CHINA'S RECOVERY AND IMPLICATIONS FOR HONG KONG SAR[1] REAL ESTATE

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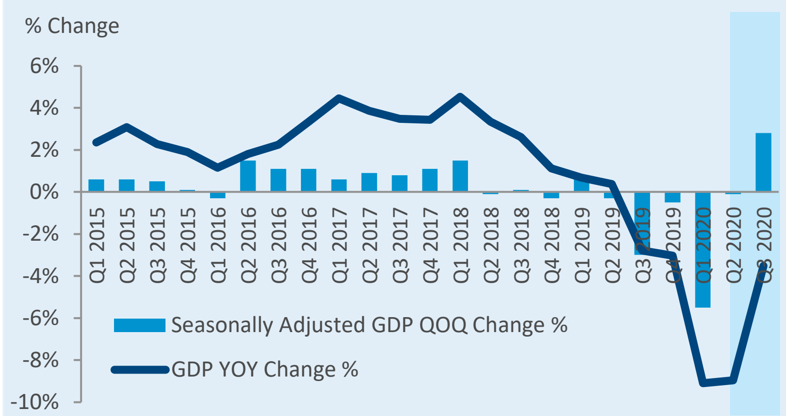
Insights & Recommendations

While the other major global economies are still struggling with COVID-19, China has emerged from the health crisis. China's economic and GDP rebound will likely have a ripple effect on the Hong Kong SAR's economy.

Looking into 2021, we believe mainland companies, particularly financial and asset management firms, will become the key new demand drivers for Grade A office space. The stronger RMB-to-HKD FX rate is also reinforcing Hong Kong as an attractive investment destination for Chinese capital.

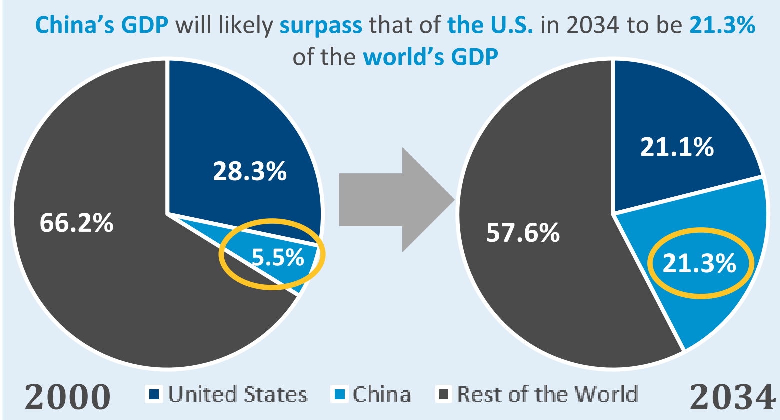
We recommend landlords focus on customised incentives that are curated towards the mainland clientele for higher occupancy. Hoteliers and retailers should also strategise ahead for their logistics, organisational and marketing campaigns to better prepare for the border-reopening.

Hong Kong's GDP shows signs of recovery in Q3 2020



Source: HK Census Statistics

Proportion of Global GDP, U.S. and China, 2000 & 2034



Source: Oxford Economics

Hong Kong's economy showed signs of recovery with its GDP returning to 2.8% QOQ growth in Q3 2020 after five consecutive quarters of GDP contraction, as indicated by the chart at left[2]. This was largely propelled by China's GDP rebound offset from its stabilisation of the pandemic. For instance, China's GDP grew 4.9% YOY in Q3 2020, compared to 3.2% YOY in Q2 2020[3].

China could potentially overtake the U.S. in the mid of 2030s to become the world's largest economy, according to Oxford Economics' data[3]. The opening up of China's financial industry and the Greater Bay Area (GBA)'s initiative should lead Hong Kong to further tighten its economic ties with the mainland and benefit from China's growth.

In the latest *Hong Kong Policy Address 2020*, the government plans to expedite the GBA cross-boundary wealth management connect scheme, as well as to promote Hong Kong's REITs market, private equity funds and family office businesses. These proposals should bring new impetuses to Hong Kong's economy and reinforce its status as a financial centre.

