nuveen
REAL ESTATE

Q3

Think
Asia Pacific cities

Trends and tactics
Q3 2019 outlook

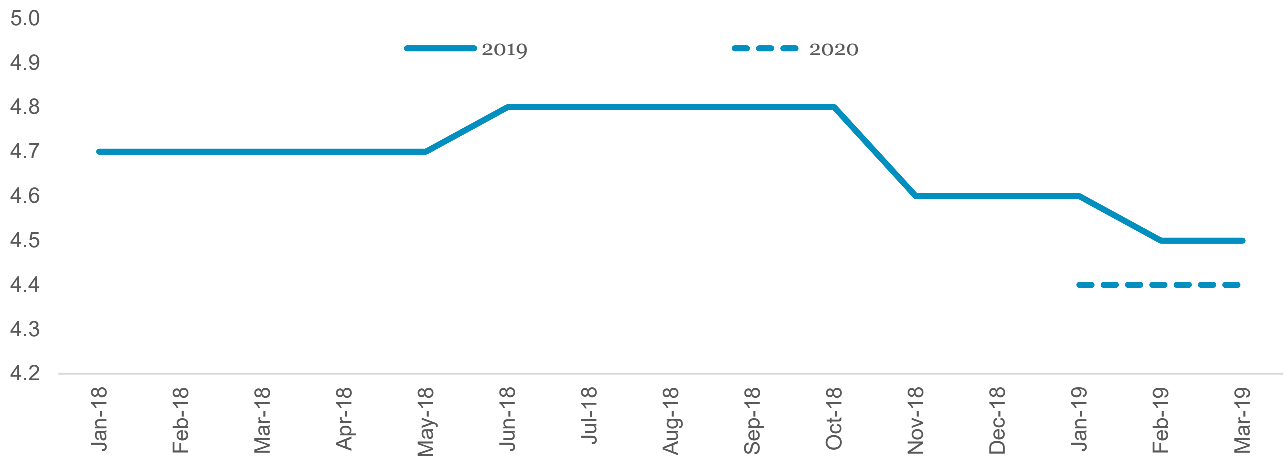
Economic dashboard

Just when we thought it was over

The outlook for global growth has significantly deteriorated recently, in large part mirroring the heightened risk climate from the trade and technology war between the U.S. and China, and the U.S. tariff threats on other major economies. As a result, rising headwinds to global growth (and demand) will pose further downside risks to some regional economies already hit by softer domestic consumption. While labour market conditions remain relatively robust overall, it is unlikely that regional growth can withstand additional external headwinds on top of a domestic housing market slowdown (Australia, South Korea), soft retail trade (Singapore, Japan) and a generally more uncertain business investment climate. The stepdown in Asia Pacific growth forecasts is likely to accelerate in the coming months from the 4.5% currently projected (according to Oxford Economics, May 2019), with the biggest drag reflecting the potentially sub-6% growth in China.

Alongside heightened risks, a weaker outlook for the global economy will likely keep global and regional central banks on a more accommodative monetary policy stance in the coming months to support economic activities. After slowing its Quantitative Easing programme since early 2018, the Bank of Japan may undertake additional Japanese Government Bond purchases if the macro outlook deteriorates, especially in view of the consumption tax hike in October. China will also likely turn on the credit tap in order to buffer short-term cyclical headwinds, a mainly liquidity injection through the reserve requirement ratio. A sub-trend outlook now points to potentially two rate cuts in Australia this year, reversing expectations for a rate increase (at mid-2020) at the beginning of this year. Loose(r) monetary conditions should support real estate pricing in the near term. However, investors should be conscious that if there is any one point in the current extended 10-year cycle where markets dislocate, this may be the year that we see a more pronounced divergence in performance due to significantly higher risks and a more uncertain outlook.

Fig.1: Asia Pacific real GDP forecast



Source: Consensus Economics, 2019

Quick read

- *Near-term macro and political risks have risen sharply, posing significant headwinds to the regional growth outlook*
- *Central banks will keep monetary policy conditions supportive of growth this year, which will help to anchor pricing*
- *A greater dislocation in market performance will result from the more uncertain landscape*

Economic dashboard

Heightened near-term downside risks

Market health	Growth	Retail sales	Job growth	Inflation	Bond yields*
Australia					
China					
Hong Kong					
Japan					
Singapore					
South Korea					

Source: Nuveen Real Estate, Oxford Economics, Q1 2019
*Bond yields symbols are illustrative of whether they are supportive for real estate pricing.

