SPECTER OF LONG TRADE WAR LOOMS OVER PROPERTY

Extended U.S.-China trade sanctions likely to weigh on interregional property capital flows, lessen confidence in office leasing markets in greater China, and affect demand for U.S. industrial real estate.
Summary and Recommendations

Washington has shattered the truce in the U.S.-China trade war by announcing that existing tariffs of 25% on $250 billion (\$ denotes U.S. currency) of Chinese imports will be extended, with a 10% tariff applied to nearly $300 billion of remaining imports from 1 September. The chances of a protracted trade war have now increased.

Despite active recent interest from Singapore and South Korean capital in global property markets, trade tensions appear to be weighing on both Asia-to-global and global-to-Asia property capital flows. In contrast, intra-Asian property capital flows still look firm.

In Asian leasing markets, we expect falling confidence among tech firms in South China, despite firm long-run prospects. The Shanghai and Beijing office markets have been affected by both delayed demand due to the trade war and heavy new supply. If trade war resumes, Hong Kong SAR may have more to lose than mainland Chinese cities, given high multinational occupancy and reliance on finance. It is reasonable for large occupiers to consider expansion in other markets to mitigate risk.

In contrast to Asia, the impact of the trade tensions on U.S. office occupiers is likely to be minimal. However, demand for U.S. industrial property could be undermined. Notably, demand from manufacturing occupiers could decline, hurting regions in the Midwest and Southeast.

Summary and Recommendations

Washington has resolved to address what it regards as imbalanced China-U.S. trade flows. A tariff of 25% currently applies to $250 billion of Chinese imports. After inconclusive negotiations in Shanghai in late July, President Trump shattered the truce in the trade war agreed in Japan in June by announcing that the U.S. will apply a 10% tariff to all remaining Chinese imports (worth nearly $300 billion) from 1 September. It is impossible to predict the outcome of trade wars once they start, and the impact of renewed tensions on the U.S. economy would be material, although the hit to Chinese GDP would be greater.

Trade tensions appear to have already impacted property capital flows. Despite high activity by Singapore capital in 2018 and South Korean capital this year, RCA data show that Asia-to-global property investment fell 33% year over year in H1 2019. After a strong pick-up in 2018, global-to-Asia property investment fell 28% in H1 2019. While these figures may well be revised upwards, both headings of investment now look likely to be flat at best in 2019. In contrast, intra-Asian capital flows (up 3% in H1 2019) still appear firm.

In Asian office leasing markets, while South China will initially feel a greater impact from trade tensions due to its focus on technology, confidence is also falling in Tier 1 cities elsewhere in China. In Shanghai and to an extent Beijing, uncertainty linked to trade tensions is delaying demand for office space and compounding the impact of sharply rising supply, pushing up vacancy. With 60% MNC occupancy of Grade A office space, Hong Kong SAR is also vulnerable to lower demand for space, especially if a renewal of the trade war pushes down stock markets. It is reasonable for finance, professional services and technology groups to consider expansion in Singapore to mitigate risk, while we expect trading or manufacturing occupiers to consider India or Southeast Asia.

Unlike in Asia, the U.S.-China trade tensions are likely to have a minimal impact on U.S. office occupiers. However, they may undermine demand for industrial property, especially in port and manufacturing markets. Notably, demand from manufacturing occupiers, which accounted for nearly 13% of total industrial transactions in the U.S. in H1 2019, could decline, hurting regions in the Midwest and Southeast.
Total of $601 billion trade flows of goods between U.S. and China in 2018

$481 billion

Total trade flows between China and the U.S. in 2018 according to IMF data, split thus: Chinese exports to the U.S., $481 billion; U.S. exports to China, $120 billion. U.S. data give a total trade balance of $660 billion, while Chinese data give a total trade balance of $623 billion.

Asia-to-global, global-to-Asia and intra-Asian capital flows in H1 2019

Asia-to-global flows: $16.1 billion, $33% YOY

Intra-Asian flows: $53.8 billion, $3% YOY

Global-to-Asia flows: $7.8 billion, $28% YOY

A tariff of 25% currently applies to $250 billion of Chinese imports

Volume of Chinese exports to the U.S. on which a 25% tariff currently stands, with the expectation that a 10% tariff will be applied to all remaining Chinese exports (worth nearly $300 billion based on total 2018 exports of $540 billion according to U.S. data).

