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SLOWDOWN OF RETAIL MARKET CONTINUES

Cloudy conditions to persist in 2019

Summary & Recommendations

Weak stock markets, uncertainty surrounding the US-China trade spat, and a weak RMB, have clouded the spending sentiment of both tourists and residents in Q4. The ongoing surge in tourist arrivals has not translated into higher retail sales as yet.

Despite the recent slowdown, retailers have kept expanding, albeit at a slower pace. Smaller shops in prime locations have performed best, and high-street rents mostly stabilised in 2018.

While uncertainty about the future path persists, increasing tourism, aided by the new infrastructure, coupled with rising household incomes should support a further upward trend in Hong Kong's retail market. Retailers should consider new leases in Tsim Sha Tsui's prime location, given higher foot traffic due to the new Express Rail Link.

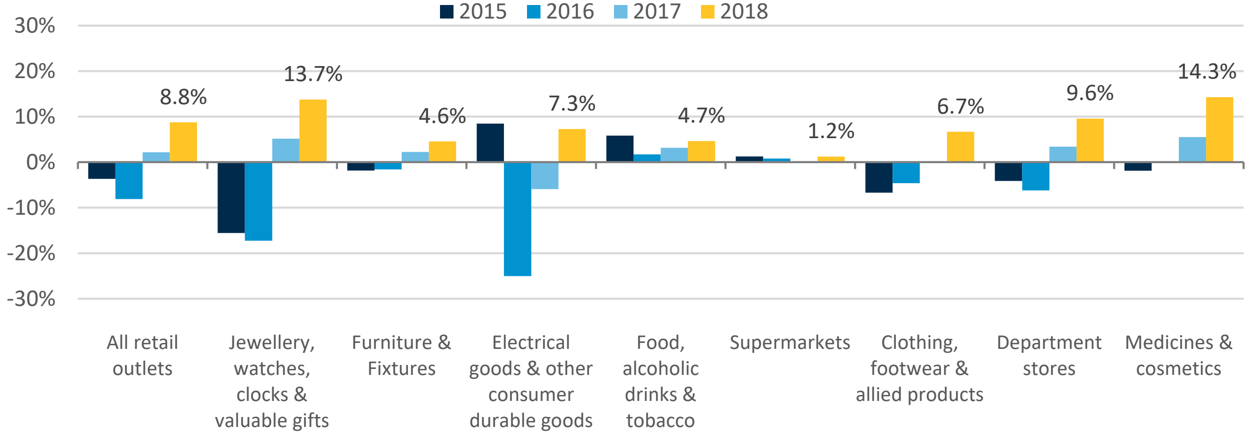
		QOQ/End Q4	YOY/End 2019	Annual Average Growth 2018–23/ End 2023
Rent	> Retail high-street rents mostly stabilised in 2018, edging up 0.3% yoy overall. > For 2019, we expect a continued gradual overall growth of 1% yoy for core retail districts, and steady growth of 2.5% over 2020 to 2023.	-0.1% HKD 389 psf per month	+1% HKD 393 psf per month	+2.0% HKD 433 psf per month

		YOY	YOY	Annual Average Growth 2018–23/ End 2023
Sales	> Retail sales rose 2.3% yoy in Q4 2018 > Backed by a robust job market, and likely a continued rise in tourist arrivals, we expect sales to grow by 6% yoy in 2019, followed by further single digit growth p.a. through 2020 and a positive outlook through 2023.	+2.3%	+6%	+5.5%

		Q4 2018	Full Year 2019	2018–23 Annual Average
Supply	> For 2019, we expect a total of 1.26 million sq ft (117,430 sq m) of major new retail space to come online in core retail districts. > Due to open in Q3 2019, K11 Musea mall in Tsim Sha Tsui provides the majority of the new supply.	0 sq ft	1.26 million sq ft	466,200 sq ft

Source: Colliers International. 1 sq m = 10.76 sq ft.

Retail sales growth (YOY, in %)



Source: Census and Statistics Department

Demand

Continued high demand for healthcare and beauty products

Creative F&B and light refreshment concepts perceived well in market

Premium accessories remain in vogue

Ongoing demand for lifestyle fashion brands and active wear

SLOWER GROWTH TO CONTINUE

Overall healthy year for retail sales, but cloudy sentiment in Q4

Hong Kong is looking back at a healthier retail environment in 2018, with retail sales rebounding significantly. Supported by a surge in tourist arrivals, jewellery and watch sales had a come back. Lifestyle fashion, health and cosmetics products as well as premium accessories have continued to be major demand drivers throughout the year, and we expect these areas to remain popular in 2019.