Office

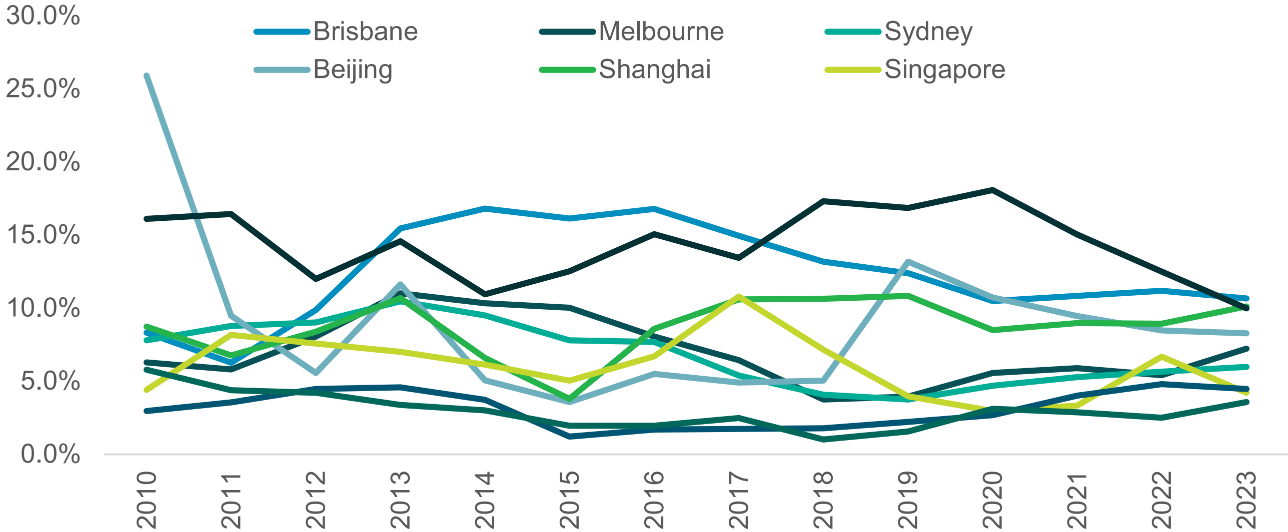
Uneven regional performance ahead

Concerns over slowing global growth and lingering U.S.-China trade tensions have weighed down on regional business sentiment in recent months. However despite the softer macro backdrop, office market fundamentals remain mostly sturdy, with positive net absorption continuing to drive lower vacancy across most regional markets. That said, fundamentals are likely to be more uneven (and uncertain), in light of the rising economic and political uncertainties, which will underscore a larger divergence in market performance in the near to medium term. The balance of risk is to the downside, with a rising likelihood of an ongoing deterioration in economic conditions driving a pullback in occupier demand.

With the exception of Singapore, Hong Kong and Shanghai, net increase of CBD office stock across most regional markets in 2019/2020 should be higher than the historical 5-year average. As such, the occupancy rate is likely to soften over the next two years. Nevertheless from 2021 onwards, supply should be more restrained especially in Tokyo, Seoul and Beijing where few new projects will be launched. Take-up is forecast to be strong in Brisbane, Beijing and Seoul, aided by a growth outlook on employment in the financial and business services sectors of these cities.

Our view remains that long-term structural trends are favourable for the regional office sector, however from a tactical perspective, we believe investors should stay focused on markets like Sydney, Melbourne and Tokyo offices, where demand fundamentals are resilient enough to overcome short-term cyclical headwinds. We also recommend Brisbane, on account of its robust rental outlook and relatively attractive pricing.

