ARA Asset Management Limited

ARA THOUGHT LEADERSHIP SERIES: Research Paper

Feb 2020

Novel Coronavirus
Hunker down and brave the storm

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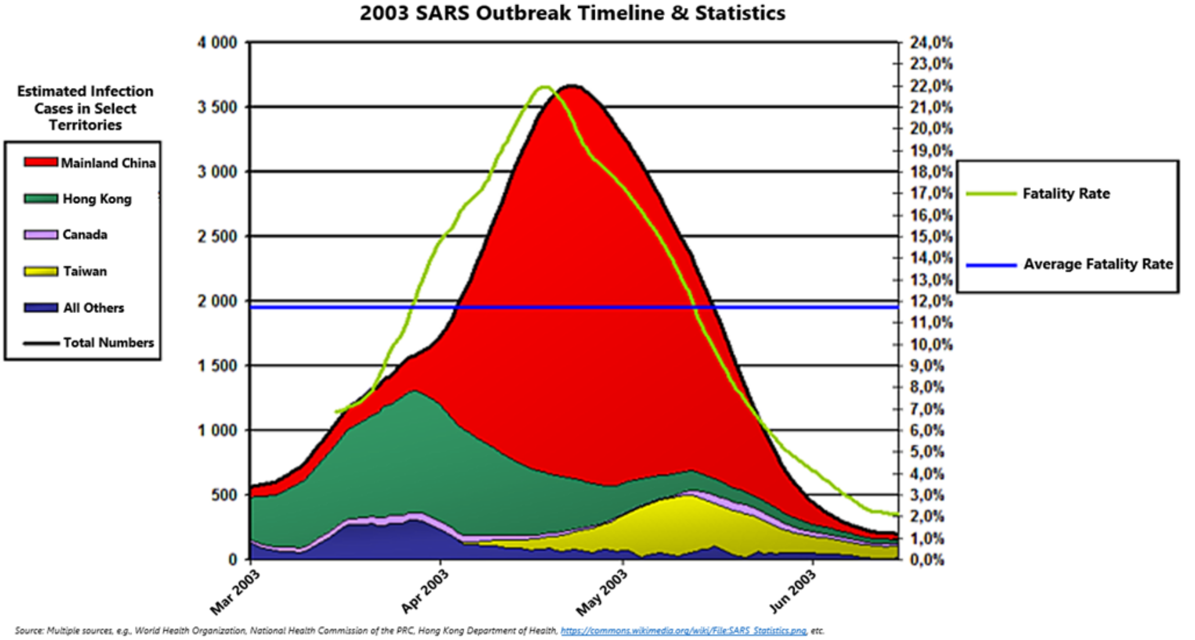
Table of Content

A new contagion

The novel coronavirus outbreak began in mid-Dec 2019 in the seventh-largest city of China - Wuhan, home to over 11 million people and the capital of Hubei province. The first suspected cases were reported on 31 December 2019, and to date, over 40,000 infections have been confirmed with a death toll of over 900. While scientists do not know how lethal the new coronavirus is, they agreed the virus is spreading more like influenza than Severe Acute Respiratory Syndrome ("SARS") and Middle East Respiratory Syndrome ("MERS"). Experts opined that this current virus outbreak might turn into a pandemic although the World Health Organization has declared it as a "Public Health Emergency of International Concern". Besides in China, over two dozen countries/territories have reported infected cases; Thailand, Japan, Hong Kong, Singapore, Taiwan, Australia, Malaysia, Macau, Russia, France, the United States, South Korea, Germany, the United Arabs Emirates, Canada, Britain, Vietnam, Italy, India, the Philippines, Nepal, Cambodia, Sri Lanka, Finland, Sweden and Spain.

