Pacific real estate for the first time. Investors from Europe in particular have become much more active within the last few years and showed no signs of slowing down in 2020, particularly in resilient income sectors such as Japan multifamily sector (Figure 9)

Figure 9: European capital inflows into Asia Pacific (cumulative, USD billion) *



*excludes development sites
Sources: RCA, Savills IM

■ While there are still no signs of distress in the office sector, uncertainty over office demand post-COVID is likely to steer investors towards gateway cities with less supply in the pipeline in order to benefit from a wider safety margin.

■ PMA data showed yields remained flat across most markets in the region in Q3 2020. PMA also expects yields to expand 10 basis points in 2020 in the office space and 20 to 50 basis points in the prime retail segment on the back of continued closure of borders and travel restrictions that affect retail sales. In contrast, yields in the logistics space is likely to record further yield compression by end of 2020 given its resilient income profile.

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