33% total office leasing volume delayed

In Shanghai, we believe that up to one-third of total office leasing demand could be delayed through uncertainty linked to the U.S.-China trade tensions.

31%-60%

is the range of occupancy of Grade A office space by MNCs in Shanghai, Beijing and Hong Kong SAR*. Reduced expansion activity and possible relocation by large occupiers will weigh on leasing demand in these cities.

* Special Administrative Region (of the People’s Republic of China)
Washington has resolved to tackle what it regards as imbalanced China-U.S. trade flows. At present, a tariff of 25% applies to $250 billion of Chinese imports. The U.S. now looks set to apply a 10% tariff to all remaining Chinese imports (nearly $300 billion).

In this report, we assess the implications for investment property capital flows and occupier property markets of the worsening trade tension between the U.S.A and China. The report is comprised of four sections:

- Overview of the key developments in the trade dispute, with an assessment of the impact on the U.S., China and global economies
- Likely impact of the potential trade war on investment property capital flows
- Likely impact of the potential trade war on Asian office leasing markets
- Likely impact of the potential trade war on U.S. office leasing and industrial property

**SECTION I: ECONOMIC IMPACTS**

The U.S. and Chinese economies are deeply intertwined. In 2018, according to the International Monetary Fund (IMF), China exported $481 billion to the U.S., while the U.S. exported $120 billion to China, for a total of $601 billion. In the opinion of the current U.S. administration, these trade flows have been imbalanced for many years. Last year, based on the U.S. data, the U.S. exported only $120 billion in goods to China, while importing almost $540 billion. Although the U.S. maintains a substantial trade surplus with China in services, it may be argued that these volumes pale in comparison to the large imbalance in goods traded between the two countries.

Chinese data for 2018 showed total trade flows of $623 billion, split thus: Chinese exports to the U.S. were $468 billion and U.S. exports to China were $155 billion³. Chinese official comments on these trade flows insist that the surplus in China-U.S. trade volume indicates the high complementarity of the two economies.

While the trade tensions between the two largest economies in the world go back decades, friction has risen under the current U.S. administration, which has condemned the growing trade imbalance and threatened escalating tariffs on a growing share of Chinese imports. In a series of steps over H2 2018 and early 2019, the U.S. administration imposed tariffs on a range of goods imported from China. The most recent increase took effect on 10 May. Since then, a tariff rate of 25% has been applicable to $250 billion of Chinese imports. Beijing responded to this measure by raising tariffs from 5%-10% to 20%-25% on $60 billion of U.S. products.

The U.S. and China have different figures based on their own accounting conventions. Based on U.S. data, $660 billion in goods flowed between the two nations in 2018¹. Further, they exchanged almost $70 billion in services in 2016, the last year for which data is available². If services trade grew at the same rate as goods trade, total U.S.-China trade would have hit $740 billion in 2018 — among the highest trade volumes between any two countries on earth.

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¹ Source: https://www.census.gov/foreign-trade/balance/c5700.html.
³ Source: Ministry of Commerce of China
Both sides have raised the question of additional tariffs and measures, though discussions have continued on and off. The two countries reached a tentative truce at the June G20 meeting in Osaka, Japan. Washington pledged to halt further tariff increases and reduce pressure on a disputed Chinese technology firm (Huawei), Beijing committed to purchasing more U.S. farm products, and both countries agreed to negotiate.

The next trade discussions between the U.S. and China took place in Shanghai in late July and were inconclusive. After the discussions, U.S. President Trump shattered the truce on 1 August by announcing that the U.S. would apply a tariff of 10% to all remaining Chinese goods imported into the U.S. from 1 September. Based on total 2018 Chinese imports of $540 billion according to U.S. data, the value of the remaining goods is $290 billion. We assume that this total was rounded up to $300 billion for simplicity in the announcement, and the $300 billion figure has been widely reported in the financial press.

The U.S. administration had held out the possibility of applying the 25% tariff that already applies to $250 billion of Chinese imports to all imports, so the president’s announcement was actually less severe than it might have been. It is also possible that the threatened extension of tariffs is merely a negotiating tactic which will be reversed.