[1]This report covers the Hong Kong Special Administrative Region of the People's Republic of China.
[2] Hong Kong SAR Government ; [3] Oxford Economics - Global Economic Databank

IMPLICATIONS TO HONG KONG PROPERTY MARKET

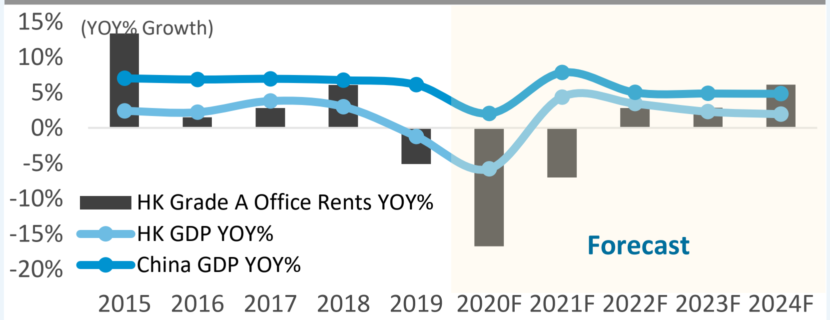
Office – China rebound to lead Hong Kong's GDP recovery; a more predictable US-China relationship to renew business confidence

The strong rebound in China should help to lead the economic recovery in Hong Kong in the next one to two years. According to Oxford Economics', China and Hong Kong's GDP are expected to grow by 7.8% YOY and 4.4% YOY respectively in 2021. An improving GDP should bring in more stability for Hong Kong's Grade A office rental market, which trends very closely with the city's GDP performance.

Meanwhile, the outcome of the U.S presidential election with Biden's victory could point to a more predictable and strategic China policy, as well as a potential improvement in the overall business confidence, which would likely benefit Hong Kong's office leasing demand.

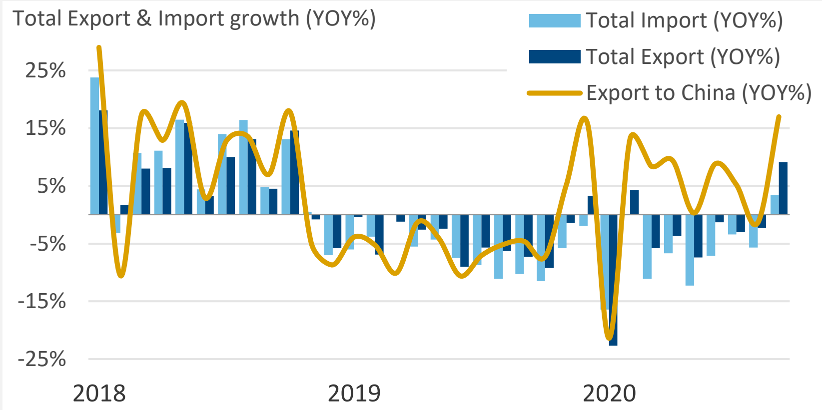
We believe one of Hong Kong's key strengths is serving as a global financial gateway for overseas capital entering and exiting Mainland China and the GBA. Hong Kong and Mainland China's closer business ties shall offer more business opportunities, and hence office demand from across the border, especially from the finance, wealth management and insurance fields. We recommend landlords develop sophisticated client engagement strategies to build better relationships with the potential PRC occupiers, which we believe will be one of the key demand drivers in 2021.

China & HK GDP vs. HK Grade A Office Rental Growth, 2020-2024F



Source: Colliers International; Oxford Economics

Hong Kong Trading Performance By Volume (in HK$)



Source: Colliers International, Census and Statistics Department

Industrial – a recovery of trade performance driven by the growth of exports to China

According to the government's statistics, Hong Kong's exports growth bounced back to positive again in September 2020, with a YOY increase of 10.3%[4]. This was mainly driven by an improved external trading environment amid the accelerated growth of the Mainland's economy. The recovery of trading volume is particularly noticeable in China, with Hong Kong's total export to China boosted by 17.6% YOY during the same month[4].