Fig.2: CBD office vacancy rates



Source: JLL, Q2 2019

Quick read

- *Office market fundamentals remain broadly resilient despite macro and political uncertainties*
- *Vacancy is expected to edge up in the short term in response to front-loaded supply across some regional markets*
- *Investors should focus on core markets with positive rental outlook in light of heightened economic risks*

Retail

Still not quite a favourable environment

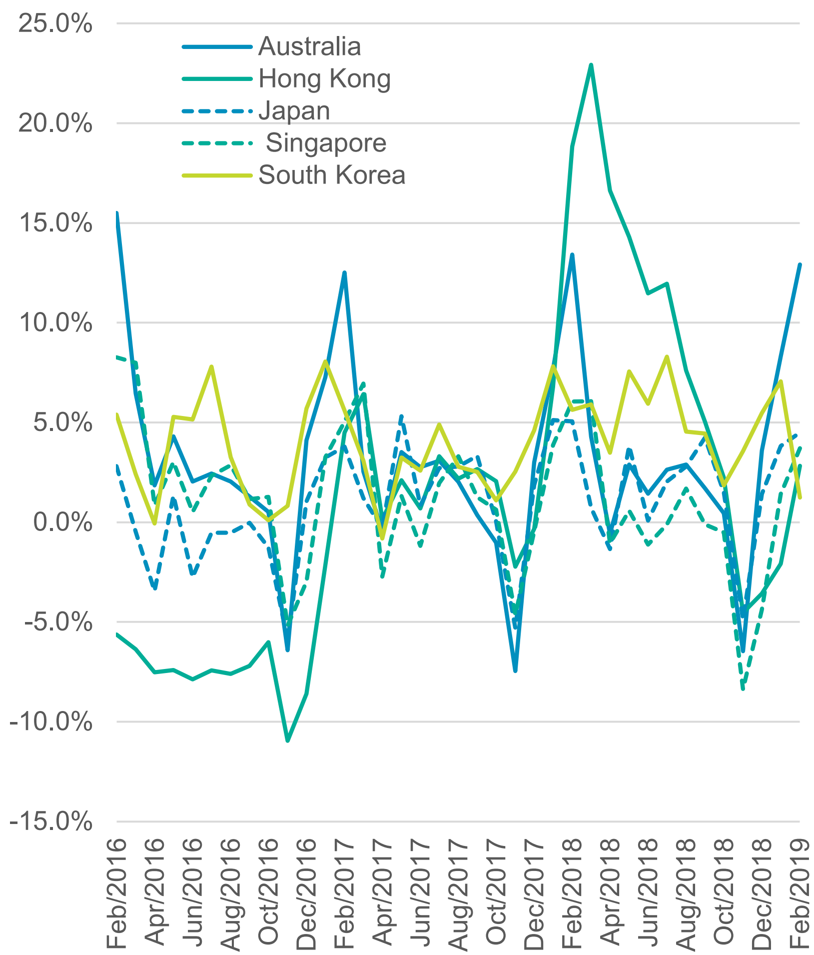
Market headwinds that impeded consumer spending in late 2018 – most notably the stock market downturn – have either eased or reversed towards the first quarter end. Having struggled in late 2018, retail sales growth in Australia and Japan bounced back and accelerated to its fastest pace in over a year. Similarly, growth in Hong Kong and Singapore emerged out of the negative territory in recent months with the recovery of inbound tourist arrivals. March reading also suggests that China might have bottomed out of the weakness witnessed last year. In South Korea, however, the strong momentum gained during late 2018/early 2019 seems to be short lived.

That said, consumer uncertainty has crept back in over the past month, from the breakdown in U.S.-China trade negotiation and tariff retaliation. U.S. threats to impose tariffs on other major economies have also roiled global markets, underscoring the growing risks and uncertainties to business investments, margins, employment and the broader economic environment. While we do not expect consumer market fundamentals to tail off sharply, backed by tight labour market conditions, undeniably Asia Pacific houses some of the most advanced e-commerce economies in the world. Aggressive e-commerce penetration means retail demand would not necessarily translate into occupier demand of the physical space, in particular the non-food categories. In this context, we favour retail assets that are able to offer customers a 'day-out' experience that cannot be easily replicated online. For instance, designer outlet malls and experiential shopping centres with innovative and high-quality leisure components. Convenient assets anchored with food retail should be comparatively shielded from the online competition and attract frequent visitation, hence outperforming.

