Commentary

Reaffirming the Invest-China Thesis

- Post 19th Party Congress

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Executive Summary

- The recent confluence of several major geopolitical happenings has recharged the economic and political energy in Asia. Kicking off these media-grabbing events was China's 19th Party Congress where President Xi Jinping in a three-hour-long speech, gave his economic vision for China as it gears toward a consumption-based economy. This quinquennial meeting has set a clear economic and political agenda for China with President Xi emerging as one of the most influential leaders after Mao Zedong and Deng Xiaoping. With such high internal political support, President Xi met with the US President Donald Trump as the latter made his round through Asia with his first stop in Japan.
- President Trump's tour concluded in the Philippines with a stopover in Vietnam for the APEC Summit. Several photogenic moments and quotable commentaries later, the Asia Pacific region looks stronger than ever. Amidst the media's extensive coverage of the US withdrawal from the Trans-Pacific Partnership agreement, there were several small but significant moments that, in our opinion, set a firm undertone for the future of Asia Pacific.
- Firstly, is the resurrection of the Trans-Pacific Partnership as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership, shored by a cyclical upswing in global economic conditions driven by China, emerging Asia, Japan and the euro area. Progress in the Regional Comprehensive Economic Partnership is anticipated as Singapore, as the new Chair for ASEAN, works closely with China to push this regional trade agreement along.
- Japan Foreign Minister Taro's voice of support for China's Belt and Road Initiative following President Xi's recent "fresh start" with Prime Minister Abe at the sidelines of the APEC Summit is another encouraging sign.
- Finally, while the South China Sea territorial disputes will surely take time to resolve, the mutual recognition of a peaceful negotiation between the parties is a positive step. Economic growth will take priority and trade among these countries is likely to continue.
- The purpose of this commentary is to provide our views on some of these less reported events and make sense of their impact on our investment thesis. These recent events as outlined have, in our opinion, strengthened the geopolitical environment and the underlining economic fundamentals in Asia Pacific. Trade flow within the region is likely to continue and support economic growth. China's explicit support for globalisation certainly bodes well for the region. The investment opportunities look positive, and we hold onto the invest-China thesis.

