B&I Capital

Asian Market Outlook

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Market Outlook

Asian RE Securities ended the first half of 2024 on a weak note. Peculiarly, Asian REITs did not react positively to the drop in UST yields after a series of data points indicated that both price increases and the US labour market may be cooling. Indeed, the latest Non-Farm Payrolls released on July 5th confirmed recent data. While the headline beat expectations, three quarters of June's job growth came from government and healthcare sectors while cyclical sectors shed jobs. The previous month's jobs growth was revised lower, taking the 3m average to levels not seen since the pandemic. In addition, labor market participation continues to expand which is helping keep a lid on wages. As we enter the second half, the outlook has become slightly more confusing. On the one hand, it appears that the US labour market is no longer tight and the drop in job openings seen over the last 12 months has gone to levels where any more deterioration may turn into higher unemployment (Beveridge Curve) which will shift the Fed's focus from prices to employment. On the other hand, the rising probability of a Trump presidency has spooked bond investors, and the yield curve steepened after the first debate as bond investors ponder inflationary tariffs, permanent tax cuts, a less independent Fed, and other potential inflationary policies. Nonetheless, we remain optimistic due to peaking interest rates and other costs that topline growth will restore dividend growth in 2025 and 2026.

Japan

The JPY and the BOJ's next step are what will dictate the direction for REITs and Developers in the mid-summer. We have written a separate piece on the historical impact of policy moves on the sector and outlook which are available to those who are interested (please contact B&I Capital). The July meeting will be a live meeting with the BOJ announcing the amount of bond purchases it will taper down to. In addition, while many still expect that the BOJ will raise rates after July once firmer spending data is available (post wage increases announced in April), they could use this meeting to surprise with two policy moves (QT and policy rate) . There is a growing consensus that this is likely given the JPY persistent decline that in itself will reaccelerate imported inflation. Developers have typically drifted during the summer as there are few fundamental catalysts to drive share prices after the full year results presented in May. Upward revisions typically don't occur until after the first half reporting in October, so barring some corporate activity or more activist engagements, we expect the sector to continue its consolidation. We see high potential for upward revisions especially driven by the strong residential sales and margins that companies have been pointing to in our current post results meetings and in their guidance.

Australia

The RBA is potentially the only other Central Bank that could tighten in the coming months. Its recent minutes highlighted continued risk to the upside on pricing and growth and has made it clear that an increase in rates is a possibility. This has ramifications for the sector. Goodman Group now representing 46% of the Australian weighting in the FTSE Index is seen as less impacted by rates due to its low gearing and its highly touted Data Center development pipeline representing about 40% of its Works in Progress. Cyclical REITs like GMG's peer Asset Manager REIT, Charter Hall Group, have struggled recently as rate cuts have gone off the table and recent office asset sales demonstrated cap rate expansions which would impact their AUM and growth. The housing related names have also been negatively impacted as volumes have suffered as prices have risen. Goodman Group has significantly outperformed all others and trades at a massive premium to the cyclical names, but for any reversal there needs to be a surprise on the inflation front again. We have been happy to see asset sales pick up, especially in office, and while prices have been well below previous valuations there are finally some transactions.

Mirvac Group announced that it sold a 2/3 stake in 55 Pitt Street which helped it maintain its guidance despite slower residential sales. The buzzer beater announcement at the end of June came after they had announced other leasing successes in this office development and has reduced the development's risk. Last week, the ACCC raised some concerns regarding Stockland's land lease community from Lendlease with a specific objection regarding one asset in NSW and is seeking clarity on another 3 of the 12 to be acquired. Stockland remains confident that it will be able to complete the transaction, but given the additional information request that will delay ACCC's greenlight (along with FIRB approval) until at least September, analysts are lowering their FY25 earnings expectations. We expect the stock to remain choppy until the issue is resolved but remain optimistic on the strength of their overall residential model.

Hong Kong

Not much good news to expect other than more support measures for HK Retail. May retail sales numbers were better than April, but it is rumoured that June's numbers will be another disappointment. May's visitations to HK from the mainland rose to 69% from 61% and luxury sales rose 7% MoM. However, June is expected to see another reversal with outbound HK travel rising to 116% vs. 2018 and visitors from the mainland to HK falling to 64%. Ongoing concern regarding Northbound leakage of retail sales to Shenzhen continues and it appears June numbers will confirm that. In our recent meeting with Link REIT, they commented that in their opinion they have been less affected as their F&B, an area of erosion for other retail owners, has actually shown growth while supermarket sales have softened due to increasing restaurant visits, although Link is also seeing very strong growth in their Shenzhen malls. Recent duty-free allowance for mainland tourists was increased at the start of July which raises the allowance to RMB12k (15k including purchases at duty free stores) so this will help somewhat improve HK sales. While multiple head winds exist for retail, we believe lower end non-discretionary and dominant luxury malls will fare best with the mid-range malls feeling the brunt of the Northbound leakage. The overall market remains extremely cheap but lacks catalysts and is most affected by US rates due to the HKD peg. If US macro data continues to soften this could lend some support to the REIT sector which has seen extreme increases in funding costs and remains very sensitive to short term rates as some borrowings are based on short term HIBOR and often floating. Office continues to suffer from weak demand and still ongoing supply, and we continue to see no reason to have direct exposure to it. While population growth is positive, and rents have risen for residential, recent sales have slowed and pricing is weak, so we expect weak margins and profits for the HK developers although the clearing process is positive and recent policy changes are attracting mainland buyers. We expect dividend reductions for most of the Hong Kong residential developers except Sinoland which is heavily backed by its strong cash position that is roughly 70% of its market cap.

Singapore

SREITs continue to be attractive in the current environment and we expect to see further rental growth, particularly for suburban retail given the strong sales of tenants which are more than 20% above pre-pandemic levels. We also see Office names remaining resilient due to limited vacancy in the CBD despite one large new office building entering the market. Retail remains our preferred sector as sales growth has yet to translate into high rent growth but expect this to change going forward with occupancy costs at the lowest they have been in several years. Drivers for SREITs are often generalist fund managers that have limited choices in Singaporean equities and are currently benefiting from strong performance of the banking sector due to favourable interest rate conditions. However, we have noticed that lending spreads have fallen since 2023 and if rates fall globally this could be a trigger for rotation into large cap SREITs from Banks for those investors.

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