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TRADE WAR: IMPLICATIONS FOR HONG KONG

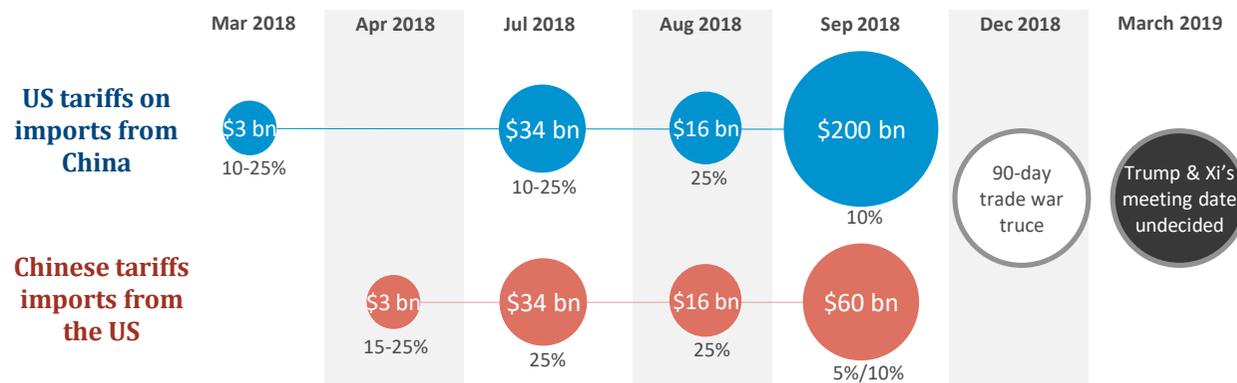
Summary & Recommendations

The US-China trade war has been weighing on the slowing global economy. Despite the end of the 90-day truce, China and the US have delayed their negotiations, leaving any resolution to the trade dispute uncertain.

With a more cautious economic outlook, various sectors of Hong Kong's property market have slowed since H2 2018. However, we think that the likely very slow pace of interest rate increases in 2019 and the Greater Bay Area plan should help offset any slower economic growth from the trade war.

Meanwhile, property players should take this window of opportunity to review their real estate strategies, such as upgrading properties and diversifying tenant mix in order to stay ahead of a market rebound from a sentiment-driven slowdown.

Chronology of US and Chinese tariffs



Source: [Bloomberg](#), 30 January 2019

Notes: Figures are in US dollars; percentage represent tariff rates.

Since March 2018, US President Donald Trump has imposed up to 25% tariffs on HKD390 billion (USD50.0 billion) worth of imports from China, and 10% tariffs on HKD1.56 trillion (USD200 billion) worth of Chinese goods¹, in an attempt to reduce the trade deficit with China. However, China has retaliated by imposing tariffs on HKD881 billion (USD113 billion)² worth of imports from the US.

In early December 2018, the US and China entered a 90-day truce in imposing additional tariffs on imported goods³. A meeting was originally scheduled to take place between President Trump and Chinese President Xi Jinping in late March, with the hope of reaching an agreement to end the trade war. However, it is now widely reported that the meeting will probably be postponed.

The US-China trade war has cast a shadow over financial markets and various industries, triggering a ripple effect that is filtering through different real estate sectors in Hong Kong. Whether or not the dispute improves, Hong Kong's economy and property market have already felt the impact of the trade war since H2 2018.

¹ United States Trade Representative, [8 March 2018](#), [6 July 2018](#), [7 August 2018](#), [18 September 2018](#)

² Ministry of Finance of the People's Republic of China, [1 April 2018](#), [16 June 2018](#), [8 August 2018](#), [18 September 2018](#)

³ [White House](#), 1 December 2018

THRIVING DESPITE TURBULENCE

Slower-than-expected rate hikes and the Greater Bay Area plan to offset the trade war tension

For the time being, there is no clear sign of solution to the trade tensions between China and the US. As the impact from the ongoing trade war has become significant with a consensus forecast of slower economic growth for 2019, Hong Kong's business expectations⁴ in Q1 2019 have further weakened, recording the worst sentiment since Q3 2009.