Travel restrictions have been imposed by several countries to contain the spread of the virus, but anxiety remains elevated if not escalating. The initial economic impact of contagion diseases typically arose from uncertainty and loss of consumer confidence, especially in tourist arrivals and consumption. Shanghai stocks opened 8.7 per cent lower while those in Shenzhen fell 9 per cent on Monday 3 February 2020 – the day investors returned after the lunar new year holidays. Other Asian markets, having digested much of the impact earlier, also opened lower - Tokyo and Australia down 1.5 per cent while Hong Kong about half a per cent lower. Expectedly, share prices of some health care firms strengthened as at the end of January.



Source: Multiple sources, e.g., World Health Organization, National Health Commission of the PRC, Hong Kong Department of Health, https://commons.wikimedia.org/wiki/File:SARS_Statistics.png, etc.

An economic fallout that could be larger than that during SARS

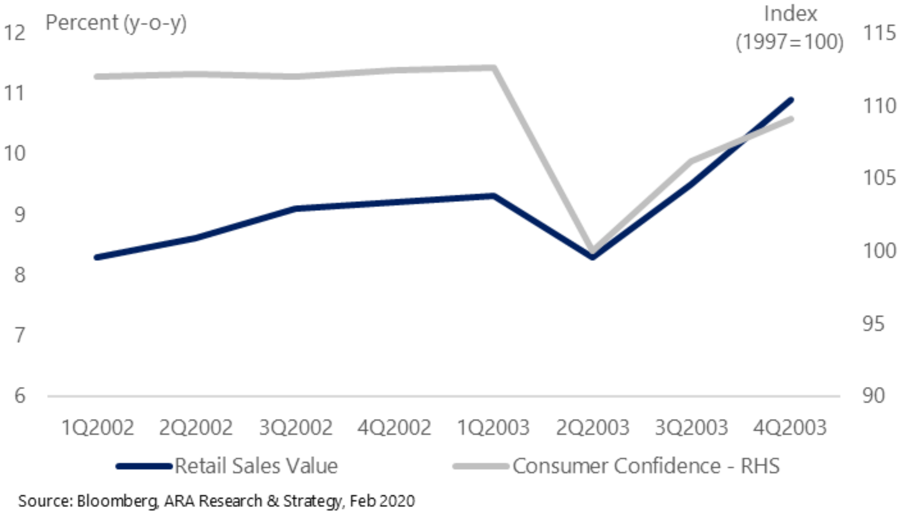
The novel coronavirus will impact China as well as the regional economies this year. Looking back to 2003, China's economic growth momentum, particularly in retail and tourism-related sectors (refer to charts), slowed dramatically during the first two quarters when the situation of SARS was noticeably worsening. The recovery was equally pronounced. Consumer confidence rebounded and the economy witnessed a marked recovery since 3Q2003 after the contagion was reportedly under control by that same year. Both Hong Kong and Singapore also experienced similar trends during the SARS epidemic. Tourism numbers fell over 50 per cent y-o-y, but retail sales volume was more resilient, correcting by about 2 to 8 per cent before rebounding as the contagion situation improved.

A highly interconnected region

Most market observers and economists agree that the economic downwind is likely to be stronger and more multi-faceted than that of SARS. Today, China economic footprint is larger and has more diverse trade linkages with Asia-Pacific region than during SARS. According to a Bloomberg report[1], China's GDP is some 17 per cent of the global economy - over four times what it was back in 2003. Regional trade activity, as reported by the World Trade Organization in terms of the value of total merchandise trade that Asia has with China, has expanded by 3.4 times in 2017 compared to that in 2003. In comparison, trade flow within Asia only grew by 3.1 times during the same period.

China's consumption market (as measured by government and private consumption spending in nominal, local currency terms) in 2018 has grown eight times that in 2003 while correspondingly, fixed investment expanded by only three times. A loss of consumer confidence resulting from this current outbreak would dampen the domestic consumption market and trade flow quite substantially. Reportedly[2], some 24 provinces and municipalities and regions have announced extended business closures and this accounts for over 80 per cent of China's gross domestic product and 90 per cent of exports in 2019.