Quick read

- *Retail sales growth strengthened across most key regional markets in Q1, aided by stock market recovery but risks are creeping back in from rising macro uncertainties*
- *Retail occupier demand threatened by e-commerce; experiential and convenient retail schemes are expected to be more defensive and perform better*

Fig.3: Retail sales year-on-year growth (3-month rolling)



Source: Macrobond, Q2 2019

Investment market

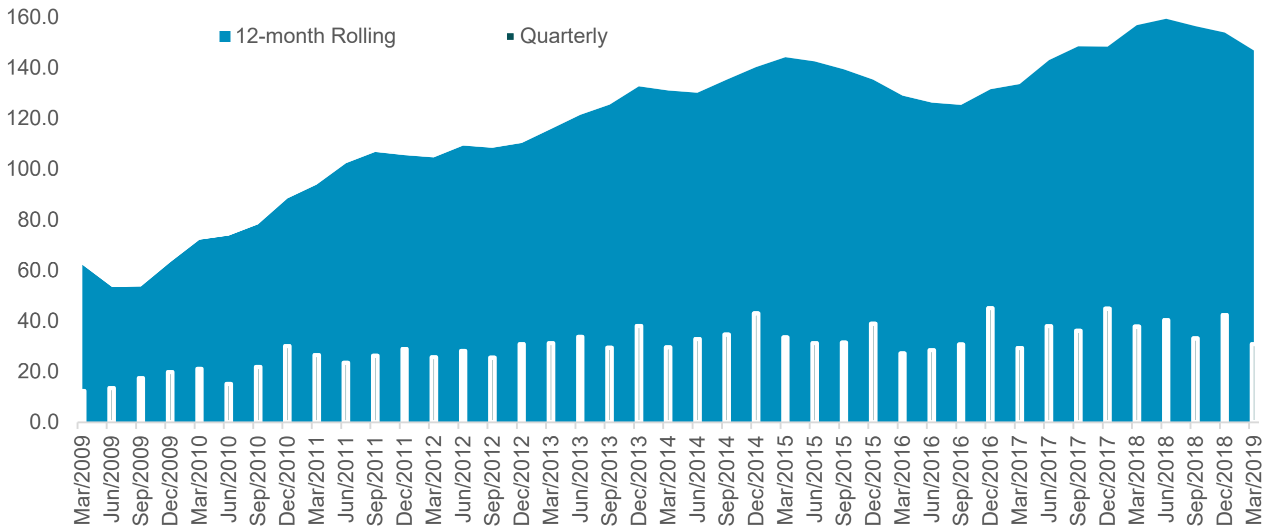
Robust capital market, rising risks

Investment activities across the Asia Pacific commercial property market started the year in a relatively soft patch after the record-high in 2018. Transactions slowed to US$30.8 billion in Q1, 13% below the quarterly average of the past five years. This trend is similar throughout most regional economies, with Japan and Hong Kong witnessing the biggest drop in volumes versus the same period last year.

While transactions slowed in Q1, capital flows into Asia Pacific over the near term should be supported by a more accommodative interest rate environment. As most regional central banks have reversed the tightening bias since the end of 2018, interest rate expectation has been lowered lately, pointing more benign financing conditions and, consequently, ongoing sturdy capital market strength. Concurrently, the immediate pressure for outward yield shift has subsided as interest rises are kept on hold.

Looking beyond interest rate cycles, the Asia Pacific real estate market is rapidly becoming more institutionalised, as reflected by the increasingly important role played by cross-border investors. This trend is most pronounced in China over the past quarter. To some extent, this is attributed to the divestment pressure of the Chinese asset holders (in response to the government's ongoing deleveraging initiative) and also signals that the country's financial reform has started to bear fruit. As regional markets continue to mature, Asia Pacific is set to see further expansion of its investable stock.