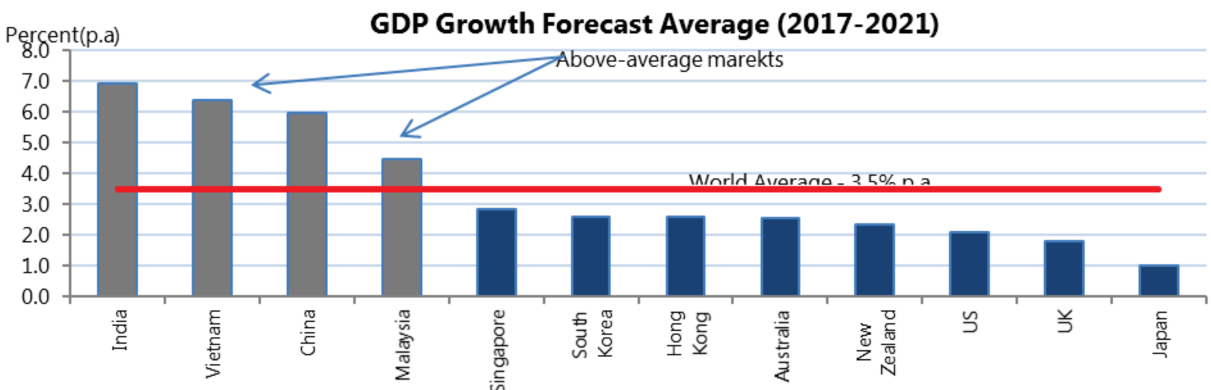
China’s 19th Party Congress

- China's economic and political strength, both on a domestic and international front, has been growing slowly, only to be spurred further by a recent turn of events. Among them is the 19th Party Congress that concluded in October. China's economic strategy for the next five years was unveiled at this closely watched political gathering of the socialist party; cemented by a renewed politburo comprising several new and younger candidates, all supporters of President Xi’s economic vision.
- “Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era" was also enshrined into the Party’s constitution, making Xi Jinping (“Xi”) one of China's most powerful leader after Mao Zedong and Deng Xiaoping. During his 3-hour speech, Xi identified the development dilemmas of the Chinese society has shifted from "meeting the material and cultural needs of the people while upgrading the backward production" to the current "rebalancing uneven and inadequate development while fulfilling the people's ever-growing needs for a better life". This economic development focus is a notable shift from mere production expansion to a more balanced development going forward. Xi further reiterated that "residential houses are for living in and not speculation", pointing to the development of a healthy residential market where there is sufficient housing to meet both rental and ownership demand.
- The CPC has also reaffirmed its commitment to doubling China's 2010 GDP and per capita income by 2020, which entails an average of 6.3% annual GDP growth in 2018-2020. To achieve this target, the three priorities over the next three years (2018-2020) are; 1) preventing financial risk, 2) reducing poverty, and 3) fighting environmental pollution.
- Xi further extended Deng Xiaoping's vision to "realise socialist modernisation" in 2020-2035, and to develop China into a "great modern socialist country" in 2035-2050. Toward this end, there are six strategic initiatives; 1) boost Belt and Road investment and support further liberalisation, 2) accelerate research & development and innovation; 3) pursue balanced regional development; 4) boost the rural economy; 5) stimulate SOEs’ reform, and 6) deepen supply-side reforms. Of these six, three should have more impact on the real estate market (see Annex A for in-depth analysis).
- While growth still takes centre stage in Xi’s grand economic vision, what is noteworthy is the secular shift in growth quality and structure. China is amid gearing up for a consumption-based economy and achieving that, China is likely to cut excess capacity, rein in financial leverage, and stabilise housing markets. Alongside the recovery in global economic conditions, this bodes well for overall real estate demand in China.
- Amidst this renewed economic ambition and political directive, several global and regional trends that may impact China directly or indirectly, have also been slowly unfolding.

Affirmative Trends

Global economic recovery in sight

- The cyclical upswing in global economic activity has strengthened, with growth led by China, emerging Asia, Japan, euro area and emerging Europe. This has motivated the International Monetary Fund to revise their October forecast on global growth for 2017 and 2018 to 3.6 percent and 3.7 percent respectively – a 0.1 percentage point higher than their July forecast. Overall the growth outlook in Asia till 2021, looks positively robust (see chart below).
- Developing Asia i.e. China alongside with India and Vietnam, are forecasted to outpace global average while advanced economies in Asia should maintain a lead over those in the UK and US. The high domestic demand in developed economies and China, coupled with a continual recovery in investments, have lifted manufacturing activities in these countries.
- While these trends bode well for the global economy, some risks could dampen the growth – a stubbornly low US inflation environment amidst full employment, China's debt burden that is slowly deleveraging, and rising nationalism in advanced economies of the West.
- Surrounding a steady macro trend in Asia Pacific is a political haze that has been lifting gradually, revealing a warmer investor climate in this region:
    1. Resurrection of the Trans Pacific Partnership Agreement (TPP) as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP);
    2. Positive signs to the Regional Comprehensive Economic Partnership (RCEP) despite some challenges in the negotiation;
    3. Rejection of President Trump's offer to meditate on the South China Sea territorial disputes by Vietnam and the Philippines; and
    4. Japan's support for China's Belt and Road Initiative.
- The next section explores the evolvement of these issues and how they could support the long term economic growth prospects of the Asia Pacific region.