Retail sales in China fell alongside consumer confidence during SARS



Source: Bloomberg, ARA Research & Strategy, Feb 2020

Wuhan a major passenger transport hub

Furthermore, Wuhan is a major passenger-transportation as well as a maritime hub in Central China. The disruption to passenger flow as a result of the shutdown of the city would have impacted the larger economy, especially if the contagion continues to spread to other major cities and transport nodes. GM factory in Wuhan employs about 10 per cent of its total workforce in China, is working closely with the local government to minimise disruption according to a report by CNN.

Travel & Tourism – first to feel the brunt

Several major airlines have cancelled flights into and out of China, while business in China is adding a week or so to the lunar new year holiday i.e. operations could be on hold for longer. Cathy Pacific has asked its staff of 27,000 to take unpaid leave for three weeks as the national carrier faces financial pressure from the outbreak[3].

China's temporary suspension of domestic and international tours as part of an effort to contain the spread of the outbreak would have adverse impact on the tourism markets in Asia particularly Hong Kong, Macau, and Thailand which are the top three destinations for Chinese tourists in 2018 according to latest data from China Outbound Tourism Research Institute. Chinese tourists, the biggest source of outbound travellers worldwide, spent some US$130 billion in 2018 according to another Bloomberg report[4] while over 50 per cent of travel and tourism GDP in Asia-Pacific region is from China alone. Chinese visitors were also the strongest contribution to inbound spend in Southeast Asia according to a report by the World Travel and Tourism Council[5]. Thailand, being one of the largest beneficiaries, has since cut its economic forecast for 2020 to 2.8 per cent from 3.3 per cent earlier, citing weaker exports, delayed budget and the outbreak of novel coronavirus in China.

The impact of this outbreak on China's full-year growth in 2020 has most economists calling for a haircut to their previous forecast, ranging from a low of 20 bps to a high of 100 bps. Oxford Economics shaved its earlier forecast of China's 2020 growth by 40 bps to 5.6 per cent, slightly higher than the lowest at 5.5 per cent[6].

Most economists agreed that the impact of this current outbreak would be greater than that during SARS, and the effect would be most severe over the first quarter of the year. The most bearish called for a possible contraction if not a technical recession in 1Q2020[7].

In contrast, China's GDP in 2003 maintained at 10%, only losing some 1.1 per cent as a result of SARs according to one study[8].

In our opinion, a technical recession cannot be ruled out, especially if trade and businesses remain shut beyond the currently extended business closure of up to mid-February.

Mitigating the fallout

Of rescues packages and monetary easing

In anticipation of the economic drag, the Chinese government announced RMB 1.2 trillion (USD 170 billion) in extra liquidity to buy up securities from investors seeking to sell. People's Bank of China (China's central bank) has also cut interest rate in a move to take some pressure off the banking system.

Likewise, the Bank of Thailand has cut interest rates to a record low of 1.0 per cent, citing the outbreak, recent drought and delay in the passing of the fiscal budget as contributing to an already weak domestic economy. In Singapore, the government has promised financial support for local industries affected by this outbreak in the upcoming budget.

Boosting consumer confidence

On the asset level, several foreign investors have taken steps to stem the spread. CapitaLand reportedly has shut down six of their malls in China while cutting down the operating hours for the remaining 45. Likewise, our asset management team in China has taken precautionary steps to help mitigate the spread of the virus as well as boost shoppers' confidence through several initiatives from stepping up cleaning frequency to offering temporary rebates to our retailers. Lorayne Lie, Head of Asset Management at ARA Private Funds ("APF") says, "We are closely monitoring the situation and have put in place precautionary measures. Apart from increasing the frequency of cleaning common areas with high contact points, for example, toilets, lifts, handrails, we conduct temperature screening of all tenants and visitors into our offices and malls.

We are also reviewing measures to grant temporary rebates to our retail tenants to ride through this challenging period. To mitigate the negative impact on sales turnover, we are working with our tenants to roll out online free delivery initiatives via social platform such as WeChat as well as targeted promotions to capture immediate office catchments to our malls." Ms Lie added.

