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Biding your time; President Joe Biden's first 100 days and the impact on Hong Kong's real estate market

As the global economy looks set for a rebound after COVID-19, all eyes are on the recovery in the U.S. With the passing of the US$1.9 trillion COVID-19 Stimulus and Relief Package, the economy is set to go into overdrive. As demand for products and services strengthens, there are questions around the recovery of disrupted supply-chains and the sustainability of the Chinese economy. On 18 May, the Colliers Leaders Forum looked at the potential headwinds facing the global and local economies and discussed how Hong Kong real estate stakeholders can position themselves from an investment and occupier perspective.

The Biden effect

- The Biden administration's U.S. COVID-19 Stimulus and Relief Package should drive a surge in **GDP growth to 7.7%** in 2021
- Sharp economic recovery paired with the American Jobs Plan should drive the strongest absolute employment growth in U.S. history in 2021 - some **eight million new jobs**
- With inflation rising, it is reasonable to ask whether the U.S. faces a risk of economic overheating

Interest rates set to turn

- Financial markets are predicting an upturn in Fed Funds, i.e. short-term U.S. interest rates, for the first time since the Global Financial Crisis
- Long-run rates are already rising: the U.S. 10-year bond yield has increased from **0.51% last August to 1.66%** now
- Rising U.S. interest rates have implications for Asia and Asian property – not least in Hong Kong due to the U.S. dollar peg – including the direction of the cap rates used in property valuations
- While the near-term growth outlook is strong, there is concern about possible stagflation (high inflation, low growth) beyond 2021

China's impact on Asia and US relations

- **China is now the largest economy** in the world based on PPP – 19% of the total versus 16% for the U.S. – and accounts for 47% of the economy of APAC
- In terms of economic size and power, the only market which really matters in Asia is China
- China alone can pull APAC out of last year's recession, as it did after the Global Financial Crisis when the economy was significantly smaller
- Nevertheless, the recovery in the U.S. is icing on the cake for APAC

Is there any common ground?

- President Biden takes climate change seriously. The U.S. will rejoin the Paris Agreement
- While the U.S. and China disagree on many things, they agree on the need for action over climate change
- We expect national governments across APAC to start setting sustainability guidelines for the property and construction sectors. This will include Hong Kong as an integral part of China

Where is the Hong Kong property market heading?

- We believe the worst has already passed for the property market in 2020. On the macro side, the latest GDP figures shows that the 18-month recession in Hong Kong has come to an end, with **first quarter 2021 GDP rising 7.9% YoY** – far above consensus
- Hong Kong's property sector closely tracks its economic performance. For instance, Grade A office and warehouse rents are highly correlated with GDP and trading figures, respectively.
- While Central remains one of the world's most expensive submarkets for investors and tenants, this is not true for Hong Kong as a whole. Based on average rents, by end-2021, Hong Kong may well be only the third most expensive APAC market for office occupiers after Tokyo, and Singapore. Further, Hong Kong has APAC's widest spread between CBD rents and rents in outer areas

Office

- Hong Kong's real estate market could be accused of being complacent as it has missed the opportunity to innovate. COVID-19 has led to other industries adapting, but the office market has remained relatively still with the impact of work-from-home still being debated
- The city has its **highest vacancy in 15 years** with new supply planned over the next five years. Combined with the recent brain drain effect on the economy, the long-term stability of Hong Kong as a financial sector will be a concern unless it can reposition itself as the capital of the GBA

Investment

- There is a wall of investment capital in the real estate market propped up by pent-up demand. But values are holding with the bid-ask price remaining wider than expected
- Real asset investment is here to stay. In a digital world it is good to invest in something that is tangible, creating strong interest in bricks and mortar
- Retail investment may present the greatest opportunity as the sector bottoms out and we witness high sales activity in the first quarter. Investors need to embrace the changes occurring in consumer behaviour and demand with the sector looking promising

Industrial

- The industrial sector has seen strong activity in the first quarter following a positive 2020. With **exports up 33%,** the industrial sector will be the first to recover
- Retained imported frozen food for Hong Kong increased by 49% over the last three years, while online retail sales also expanded by over 60% in the first quarter
- For data centre and cold storage, these two sub-sectors exhibit a higher **yield band between 3%-4%,** when compared to traditional assets like office and retail where the cap rates are still tracking below 3.0%

Hotels:

- Hotels are seen as an opportunity, but global tourism is unlikely to recover fully until 2024. Some hotels and listed hotel chains have priced in a recovery for the sector, which seems a little premature

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