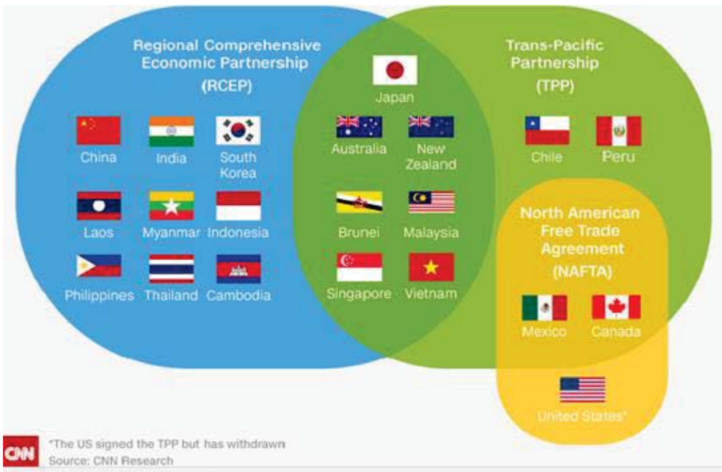
Source: IMF, Bloomberg, ARA Research & Strategy, Oct 2017

- The original TPP involved 12 countries (Australia, Brunei, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, US, and Vietnam) with a collective market size of about 800 million people – almost double that of the European Union. This 12-nation trade bloc is already responsible for 40% of the global GDP and 20% of global trade. Some 18,000 tariffs would be removed, if all 12 nations ratified the agreement by February 2018. For the deal to take effect, at least six countries that account for 85% of the group's economic output had to be on board, so with the US's withdrawal, the deal is no longer possible.
- Despite President Trump's recent announcement to withdraw the US from this deal, the remaining 11 nations have forged ahead and issued a joint statement stating they agreed on the TPP core elements and were committed to opening their markets.
- With some modifications to the earlier framework, the remaining nations are moving forward, and the deal has been resurrected as the Comprehensive and Progressive Trans-Pacific Partnership. According to the new agreement, at least 6 of the 11 countries must ratify the CPTPP for the new deal to come into force, with a targeted date of late-2018 if not early 2019.
- We think this pact will be instrumental in deepening economic ties between Americas and Asia Pacific. The mutual removal of tariffs, albeit at different timing, could foster more considerable trade between the countries bordering the Pacific Ocean. It would support a more balanced and sustainable economic growth and promote further investment flow between the two regions. While China is not a direct party to this regional FTA, the improve trade flows would benefit China inevitably.

Affirmative Trends

RCEP – end in mind

- The Regional Comprehensive Economic Partnership (RCEP) spearheaded by the Association of Southeast Asian Nations (ASEAN) and involving six other states with which ASEAN has existing free trade agreements, i.e. Australia, China, India, Japan, New Zealand and South Korea. These 16 participating countries currently account for about 30% of global GDP and 25% of world exports. The RCEP is into the fifth year of negotiations since its launch in 2012, and while there are still substantial challenges ahead, the group is committed to taking it forward.
- While market observers have recently doubted the relevance of RCEP especially considering the resurrected TPP, this potential free trade bloc has received substantial support from China in the past. If President Xi's recent affirmative comment on globalisation were anything to come by, it would be an assurance of China's continual support for free trade, and thus the RCEP as a case in point. No doubt challenges remain from the lack of existing FTA between the member countries such as India-China, Japan-China or Japan-South Korea, with Singapore as the new ASEAN Chair, committing to pushing the RCEP further forward, and together with China's support, we should expect the RCEP to make some headway going forward.
- While the scope of the RCEP is less extensive as compared to CPTPP, the impact of this deal would be similar in that it would promote trade and investment flow between these member countries and bode well for economic growth within the Asia Pacific region, including China.



Affirmative Trends

Peaceful negotiation - Asian-Chinese approach for the South China Sea territorial disputes

- At the recent APEC meeting in Vietnam, both Vietnam and the Philippines, who are parties to the South China Sea territorial disputes with China, have separately rejected President Trump's offer to meditate.

- Interestingly, both countries quoted peaceful negotiation as their option of choice in resolving the issue with China rather than involving a third party. This new stance is a sharp contrast to the Philippines' position in 2013 when it first brought the case to the United Nations Convention on the Law of the Sea. However, it does reflect an emergence and acceptance of an Asian-Chinese negotiation style - where issues are better to resolve mutually between the parties behind closed doors rather than publicly through a third party - could be more beneficial to all. This should not be read as a disregard for law and order but a preference for softer, mutually helpful order of things, and more importantly the Asian-Chinese face-saving approach to resolving issues.