Recently, the market has been showing signs of a slowdown. In Q4 2018, retail sales grew by only 2.3% yoy. Along with a higher comparison value, as retail sales started to pick up in H2 2017, other likely factors that contribute to a slower growth rate are rising interest rates, weak stock markets, a weak RMB, and mounting uncertainties in the context of the US-China trade spat.

Notably, since September sentiment for discretionary spending on high-value items such as jewellery and watches and other luxury products has softened significantly. Popular with mainland Chinese tourists, this is pointing to spillover effects from the mainland's slowing economy. The sector's weak performance has been pulling down overall retail sales growth.

In addition, Hong Kong residents' spending sentiment weakened. It remains to be seen how the year-end festive season will turn out. While several mall operators reported upbeat activities in major shopping malls with increased foot traffic and solid holiday season sales growth compared to last year[1], the cosmetics retailer Sa Sa recorded a dip of 3.7% yoy in sales in Q4.[2] Overall, retail sales during the festive season in December were stagnant compared to the same period in 2017.

Cloudy conditions likely to persist

Aided by rising household income and a consistently low unemployment rate, local consumption expenditure should continue to grow. However, declining household wealth from a potentially ongoing tumble in the stock and property markets may hurt consumer confidence and further limit spending. We believe that tourist arrivals will continue to rise in 2019, especially in light of enhanced connectivity though the recently launched Hong Kong-Macau-Zhuhai Bridge and the Express Rail Link. However, sentiment is already taking its toll on international luxury sales, and the ongoing economic slowdown on the mainland, together with a shift towards more domestic shopping[3] may dampen spending by this consumer group, particularly on luxury items. Despite this, we expect Hong Kong's retail sales to continue to be on an upwards trajectory, albeit at a lower pace of 6% in 2019.

Source: [1] SCMP, [2] hkexnews,[3] OC&C Strategy Consultants LLP

STAGNATION OF RETAIL RENTS, BUT OVERALL STABILISATION

First positive yearly rental growth since retail downturn

Since turning back to positive territory in mid-2018, rental growth has been slowing and stagnating. In Q4 2018, overall high-street retail rents edged down by 0.1% qoq. The weak performance comes amid Central's ongoing rental struggle, declining 1.1% qoq. However, it is notable that, despite the recent marginal drop, high-street retail rents have mostly stabilised in 2018. The slight rise of 0.3% yoy marks the first positive rental growth rate since the latest retail market downturn.

The prospect of securing a prime location at a reasonable rent, which comes with potential benefits for both the brand image and revenue amid higher foot traffic, has driven robust demand for first-tier high-streets, fuelling rental growth. Led by continued demand for Russell Street, Causeway Bay's rent edged up 1.1% yoy. Mong Kok, although stagnant in Q4, has outperformed other major retail districts, with rents rising 4.7% yoy in 2018.

Steady growth path in 2019

Although the rental recovery has been slower than previously anticipated, we estimate that high-street retail rents should continue to rise gradually in 2019. Due to the stagnation in H2 2018, we have made reasonable downward adjustments to our rental outlook. In 2019, we expect overall high-street retail rents to show a mild rise of 1% growth yoy, and an average annual increase of about 2.5% from 2020 to 2023.

As rents in Central have not reversed their downward trend as yet, the district will likely face further downward pressure, with a rental decline of around 3% in H1 2019.

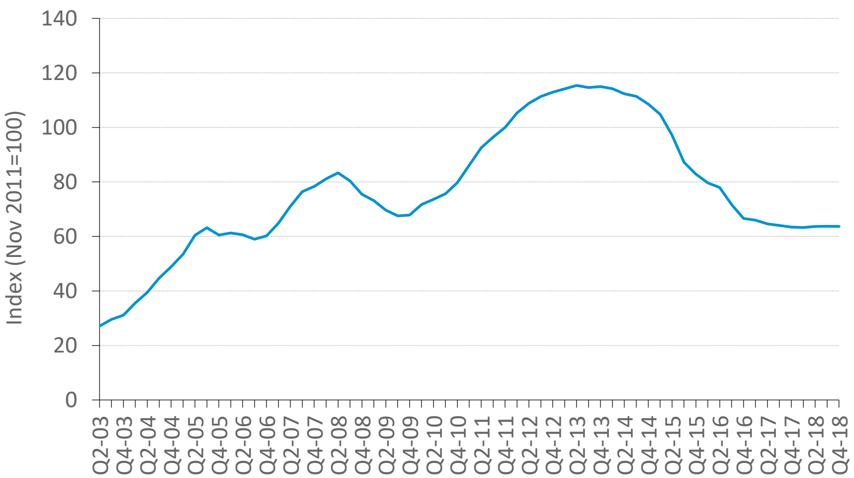
Tsim Sha Tsui on the other hand, is already benefiting from increased foot traffic due to the opening of the Express Rail Link. The new infrastructure, and the progressive launch of the West Kowloon Cultural District, featuring museums, arts and exhibition venues, should draw in even more visitors and tourists. This can potentially increase retail space demand and spur rental growth.