David Kim, CEO of APF opines "While social media has improved awareness of this contagion, there is plenty of fake news as well. We have, to the best of our ability, taken steps to provide timely and accurate information to our clients, shoppers and tenants."

"Apart from increasing the frequency of cleaning common areas with high contact points, for example, toilets, lifts, handrails, we conduct temperature screening of all tenants and visitors into our offices and malls."

Lorayne Lie,
Head of Asset Management at
ARA Private Funds

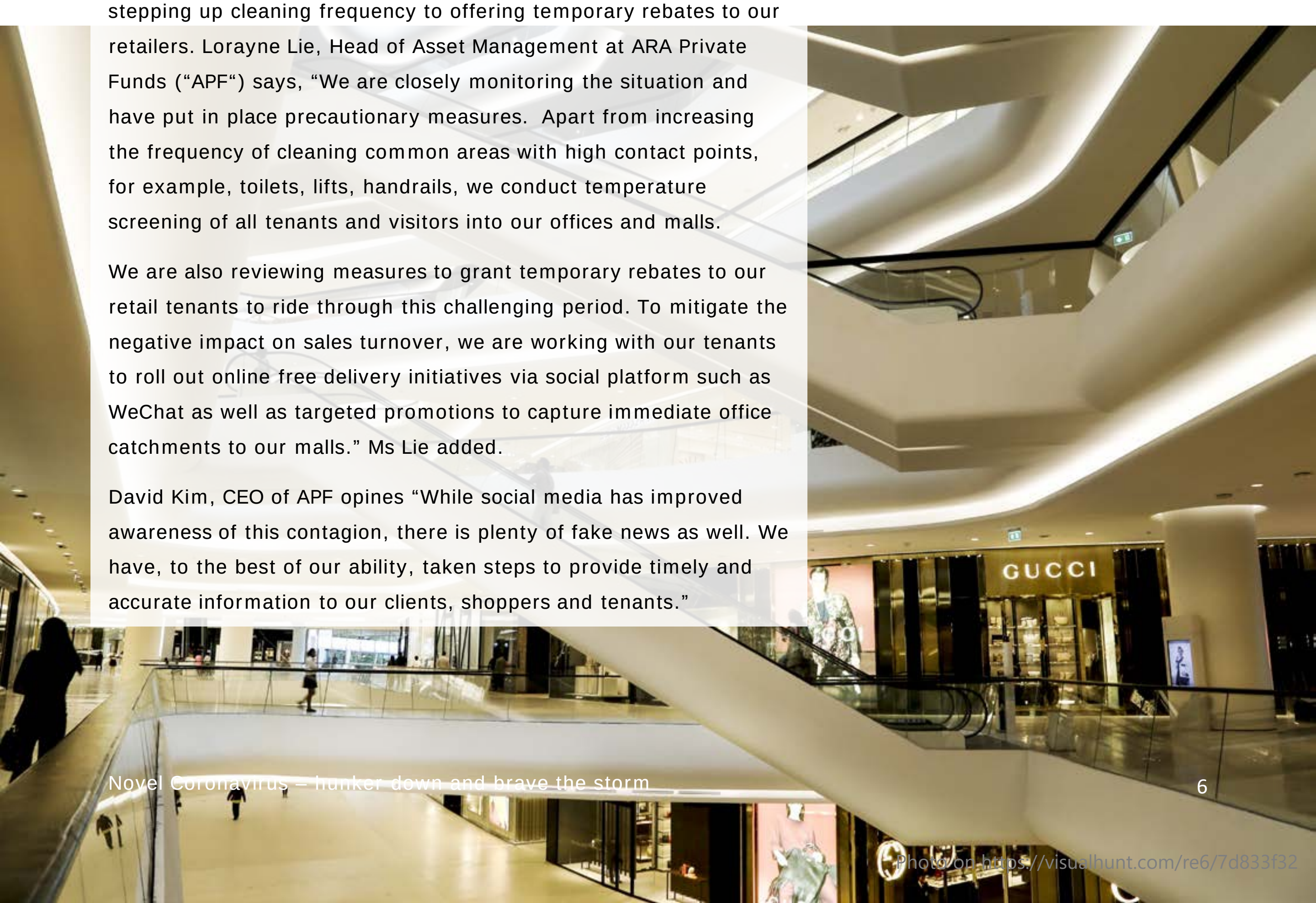


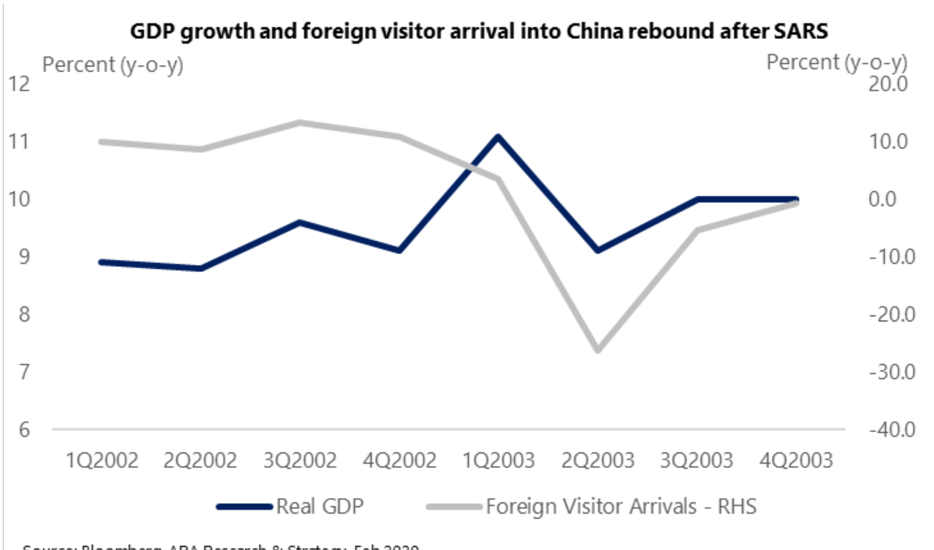
Photo on https://visualhunt.com/re6/7d833f32

Hunker down and brave the storm

The novel coronavirus outbreak looks to continue and to what end before the situation is controlled, is anyone's guess. Hospitality, airlines, retail sectors are likely to feel the brunt of this outbreak while the office leasing market could follow if the outbreak is not contained and begins to affect business operations in major cities. Another potential casualty is universities in Australia, which is one of the top three locations for international students worldwide. It is estimated that some 165,000 Chinese students in Australia have gone home for the lunar new year, and a majority have not returned for classes. As the deadline for semester enrolment draws near (30 March), the financial risk for top universities estimated at some US$ 2 billion according to Standard and Poor's, is getting increasingly close.