- The territorial issue will surely need time to resolve, but economic needs will take priority. Meantime we can expect trade and investment to keep flourishing among these nations.

Affirmative Trends

Japan’s support for BRI

- Beyond territorial politics, a recent annual visit by over 250 Japanese businessmen to China has sparked off a warming of ties between the two countries. On the back of this annual visitation by Japanese businesses to China, Japan Foreign Minister Taro Kono praised the Belt and Road Initiative. This is a further affirmation of the warming of ties between the two countries; first coming on the back of President Xi’s recent meeting with Prime Minister Abe on the sidelines of APEC Summit in Danang, Vietnam, which was hailed as a “fresh start” to the relationship between these two Asian titans.

- Japan had previously along with India, expressed their concerns over China’s plan to connect world trade through an ambitious network of road and maritime. The common concerns over China’s grand “Marshall Plan”-like vision included environmental exploitation especially of resource-rich stakeholder countries; the economical influence China might assert over these participating stakeholders, and dumping by Chinese firms.

- Nonetheless, these negative comments are less frequent as more nations came on board with China's vision of the Belt and Road Initiative (“BRI”). Some 68 signatories together with China has committed to raising USD 7 trillion. Nearly USD 2 trillion has been allocated over the last three years; compared to USD 1 trillion that the US has committed to invest in its infrastructure over the next ten years.

- Reportedly, Asia needs about USD 51 trillion (or 54%), comprising transportation (USD 26.5 trillion), energy (USD 17 trillion), telecommunications (USD 4.0 trillion) and water (USD 3.1 trillion). The BRI would certainly help to close this gap. In Malaysia, the level of Chinese investment grew by over 119% in 2016, with a further 64% growth over the 1H17.

- BRI has often been compared to the post-war Marshall Plan (USD 130 billion in 2006 value). With Japan, possible participation, the impact of the BRI will have a long-lasting effect on mercantile flow soon. This recent development bodes well for investment primarily in gateway cities in China and the region.

Investment Outlook

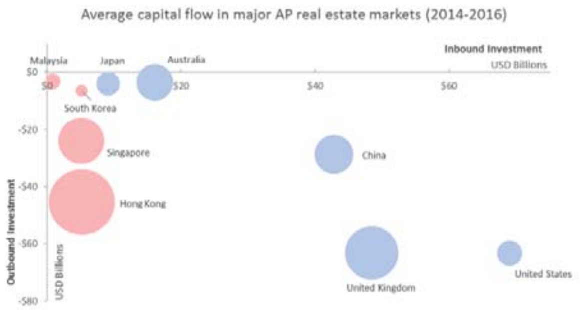
Pink in Health

- Amidst these rising regional and global undertones, the real estate investment market in Asia Pacific continues to flourish. According to RCA data, capital flows in Asia Pacific has recently outpaced those in Europe and America. In our opinion, this trend is likely to maintain in short to medium term. The favourable economic and demographic conditions in Asia are expected to support continual investor interests into this part of the world.

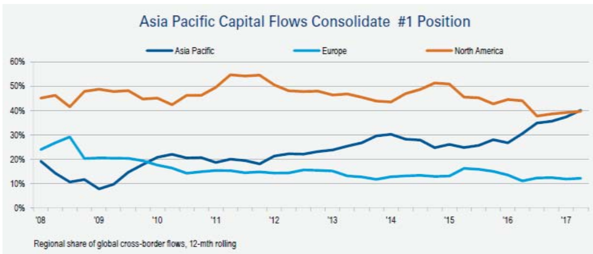
- Some key markets worth keeping an eye on are China, Australia and Japan which have seen net inflow of capital over the last three years, in contrast to Hong Kong and Singapore which saw a net outflow of capital, primarily due to a shortage of investment opportunities and steep pricing in these markets.