High-street retail rents

District	QOQ	2018	2019F
Overall Rental Index*	-0.1%	+0.3%	1%
Central	-1.1%	-3.9%	-2%
Causeway Bay	+0.2%	+1.1%	+1%
Tsim Sha Tsui	+0.2%	0.0%	+1%
Mong Kok	0.0%	+4.7%	+3%

*Street level shops on key shopping streets
Source: Colliers International

Hong Kong high-street retail index



Index: Nov 2011 = 100.
Source: Colliers International

SLOWING, BUT ONGOING EXPANSION

More conservative expansion plans ahead

Hong Kong has remained an attractive market for newcomers in 2018. Mid priced lifestyle brands and health, cosmetics and personal care drove strong leasing demand in H1 2018. However, the recently sluggish retail sales performance and uncertainties in light of the US-China trade dispute have slowed overall expansion activities. Notably, leasing demand of fashion apparel brands was subdued in Q4 2018. Despite the slowdown, lower rents should continue to support brands' expansion. Higher foot traffic, a better image, and adjusted rents, have made first-tier high-streets the preferred option. The coming months are likely to show if the trade spat and weak stock markets will take a bigger toll on the local retail scene.

Leasing demand of health and personal care sector more resilient

Meanwhile, supported by the ongoing surge in visitor arrivals, leasing from drugstores and pharmacies has remained more active. Directly benefiting from the new Express Rail Link (XRL), we noted stronger leasing demand Tsim Sha Tsui. *Bonjour*, for instance, renewed its store on 36-44 Nathan Road, while Watsons opened a new outlet in Mirador Mansion on 54-64B Nathan Road. Positive influence from the XRL should further fuel leasing activities in Tsim Sha Tsui.

In Causeway Bay, *Leica*, a German camera manufacturer, leased a shop on 12 Pak Sha Road, representing their first street-level flagship store. The district offers smaller shop configurations, making it more attractive to new tenants, while Central still has higher vacancy due to larger shop configurations. The increasing focus on e-commerce could lead to more retailers reducing their shop sizes, further increasing large vacancies.

Dynamic but more challenging market for F&B

Creative food and light refreshment concepts have been thriving, and we expect expansion to continue in 2019, amid robust demand. However, increasing competition makes new enticements like award-winning chefs necessary to entice foodies.

Renowned local restaurant groups are adding new tastes to their portfolios. Among the latest are *Hotal Colombo* on Elgin Street in Soho, celebrating Sri Lanka's vibrant food culture, and the stylish *Estiatorio KEIA* in H Queen's in Central, giving traditional Greek food an up-market spin.

Leasing demand for existing light refreshment concepts and market entrants, notably Taiwanese tea specialities, is concentrated in core retail districts, amid robust consumer demand. With total monthly rental budgets typically ranging from HKD150,000 - 300,000 (USD19,100 - USD38,200), the majority of leases are on second-tier high-streets. A recent newcomer, Taiwan's popular *Chun Yang Tea*, which is known for its authentic milk tea, opened its first shop in the city on Jubilee Street. Amid the craze for new tea creations, and supported by reasonable rents, we believe the expansion will continue in the near-term.

Selected lease transactions in Q4 2018

District	Tenant	Address	Floor/ Unit	GFA (sq ft)	Lease Type
Central	G2000	New Henry House, 8A-8C Des Voeux Road C	G/F	910	New Lease
Causeway Bay	Watsons	JP Plaza, 22-36 Paterson Street	G/F	1,800	New Lease
Causeway Bay	Tag Heuer	Happy Mansion , 76 Percival Street (Facing Russell Street)	G/F	600	New Lease
Tsim Sha Tsui	Bonjour	Chungking Mansion, 36-44 Nathan Road	G/F	1,040	Renewal
Tsim Sha Tsui	Rimowa	The Sun Arcade, 28 Canton Road	G/F	3,200	New Lease
Mong Kok	Daniel Wellington	64 Sai Yeung Choi Street S	G/F	625	New Lease

Source: Colliers International, EPRC

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