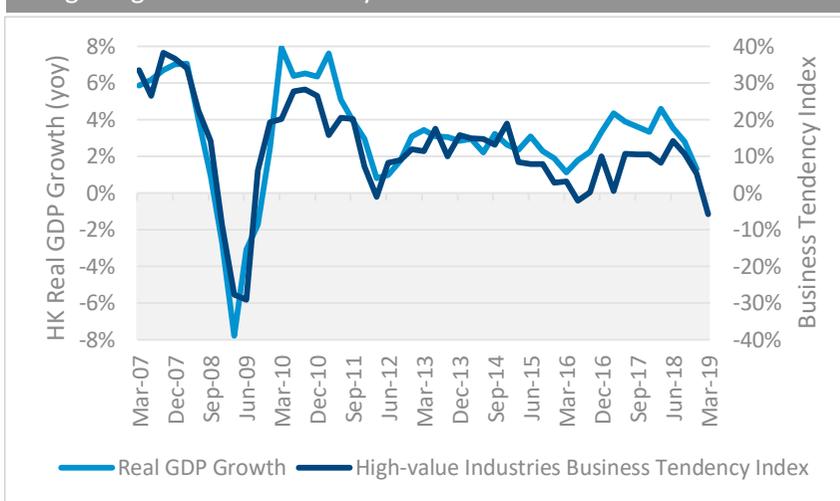
In February 2019, the Hong Kong government revised down its 2019 real GDP growth forecast from 3% in 2018 to 2-3% for 2019. This is closer to the baseline scenario from Oxford Economics, which currently forecasts slower growth of 1.6% in 2019 and 2.3% in 2020⁵.

In a more bearish scenario from Oxford Economics, considering a full-blown trade war and market turmoil, based on the downturns which have lasted 1.0 to 1.5 years over the past decade, Hong Kong's economy and property market are likely to adjust and stabilise towards the end of 2020 or early 2021⁶. However, we expect Hong Kong to post positive real GDP growth even in the negative scenario, given the stronger labour market and more stable financial system than during the last downturn in 2008.

Despite the weaker economic outlook, the prospect of rising interest rates in Hong Kong has receded even though Hong Kong's real interest rates will almost certainly return to positive in 2019 for the first time since the GFC. The US Federal Reserve indicated on 20 March that there would be no rate increases in the US in 2019, in contrast to its previous indication of two increases⁷. The Asian market which may benefit the most from this news is Hong Kong, where interest rates are effectively tied to US interest rates by the territory's currency peg to the US dollar.

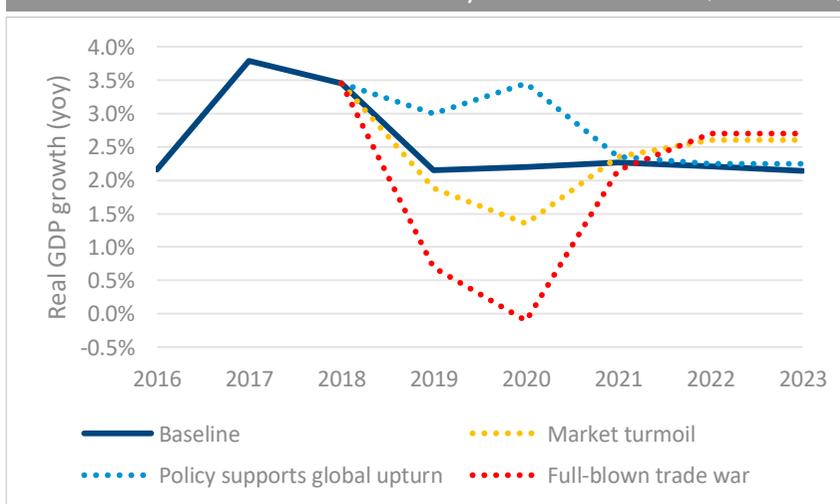
Moreover, the emerging Greater Bay Area plan and new opportunities heralded by new infrastructure projects should carry benefits for Hong Kong which offset certain impacts of the trade war. With Hong Kong being the stepping stone for companies expanding in China and internationally, we expect business opportunities to increase, and Hong Kong's economy, even if it expands at a slower pace, is likely to ride through the market turmoil and continue to grow sustainably after 2020.