Whilst Hong Kong derives most of its trading activities from China[4], it is also China's third-largest trading partner after the US and Japan. In this respect, China's accession to the new Regional Comprehensive Economic Partnership, signed on 15 Nov 2020[5] as the world's largest regional free-trade agreement, with 14 other Asia-Pacific countries including Japan, South Korea, Australia and New Zealand, should strengthen its supply chain, bolster economies by reducing tariffs, and ultimately improve the trading prospects and leasing demand for Hong Kong's logistics and industrial facilities.

[4] Trade and Industry Department; [5] Bloomberg; ASEAN

FURTHER IMPLICATIONS FOR HONG KONG PROPERTY MARKET

Hospitality and retail – all eyes awaiting the reopening of the border

Although China's retail spending has been lagging the recovery of investment and export activity post-COVID-19, the latest data saw signs of a consumption recovery. In October 2020, online services sales (e.g. travel and hotel bookings) spiked by 23.5% YOY, while the urban employment increased by 15.6% YOY [6], the strongest recorded since 2013. This all suggests a very solid future mainland consumption power.

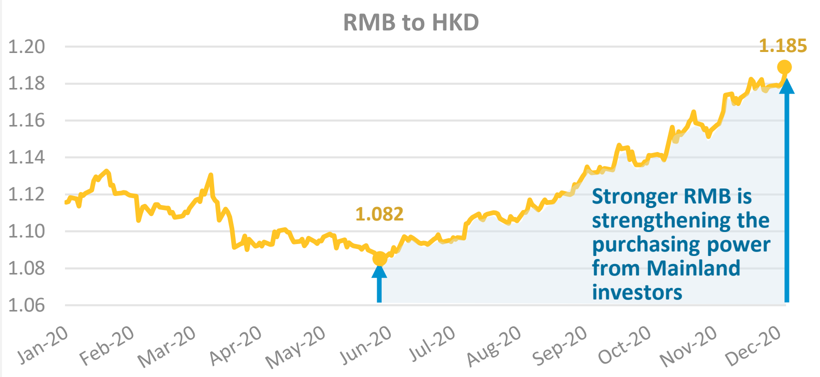
Hong Kong is highly reliant on large volumes of business and leisure travellers from out-of-town. Mainland Chinese tourists used to be the leading source of visitors for Hong Kong, which accounted for almost 80% of the city's visitor arrivals [7]. The chart below further demonstrated the high correlation of Hong Kong's retail sales performance and the visitor's arrival rates from China to Hong Kong. As such, reopening the border and resuming free travel is crucial for the recovery of Hong Kong's hospitality and retail sector. We believe the GBA region should be the first step in opening the border. Retailers and hoteliers should strategise ahead for operations plans and marketing campaigns.

Total Retails Sales & Visitors Arrivals from China to Hong Kong

Source: Oxford Economics; *Note – HK Census Stats data up to Sept 2020

[6] Oxford Economics [7] Tourism Board

Exchange Rate Trend – RMB to HKD



Source: Colliers International, Bloomberg; data as of 4 Dec 2020

Investment – more Chinese capital is looking for properties in Hong Kong

In our earlier published report *Mainland Chinese demand to stimulate opportunities for Hong Kong SAR's real estate sector*, we mentioned that the investment demand into Hong Kong's property market from Chinese capital had regained momentum in recent months. According to RCA, Mainland Chinese capital accounted for 60% of the cross-border transactions year-to-date[8]. We believe that once the Hong Kong-Mainland China border reopens, it will likely give further boosts for Chinese capital to re-enter Hong Kong's property market.

Meanwhile, the fiscal stimulus under Biden will likely depress the U.S. dollar, while adding upward pressure on the Chinese RMB. Notably, RMB had appreciated by 9.6% since its last trough in end-May 2020. The potential upward pressure of RMB should make the property pricing in Hong Kong more attractive to Chinese or RMB-dominated investors. We recommend investors focus on residential sites, strata-office for end-users, strategic industrial assets and en-bloc commercial buildings as Chinese buyers are likely continue to eye opportunities in these asset types.

[8] Source: RCA; data as of 19 Nov 2020

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