

ARA THOUGHT LEADERSHIP SERIES: Research Commentary

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Hong Kong in uncertain times

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The protests in Hong Kong started in June over Chief Executive Carrie Lam's proposed extradition bill. While the bill has since been shelved, the rallies continue into the 11th consecutive weekend. The protests have now centred around broader demands of democratic reform in Hong Kong including an inquiry into the police brutality in handling the recent rallies, the release of the imprisoned protestors, as well as a retraction of the extradition bill and resignation of the Chief Executive.

Domestic market dampened

The impact of this almost three months of social unrest is beginning to take a toll on the local businesses. According to recent government data, June retail sales have slipped 6.7% y-o-y, the largest decline since February. Hotel occupancy rates have also fallen by 20% y-o-y in June and could decline by 40% y-o-y in July according to the Federation of Trade Unions. Cathay Pacific – Hong Kong's flag carrier - share prices slipped to a 10-year low before recovering some 12% after CEO Rupert Hogg and Chief Customer and Commercial Officer Paul Loo announced their resignations. Both were taking full responsibility for the poor management of the company considering the participation of some of the employees in the recent political protests.

Reportedly some US\$56.9 billion (HK\$446 billion) was wiped off the market value of the island's nine largest developers while the Hang Seng Properties Index slipped by more than 16% since April. Overall, the equity market has had a beating too, with the MSCI Hong Kong Index losing about 9% since protests began.

Additional reports from RCA showed that the level of commercial deals in Hong Kong had dropped 42% in 2Q19. However, this decline had started before this current spate of political unrest, possibly on the back of weakened global growth. The ongoing trade war between the US and China has weighed on global trade flow motivating the IMF to cut its global growth projection for 2019 by 0.1 percentage point to 3.2% in July. Further cuts can be expected come September when the additional 10% tariff on the remaining US\$300 billion worth of Chinese imports kicks in. This new tariff could further hurt global trade flow and weigh on investment sentiments.

Commercial property prices in Hong Kong have also slipped 1.3% between April and June as compared to 1Q19 based on RCA data. Cap rates have consequentially risen by 30 bps y-o-y in 2Q19. This adjustment in Hong Kong, however, merely echoes what is already happening in the wider Asia Pacific region on the back of global trade uncertainties and is not necessarily a result of the social unrest. According to RCA, prices for ten out of 18 metros that RCA measures globally have fallen on a quarterly basis. The last time this happened was in 2010 during the global financial crisis.

Anecdotal evidence suggests that the cost of capital has also spiked on the back of this social unrest. Foreign banks in Hong Kong are delaying decisions on loan applications, if not increasing the premium by a hefty 100 bps. Similar to the banks, some fund managers have also put on hold new investment deals. The current unrest has dampened trust in the market, and this may not bode well for more extensive development sites or projects where huge capital outlay is involved. However, given that the market fundamentals remain stable, investors are likely to be more flexible with smaller ticket deals in Hong Kong.

Hong Kong remains an important market in the Asia Pacific region

Amidst the social unrest, we remain confident over Hong Kong's long-term relevance as a global financial hub.

Recognised as a leading global financial centre due to its strong rule of law and stable regulatory, fiscal, and monetary policies, Hong Kong has an efficient capital market and a highly transparent real estate market. The overall ease of doing business separates it from other tier-one Chinese cities. While these cities may be closing the gap, the attitude and pro-business mindset are harder to replicate immediately. This should bode well for Hong Kong when the political dust settles.

Additionally, China has positioned Hong Kong as part of the Greater Bay Area, which would provide the continual driver of growth as the region, comprising two Special Administrative Regions of Hong Kong and Macao, and the nine municipalities of Guangzhou, Shenzhen, Zhuhai, Foshan, Huizhou, Dongguan, Zhongshan, Jiangmen and Zhaoqing in Guangdong Province, continue their urbanisation paths. The central government has endorsed this GBA initiative as China's long-term growth engine of national significance. To enhance the GBA's synergy, Hong Kong is strategically positioned by the top policy-

making body to continue to strengthen its position as a global offshore RMB business hub and international asset management and risk management centre, while promoting the development of high-end industries, fostering innovation and technology, nurturing emerging industries and increasing global competitiveness. Such improved connectivity, rising affluence from sustained economic growth in the region should continue to feed the demand for more financial products and sustain Hong Kong as an international financial hub.

The government has also recently stepped in with a hefty US\$2.4 billion (HK\$19 billion) stimulus package to help offset the impact of protests, trade war, etc. Any further economic downside may be limited by the HK government's willingness to intervene financially.

Nonetheless, given the political volatility, we caution more care and due diligence when underwriting deals. But barring no severe degradation of the social and political environment, we maintain our investment thesis for Hong Kong as a good long-term investment location in the Asia Pacific region.



About ARA Asset Management Limited

ARA Asset Management Limited is a premier global integrated real assets fund manager. As at 30 June 2019, Gross Assets Managed by ARA Group and its Associates is more than S\$83 billion* across over 100 cities in 23 countries.

Driven by a vision to be the best-in-class real assets fund management company, ARA Group and its Associates' businesses include:

- (a) REITs – ARA is one of the largest REIT managers in Asia Pacific. The Group directly manages Suntec REIT, Cache Logistics Trust and ARA US Hospitality Trust, listed in Singapore; and Fortune REIT, Hui Xian REIT and Prosperity REIT, listed in Hong Kong. It also indirectly manages REITs in Japan, Australia, Singapore and Malaysia through its associate companies.
- (b) Private real estate funds – The Group manages private funds providing investment opportunities in diverse real estate sectors and geographies that cater to different investor risk appetites.
- (c) Country desks – ARA operates country desks in China, Korea, Japan, Malaysia, Australia, Europe and the United States. The country desks employ a strong understanding of each local market to facilitate the flow of inbound and outbound capital and cross-country collaborations. ARA has an expanded presence in Japan via its strategic stake in Kenedix, Inc. and in Europe via its strategic stake in Cromwell Property Group.
- (d) Infrastructure – ARA Infrastructure was established in 2018 to cater to strong investor demand for global infrastructure investment.
- (e) Real estate management services – As part of the Group's investor-operator philosophy, its dedicated property management teams actively work the ground to manage its assets globally.

ARA's multi-platform, multi-product global fund management strategy, combined with its dedicated teams with in-depth local knowledge, enables the Group to offer enduring value to investors. Built on a foundation of strong corporate governance and business integrity, ARA counts some of the world's largest pension funds, sovereign wealth funds, financial institutions, endowments and family offices as its investors.

For more information, please visit <http://www.ara-group.com>.

*Includes assets under management by ARA Asset Management Limited and the Group of companies ("ARA Group") and its Associates as at 30 June 2019

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About the Author



Dr Chua Yang Liang

Dr Chua Yang Liang heads up the Research & Strategy team at ARA Asset Management. He is responsible for monitoring the economic and property markets across Asia Pacific, and providing strategic advisory to the Firm.

Dr Chua has almost 20 years' experience in the research and planning-related field. His most recent stint was with JLL where he headed their research teams across South-East Asia.

Trained as an urban planner, Dr Chua brings to the Firm a different perspective to property market research and he publishes original papers covering property market updates as well as investment and property related matters.