Hong Kong Business Tendency⁴ vs. Real GDP Growth



Source: Census and Statistics Department; Colliers International

Scenarios for HK's Real GDP Growth by Oxford Economics (as of 18 Jan '19)



Source: Oxford Economics

⁴ Derived from corporate sentiment in the financing and insurance, real estate, professional services, and IT sectors on the expected changes in business situation for the succeeding quarter, according to the [Quarterly Business Tendency Survey](#) conducted by the Census and Statistics Department. ^{5,6} Oxford Economics *Country Economic Forecast*, 22 March 2019 and 18 January 2019. ⁷ [Federal Reserve Press Release](#), 20 March 2019.

IMPLICATIONS: STRATEGIES FOR DIFFERENT SECTORS

Office: window opportunity for refurbishment

While mainland Chinese companies had been the major rental driver over the past few years, starting in H2 2018, leasing momentum slowed with the onset of the trade war.

The softening demand has not been limited to mainland Chinese firms but also to multinational companies. The uncertainties stemming from the trade war coupled with the Hong Kong stock market's volatility have put financial companies' expansion plans on hold.

Rents in the CBD, where about half the Grade A office stock is occupied by financial firms, are most likely to decline after surging over 40% from 2014 to 2018. Landlords in the CBD, especially those with aging offices, should consider refurbishment or redevelopment of their properties, which better prepare their buildings to take advantage of rising rents in the next property cycle.

Retail: greater flexibility on smaller shop sizes

Although the renminbi (RMB) has been appreciating gradually since the end of October, it is possible for China to manage the renminbi RMB/US dollar exchange rate to counteract the impact of tariffs on Chinese goods. This could affect the purchasing power of mainland tourists in Hong Kong, who represented 91% of total tourist shopping spending in H1 2018⁸.

However, we stay positive about the retail market for 2019, as the growing number of Chinese tourists should drive higher overall spending, while the RMB has risen by about 4% versus the HK dollar since end-November 2018.

We are confident that overseas retailers and new brands are still keen to enter Hong Kong's retail market, given the city's tourism and the strong footfall on both high-streets and in shopping centres. However, given the more dynamic and fast-moving retail landscape in the current market, landlords should be more accommodating to tenants' requirements for smaller shops and greater flexibility.

⁸ [Tourism Expenditure Associated to Inbound Tourism](#), Jan - Jun 2018

Industrial: tenant diversification is the key

The industrial leasing market is feeling the first ripples caused by the US-China tension, and over the last few months, the trade war has impacted the expansion plans of logistic operators.

The lack of new industrial supply as well as the smaller stock, due to the industrial revitalisation scheme, should continue to support positive rental and price growth for industrial buildings.

Taking advantage of the new revitalisation scheme to lure start-up companies and creative industries should also help industrial buildings to boost occupancy. Landlords of warehouses and flatted factories focusing on traditional logistics operators should try to review and diversify their tenant mix as the government starts to promote more diversified usage of industrial buildings.

Residential: look again in mid-2019

The slowdown in the local economy and rising interest rates have been the most worrying factors for residential buyers. The low transaction volumes in H2 2018 and early-2019 caused residential prices to correct by 9% between their last peak in July 2018 and January 2019⁹.

However, looking ahead, we believe that the market sentiment is set to improve with residential prices likely to rebound, supported by the Fed's decision last week to halt further interest rate hikes in 2019.

We reaffirm our view that buyers should look at residential purchases in mid-2019 as uncertainty diminishes¹⁰. Buyers should be confident in the residential market with excess demand and a healthy labour market. Landlords looking to lease amid the currently low market liquidity should consider integrating green building strategies such as energy-efficient facilities to improve the livability and sustainability of their properties.

⁹ [Rating and Valuation Department](#)

¹⁰ [Colliers Radar Strategies for the Residential Market Turn](#), December 2018

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