Nonetheless, the Asian markets will rebound as they have in previous outbreaks when the contagion is finally contained. Asia has had the experience from SARS to help contain and better manage this contagion. Reportedly, some experts think the outbreak could ease when the temperature starts to rise as summer arrives in April/May. Separately, Imperial College of London scientists have claimed a breakthrough and are testing the vaccine soon, while US-based biotech firm Gilead has partnered with the China-Japan Friendship Hospital in Beijing to conduct a human test of the anti-viral drug.

Until we see a pronounced control over this outbreak, what we can do is hunker down and wait through this storm. There will be a short-term socio-economic shock to China and the global economy this year, but the impact is not likely to have any long-term systemic damage.



Source: Bloomberg, ARA Research & Strategy, Feb 2020

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About ARA Asset Management Limited

ARA Asset Management Limited (ARA or the Group) is a leading APAC real assets fund manager with a global reach. With S$87 billion in gross assets under management as at 31 December 2019, ARA manages listed and unlisted real estate investment trusts (REITs) and private real estate and infrastructure funds in 28 countries. As part of its investor-operator philosophy, ARA also operates a real estate management services division with local teams to manage its assets worldwide.

ARA's multi-platform, multi-product global fund management strategy, combined with its dedicated teams with in-depth local knowledge and expertise, 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.

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