- Tier 1 cities in China, India, and Singapore, Hong Kong, are likely to see a cyclical upswing in office demand. Recent occupier demand across Asia Pacific has been consistently driven by domestic firms, technology and media related, and business services. The substantial expected completion in the development pipeline could push vacancy northwards, but we think this would be short-lived given the cyclical economic upswing. In fact, it bodes well as there would be more opportunities in this expanded investment universe in Asia.

- We maintain our recommendation to invest in Asia with an overweight on China through an investment strategy that could ride the restructuring towards a more consumption-based Chinese economy.



Source: RCA, ARA Research & Strategy, Oct 2017



Source: RCA, ARA Research & Strategy, Oct 2017

Conclusion

- China's continual evolution within the economic and political sphere has only been punctuated by several recent developments both domestically and globally. The successful completion of the 19th Party Congress has put President Xi's economic vision of gearing up China into a more consumption-based economy in good stead especially the majority of the politburo are new and younger supporters. Concurrently, prudential measures have been put in place to arrest rising financial market risks in China.
- Globally, economic conditions remain favourable with growth continued to be driven by China, emerging Asia, Japan, euro area and emerging Europe. Emerging geopolitical and economic trends that further affirm our invest-China thesis include the resurrection of the TPP as CPTPP. Despite the US withdrawal from the global trade agreement, the remaining 11 member nations have rallied together to push it forward. Although China is not a direct party to this regional FTA, the improved trade flows would benefit China eventually.
- Another emerging trade agreement albeit less extensive that China is party to, RCEP, is also showing more positive signs. With Singapore as the new Chair for ASEAN and China's strong commitment to globalisation, we should expect some progress in the near future. The impact of this regional trade agreement bodes well for economic growth within the Asia Pacific region, including China.
- The uncoordinated but consistent preference for a peaceful negotiation rather than to involve a third party to meditate on the South China Sea territorial disputes by Vietnam and the Philippines, suggests an emergence and acceptance of an Asian-Chinese negotiation style. This territorial issue will surely need time to resolve, but meanwhile economic needs will take priority and we can expect trade to continue among these nations.
- Finally with Japan's possible participation in the BRI, a Chinese initiative that has often been compared to the post-war Marshall Plan, the impact on mercantile trade would be remarkable.
- The real estate investment market in Asia Pacific has also been strengthening. Recent capital flow data suggests that Asia Pacific has outpaced those in Europe and America. Key markets are China, Australia and Japan which have seen net inflow of capital over the last three years.
- These macroeconomic and geopolitical trends have motivated us to maintain our stance to adopt an investment strategy that would ride through the restructuring towards a more consumption-based economy in China.

Annex A
Synopsis of the 19th Party Congress

The Communist Party of China (“CPC”) opened its 19th Party Congress (the Congress, thereafter) on 18 Oct, where 2,287 delegates across the nation gathered in Beijing. As China continues to grow its global economic and political influence, the Congress will undoubtedly affect not only China’s economic outlooks but also longer-term geopolitical landscape regionally and globally.

Leadership Reshuffles

- The Congress reviewed the progress of the past five years and made social and economic development plans for the next five-year term. More importantly, it unveiled a new batch of political leaders, which marked a critical turning point for China's political cycle (Appendix 1).
- Aside from President Xi Jinping (“Xi”, thereafter) and Premier Li Keqiang, younger officials replaced 15 out of the 25 members in Politburo and five out of the seven Politburo Standing Committee members - China's most powerful decision-making body. The fact that “Xi Jinping Thought on Socialism with Chinese Characteristics for a New Era" was enshrined into the Party’s constitution symbolized Xi’s success of centralising political power, making himself as China’s most powerful leader since President Mao Zedong. Against that background, Xi would have the much stronger political capital to push for his reform agendas in the next five years than in his previous tenure term, despite some potential resistance or opponents from internal stakeholders.