Nevertheless, as of the time of writing (5 August), the apparent end of the truce has hit Asian and European stock markets, reinforced a global rally in perceived safe assets such as U.S. government bonds, and weakened the Chinese renminbi. Economic forecasters such as Oxford Economics are now arguing that the chances of a long-term trade war have increased1.

Regardless of the official pronouncements along the way, it is impossible to predict the outcome of trade wars once they start, as they are driven more by political considerations than economic forces. Nonetheless, there is little doubt that the impacts on trade and economic growth will rise the longer and more widely the tariffs are applied. With the U.S. and Chinese economies so intertwined, any disruption to the flow of goods and services between the two countries has significant consequences for their economies.

Moreover, given the rise of globalization and multilateral supply chains in recent decades, the impact of tariffs will probably spill over to the global economy itself. Some regions, notably lower-cost Asian nations, Mexico and Central America, may see modest benefit as producers shift manufacturing out of China, but we believe overall trade flows will decline.

Supply chains are complex and often span many countries. For many products and intermediate goods – goods used to produce final goods – there may be few, if any, alternate producers. Adjusting these supply chains can be costly and protracted. Thus, tariffs can raise the cost of production both directly, through tariff payments, and indirectly, by disrupting efficient supply chains for more expensive and less efficient sources.

We cite below various analyses of the likely impact on the U.S. and Chinese economies of the increase in tariffs on Chinese imports implemented by the U.S. administration on 10 May:

> A paper published by the Federal Reserve Bank of New York found that the increase would cost the average U.S. household $800 per year, of which one-quarter would come from tariffs U.S. consumers pay on Chinese imports and three-quarters would come from buying more expensive goods from other countries2.

> Oxford Economics concluded that raising the tariffs from 10% to 25%, if maintained, would shave 15 basis points (BPS) off U.S. GDP this year and 30 BPS next. But the hit to China’s GDP would be much greater: about 35 BPS this year and 80 next, according to Oxford. There would be collateral damage to other countries as well, as global trade and growth slows by similar degrees to the U.S. GDP3.

> Similarly, Capital Economics found that the current tariffs, if maintained, would shave 20 BPS off of U.S. GDP in 2019 and 30 BPS in 2020, and that global GDP would slow by 50 BPS by end-2020. Further, nearly three-quarters of economists surveyed by the Wall Street Journal believed long-term gains would not offset short-term damage to the economy4.

Assuming the extended tariffs announced on 1 August are implemented and maintained, their impact on the U.S. economy may well be magnified given that more consumer products, such as cellular phones and clothing, will now be included. U.S. financial markets have reacted to the extension in a similar manner to global markets, with the release of positive new job numbers, now being outweighed by concern over the additional tariffs.

1 See ‘China: Trump’s new tariffs increase odds of long-term trade war’ by Oxford Economics (2 August 2019).
3 Gregory Daco, Oxford Economics, “Research Briefing: In a global trade war, everyone loses,” May 9, 2019
4 Michael Pearce, Capital Economics, “U.S. Economics Update: Factoring the escalating trade war into our forecasts,” June 6, 2019
While appetite among Asian investors for international property assets remains fairly healthy, the trade tensions have undermined our earlier assumption of a notable rebound in Asia-to-global property capital flows in 2019.

**SECTION 2: TRADE WAR MAY HIT PROPERTY CAPITAL FLOWS**

**Figure 1: Asia property capital flows: Asia-to-global, global-to-Asia and intra-Asia 2010–2019 (US$ billions)**

<table>
<thead>
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<th>Intra-Asia</th>
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**Asia-to-global capital flows**

Total investment by Asian investors in the property sector (completed assets and land sites) outside Asia was strong over 2015-2017, largely due to high Chinese investment in the U.S. In 2018, however, Asia-to-global investment fell 36% to $46.7 billion. The decline has continued so far in 2019: Asia-to-global capital flows fell 33% year over year in H1 2019 to $16.1 billion (see Figure 3 overleaf). Capital flows from China to global markets had already fallen 65% in 2018 due to government controls, with tiny but wealthy Singapore becoming the #1 source of Asian investment outside the region. However, China contributed less than $1.0 billion of global property investment in H1 2019, and so fell almost out of sight.