Fig.4: Investment volumes (US$ billion)



Source: RCA, May 2019

Quick read

- *Q1 transactions slowed from the record high in 2018*
- *Accommodative monetary stance benefits capital flows and supports real estate pricing in the near term*
- *Strong pickup in overseas interests reflect the region's maturing property markets*

Cyclical recommendations

Fig.5: Short-term city and sector selection

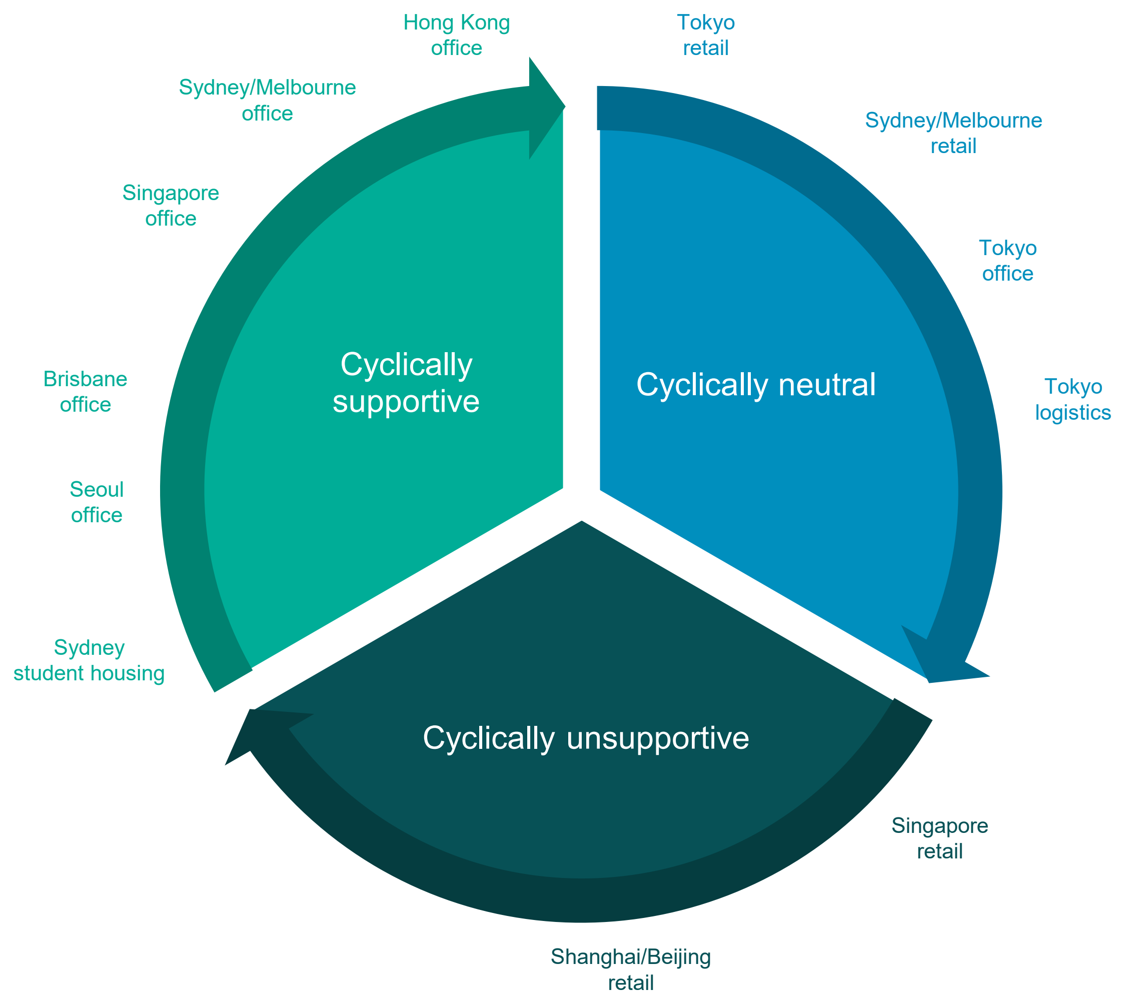


Fig.6: Key market themes

Source: Nuveen Real Estate, Q1 2019

Contact us

Alice Breheny
Head of Research
T: +44 20 3727 8122
E: alice.breheny@nuveenglobal.com

Harry Tan
Head of Research, Asia Pacific
T: +65 69140027
E: harry.tan@nuveenglobal.com

Haoran Wu
Research Analyst
T: +44 20 3727 8231
E: haoran.wu@nuveenglobal.com

For further information, visit us at nuveen.com

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