Annex A

Synopsis of the 19th Party Congress

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Grand Themes

- During his 3-hour speech, Xi identified the development dilemmas of the Chinese society has shifted from "meeting the material and cultural needs of the people while upgrading the backward production" to the current "rebalancing uneven and inadequate development while fulfilling the people's ever-growing needs for a better life". This economic development focus is a notable shift from mere production expansion to a more balanced development going forward. Besides, he reemphasised "residential houses are for living in and not speculation", pointing to the acceleration of the establishment of a healthy residential market where there is housing to meet both rental and buying demand.
- Importantly, Xi pledged to build a "moderately prosperous" society in China by 2020 and realise the "Chinese dream" of fulfilling the "great renewal of the Chinese nation". In 2018-2020, three major tasks were targeted, namely, prevent financial risk, reduce poverty, and fight environmental pollution (Appendix 2). While Xi didn't specify GDP growth targets, the CPC has repeatedly affirmed its commitment to doubling China's 2010 GDP and per capita income by 2020, which entails an average of 6.3% annual GDP growth in 2018-2020.
- In our view, growth still matters to Xi's grand visions, alongside a global cyclical upswing. What is most noteworthy is the secular shift in focus on growth quality and structure, as China is in the midst of gearing up for a consumption-driven growth engine. China is therefore likely to continue to cut excess capacity, rein in financial leverage, and stabilise housing markets post the Congress.

Annex B
Impact of the Strategic Initiatives on the real estate market

- Out of the six initiatives, three could have more significance on China's overall economy and real estate markets:

1. The Belt and Road Initiative ("BRI") and further liberalisation

- During the Congress, BRI was officially included in China's constitution considering Xi's principle of "shared growth through discussion and collaboration" as well as his grand vision of globalisation. We reckon the government would grant more powers and offer flexibilities to pilot free trade zones and free-trade ports (sea or land). The inflow of foreign capital and services are likely to receive equal if not more emphases than the outward investment of domestic players. China will liberalise further to attract more significant international participation, especially in the services sector.

- In anticipation of gradual relaxations of market access, further opening-up of the services sector, and improved intellectual property rights, multinational corporations will be increasingly enticed to either set up or expand their physical presences in China. This trend is likely to drive occupier and ownership demand for office assets in major Chinese gateway cities. In addition to the BRI, the "Go West" campaign is likely to trigger further relocations of manufacturing sectors from coastal cities to inland conurbations, boosting the demand for modern industrial and logistics spaces in these new cities. Regeneration of the stock to support the new economic directives will be key in the more traditional older coastal cities.

2. R&D and Innovation

- President Xi vowed to increase spending on R&D and innovation to upgrade Chinese manufacturing competitiveness and move it towards more advanced manufacturing. The government will continue to promote the integration of the internet, big data, and Artificial Intelligence ("AI") with the real economy, and foster the sharing economy and modern supply chains amid rising labour costs and ageing population.

- This initiative, if materialised, will augment and diversify the financial-centric office tenant pool by adding high-tech manufacturing sectors, e.g., aerospace, advanced railway, and so on. With more resources set to allocate to R&D activities, we expect to see growing demand for high-tech Business Park or purpose-built industrial space. Additionally, the broader adoption of big data or AI-related technology in the Business-to-Consumer model will likely yield robust need for data centres.

Annex B
Impact of the Strategic Initiatives on the real estate market

3. Balanced Regional Development

- The Congress emphasised the coordinated regional development with the focus on the creation of city-clusters, especially the Beijing-Tianjin-Hebei region, the Yangtze River economic belt, as well as the Great Bay area linking Hong Kong, Macau and the Pearl Delta. In our view, this signifies a push to further the urbanisation process, which will continue to motivate infrastructure investment and spur economic growth on the backdrop of favourable policies and shifting business interests. Among notable beneficiaries include infrastructure, property, advanced manufacturing, and modern services sectors.