Intra-Asian capital flows, which had strengthened gradually over 2016-2018, stayed firm in H1 2019, rising by 3% to $53.8 billion. This suggests that appetite among Asian investors for international property assets is still healthy. Moreover, Colliers has seen signs that Asian capital is spreading more broadly across cities and sectors, notably in Europe, with South Korean capital especially active. The RCA data show that South Korean capital accounted for nearly $9.0 billion of Asian-to-global property investment in H1 2019, ranking ahead of Singapore (which was much weaker than in 2018) and Hong Kong SAR. Given the firm intra-Asian capital flows and the recent active involvement in global real estate markets of capital based in Singapore, South Korea and Hong Kong SAR, we had we had assumed until recently that Asia-to-global property capital flows would rebound 21% in 2019.¹

However, this assumption of a rebound no longer looks tenable. The trade war seems to have dampened investment demand by Asian enterprises in general, and not only those based in China. Demand from South Korean capital may stay strong, and we have observed higher activity by long-dormant Japanese capital.

The trade tension also suggest that the recovery in global-to-Asia investment interest will not continue at the pace we had expected.

Still, there seems little reason to expect a pick-up in demand from other sources. The initial RCA Asia-to-global investment total of $16.1 billion for H1 2019 will probably be revised upwards. Nevertheless, we have lowered our estimate of Asia-global capital flows to $47 billion in 2019, making it completely flat compared to 2018. The risk to this forecast is on the downside.

Incidentally, it is conceivable that the Chinese authorities will strengthen existing capital controls, delaying any recovery in Chinese investment demand. The Chinese renminbi had stayed below 7.0 against the U.S. dollar for four years but broke through that level on 5 August (see Figure 4). We believe that the Chinese authorities would prefer to avoid renminbi weakness and expect them to take steps to support the currency. However, further escalation of the trade disputes may encourage China to use currency depreciation to its advantage. (The U.S. Treasury believes that China is already doing so: hence its move to label China a currency manipulator on the day of the renminbi’s break through 7.0.) Even without new capital controls, unless trade tension noticeably eases, Chinese enterprises may choose to avoid or defer investment projects in the U.S. for political reasons.

The Global Financial Crisis and indicates renewed confidence in prospects for the region. The U.S. was the key source of capital flowing into Asia. Given Asia’s status as the world’s fastest-growing major region and persistent low interest rates, until recently we thought this recovery in confidence would persist. We had thus assumed a 25% increase in global-to-Asia investment in 2019, to $30 billion¹.

However, the trade tensions suggest that this recovery in global-to-Asia investment interest will not continue at the pace we had expected. RCA preliminary data for H1 2019 show that global-to-Asia capital flows fell 28%, to $7.8 billion. Again, this total will probably be revised upwards. Looking ahead, we believe large U.S. investment institutions will continue to target Asia in general. However, if the trade war resumes, we would expect fewer U.S. enterprises to invest or expand in China. While many U.S. enterprises expanding in Asia will lease rather than buy or build facilities, at the margin there could well be some impact on investment into property assets.

Investment in China by U.S. manufacturing groups is especially likely to be impacted. We have already seen signs of Taiwanese manufacturers moving production back from mainland China to Taiwan. Looking ahead, we expect U.S. enterprises to defer some investment projects, although other projects may be shifted from China to Southeast Asia or India. Accordingly, we have trimmed our estimate of global-to-Asia property investment in 2019 from $30 billion to $24 billion, equaling zero growth over the 2018 volume.

SECTION 3: TRADE TENSION WILL IMPACT ASIAN OCCUPIER CONFIDENCE

Concerning Asian office leasing markets, we see three key impacts of the prolonged U.S.-China trade tension:

- A probable near-term reduction in confidence among technology hardware and other manufacturing groups in South China in particular, affecting demand for office space in Shenzhen in particular.

- A reduction in confidence among MNC occupiers in greater China, giving them an incentive to curtail expansion and possibly to shift to other locations.

- Tougher conditions for financial occupiers in Hong Kong SAR in particular, if a resumption of trade hostilities pushes stock markets down again.

Probable near-term reduction in confidence among technology and other occupiers in South China

South China is the fastest-growing and most dynamic region of the country and has been targeted for further investment and expansion by the central government under the Greater Bay Area (GBA) plan. However, as the prime location of China’s burgeoning technology, media and telecommunications (TMT) sector, it is also the region with the highest degree of interconnection of imports, exports and supply chains with the U.S. This situation makes South China vulnerable to continuing trade tensions.