- In our view, this will not only continue to unlock China's economic potential but also provide a healthy boost to real estate demand within these city clusters. In the case of the Beijing-Tianjin-Hebei region, the proposed relocations of non-capital functions/sectors to emerging areas, notably the Xiong'an new area, will address the urban pollution and congestion issues, thereby improving the quality of life for residents in Beijing. With improved urban infrastructure and amenities, satellite cities around Beijing, e.g., Tongzhou or Daxing, as well as Tianjin and key cities in Hebei province will also benefit from the spillover demand both for affordable office alternatives and strategically-located industrial and logistic premises.

- Besides the initiatives above carrying considerable importance to overall economy and real estate markets, the remaining three actions will have implications as well. To boost the rural economy is to unlock rural farm wealth, bridge urban-rural income gap, and support consumption growth, ultimately boosting total retail sales and demand for retail space. The supply-side reform, especially the SOE reform, will continue to optimise the resource allocation and enhance productivity and efficiency. Measures to pursue mixed ownership and increase SOE profitability, rather than outright deleveraging, are crucial to tackle solvency concerns and sustain societal and economic stability. As SOEs account for a reasonably significant portion in industrial and investment markets, the relatively dovish tone is likely to pave the way to a long-term sustainable development path in China's real estate markets.

- In tandem with the government's commitment to curbing financial risks, monetary policy stances should be biased towards moderate tightening. Therefore, existing policies such as deleveraging and capital controls will remain in place in the near term. We expect outbound investment to stay relatively muted, except for BRI-related projects. The weight of capital coupled with on-going capital controls should continue to drive domestic investors towards commercial assets in preferred Tier-1 and -2 cities with favourable market fundamentals.

Appendix 1. Politburo Standing Committee Members for the 19th Party Congress

Name	Xi Jinping	Li Keqiang	Li Zhanshu	Wang Yang	Wang Huning	Zhao Leji	Han Zheng
Rank	1	2	3	4	5	6	7
Birth Date	15-Jun-53	1-Jul-55	30-Aug-50	12-Mar-55	6-Oct-55	8-Mar-57	1-Apr-54
Official Title	President, Chairman of the PRC Central Military Commission	Premier of the State Council	Chairman of the Standing Committee of the NPC	Chairman of the National Committee of the Chinese People's Political Consultative Conference	First-ranking Secretary of the Central Secretariat of the CPC, President of the CPC Central Party School	Secretary of the Central Commission for Discipline Inspection	First Vive Premier of the State Council
Previous Position before Joining the PSC			Secretary of the CCP Central Secretariat, Chief of the General Office of the Communist Party of China	Vice Premier of the State Council	Director of the Policy Research Office of the CCP Central Committee	Secretary of the CCP Central Secretariat, Head of the CCP Organization Department	Party Secretary of Shanghai
Photo							

Source: Baidu, Wiki and Citi Research; Note: Official title in red part is our forecast, as the official announcement will not be released until next year's NPC meeting

Appendix 2. China's 19th Party Congress Grand Vision in 2050

Near-term Target (2018-2020)

Three major tasks: Preventing risks (probably referring to financial risks), reducing poverty, and anti-pollution

Long-term Target (2020-2050)

Stage 1 (2020-2035): To become a top ranked innovative nation with a large middle-class population and reduce poverty, and largely achieve pollution prevention

Stage 2 (2035-2050): Stronger nation, global leader

Six initiatives to realize the long-term plan:
(1) Supply-side reforms
(2) R&D and innovation
(3) Boost to rural economy
(4) Regional balanced development
(5) SOEs reform
(6) Opening up & boost to Belt and Road (B&R) investment.

Source: Xinhua, Morgan Stanley Research

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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.

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Prior to joining in ARA in 2015, Dr Li worked at the Investment Research and Strategy department at M&G Real Estate Asia - *the UK Prudential Plc's private equity real estate investment arm*.

Dr Li obtained his PhD from the National University of Singapore, majoring in real estate finance and economics, and MSc in real estate from the Royal Institute of Technology in Stockholm, Sweden.

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