Conditions in the South China office leasing market have already weakened. The reduction to confidence caused by trade tension has compounded the impact of a wave of new supply in Shenzhen in particular — a wave set to increase total office stock in the city by 29% in 2019 alone. Shenzhen has also been affected by retrenchment among peer to peer (P2P) financial groups due to tightened regulation. P2P tenants gave up a large amount of space in Q4 2018 in particular, although some of this space has since been occupied by other tenants.

Average Grade A office rent dropped 3% quarter over quarter in Q2 2019, and we predict a decline of 2.7% for 2019 as a whole.

Greater Bay Area

Shenzhen is likely to be more heavily impacted than neighboring Guangzhou in the near term.

- We expect the heavy new supply to push up Shenzhen’s vacancy rate by over 5 percentage points to 24.6% in 2019, with vacancy continuing to climb at a modest rate thereafter. We assume that average rent will continue declining until at least through the end of 2020.

- We should not be too negative about South China. For Shenzhen, Oxford Economics predicts that real GDP growth will drop from 7.3% in 2018 to 6.8% in 2019. While this represents a significant slowdown, Oxford Economics predicts average annual real GDP growth of 6.4% over 2019-2023, which would be well above the national average. The corresponding figure for Guangzhou is 6.3%. Looking further ahead, Oxford Economics expects both cities to be among the top 10 in the world by GDP in 2035.

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1 Source: Oxford Economics, “Asian Cities and Regional Forecasts”, 28 June 2019
2 Source: Oxford Economics, November 2018
In Shanghai, we believe that up to one-third of total office leasing demand could be delayed through uncertainty linked to the U.S.-China trade tensions. In Shanghai and Beijing, these uncertainties will compound the impact of sharply rising supply, pushing up vacancy rates.

Likely reduction in confidence among MNC tenants in other cities in greater China

A resumption of serious trade tensions may well encourage MNC occupiers to curtail expansion in cities in greater China, and possibly move away. Concerns about trade have already impacted office markets in mainland China — not only in South China. In H1 2019, there were signs of material slowdown in office leasing demand in Shanghai and Beijing. The trade war was by no means the only factor at work, but it appears to have compounded the impact of other issues such as rising supply which will drive a sharp increase in vacancy in both cities.

Shanghai: Office Market Outlook

We expect full-year net absorption to drop 37% from 2018, though policies driving business growth should help demand in H2 2019.

- Q2 2019: 149,000 square meters
- Full Year 2019: 790,000 square meters
- 2018-23 Annual Average: 1.08 million square meters

We expect new supply totals to ease slightly to just over 2.0 million square meters (21.8 million square feet).

- Q2 2019: 111,000 square meters
- Full Year 2019: 2.03 million square meters
- 2018-23 Annual Average: 1.30 million square meters

Rents should drop 5% in 2019 and flatten over 2020-2021, before rising gradually.

- Q2 2019: RMB 8.73 (per square meter per day)
- Full Year 2019: RMB 8.46 (per square meter per day)
- 2018-23 Annual Average: RMB 8.77 (per square meter per day)

Vacancy fell in Q2 2019 but should leap to 22.1% by the end of 2019 due to a DBD supply influx in H2 2019. It should drop steadily from 2020.

- Q2 2019: 16.4%
- Full Year 2019: 22.1%
- 2018-23 Annual Average: 17.8%

Source: Colliers International
Note: $1 to RMB6.86 as of Q2 2019. 1 square meter = 10.76 square feet. CBD = central business district; DBD = decentralized business districts.

As this summary shows, in 2019 we expect net absorption in the Shanghai office market to drop 37% year over year, average Grade A office rent to drop 4.7% year over year and the vacancy rate to rise by over 8 percentage points to 22.1%. MNC occupiers seem especially likely to refrain from further expansion. Indeed, we believe that uncertainties stemming at least in part from the U.S.-China trade tensions could lead to as much as one-third of office leasing demand in Shanghai being delayed. Beijing is also under pressure, though perhaps to a lesser extent (see summary overleaf).
The traditional finance and technology sectors continue to support solid demand despite declining net absorption. We expect 1.1 million square meters (11 million square feet) of new supply in 2019. With more supply coming, we predict total stock of 10.0 million square meters (107.6 million square feet) by end-2023.

Following a decline in rents over 2019-2020, we expect a steady increase from 2021.

Vacancy should reach 15.1%, a 10-year high, by the end of 2019 due to the jump in supply. Vacancy should decrease steadily thereafter.

While the current trade situation has impacted demand, the high proportion of sidelined investors points to a potential strong recovery when the U.S.-China relationship improves.

**Outlook for Hong Kong SAR**

Despite the pressures on Shanghai and Beijing, Hong Kong SAR may be more vulnerable to tenant retrenchment than any mainland Chinese city. This conclusion may appear counter-intuitive. Colliers’ “Top Locations in Asia” research series in H2 2018 ranked 16 Asian cities as locations for three sectors (technology, finance and law) on the basis of quantitative and qualitative analysis of 50-60 criteria grouped under socio-economic, property and human factors. Hong Kong, which ranked #1 in finance and law, emerged as Asia’s top city in our combined ranking for the three sectors, followed by Singapore and Tokyo.

However, we see Hong Kong as vulnerable to tenant retrenchment for two reasons. The first is the importance of the financial sector in the city: Hong Kong is Asia’s largest cross-border banking center and home to its third largest stock market. As we discuss further in the next section of this report, a resumption of the trade war could erode the confidence of financial occupiers in Hong Kong. Besides trade tensions, confidence in Hong Kong will have been dented by recent political events, including large demonstrations.

The second, related reason is Hong Kong’s reliance on MNC occupiers. For Hong Kong, we estimate that MNCs account for 60% of Grade A office space. In contrast, for Beijing, we estimate the proportion of MNC occupancy at 40%, with Shanghai coming next among Tier 1 mainland Chinese cities on 31%. The proportions are lower for Shenzhen and Guangzhou: 15% and 10% respectively, by our estimate.

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1See “Building on Strength - Investors agree momentum is stronger than drag” (July 4, 2019) by Colliers International.
We see Hong Kong SAR as Asia’s top location overall, but it may have the most to lose from a resumption of serious trade tension. Singapore and possibly Tokyo would benefit from any shift among big MNC tenants in tech, finance and professional services away from greater China. It will be reasonable for occupiers in the manufacturing and trading sectors to study expansion in India or Southeast Asia.

Aggregate rankings – Top five cities from Colliers’ “Top Locations in Asia” series (H2 2018)

<table>
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<td>Hong Kong</td>
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<td>Singapore</td>
<td>60.3%</td>
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<tr>
<td>Tokyo</td>
<td>58.7%</td>
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<tr>
<td>Shanghai</td>
<td>58.2%</td>
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<tr>
<td>Seoul</td>
<td>57.7%</td>
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Note: The combined score is a weighted average, with 40% weighting for Finance, a 40% weighting for Tech, and a 20% weighting for Law.

Unlike Hong Kong, Beijing and Shanghai are not usually the site of MNCs’ Asian headquarters. Most foreign companies with operations in these cities have chosen to locate there for access to the long-term growth potential of China rather than Asia in general, and so are less likely to retrench.

It is reasonable for finance, professional services and high-value technology groups to consider expansion in Singapore to mitigate risk. Singapore is Hong Kong’s perennial rival as Asia’s most international city, with the following strengths:

> **High political stability**, good operating conditions for businesses, and a legal system based on English common law (as in Hong Kong)
> **A key source of talent**: Singapore is often ranked as Asia’s top university city, and its service and knowledge sectors are growing in importance
> **Average rent is still only about 70% of the level of Hong Kong**
> **The clear top position in Asia on human factors such as quality of life**

Singapore’s disadvantages include its small size (even though Singapore is the hub of Southeast Asia, its population is only 5.6 million), and the small stock of office space.

Large finance occupiers in particular may choose to look again at Tokyo¹, Asia’s largest urban agglomeration with a population of 38.1 million, total office stock seven to eight times Singapore’s level, and a rising reputation for quality of life.

We expect other occupiers to study the rest of Asia. Southeast Asia — especially Vietnam — has benefited from migration of manufacturing and trading groups out of China into lower-cost markets. This trend was already happening, but it has received added impetus from the trade war. However, we would advise larger occupiers — especially those with in technology-related sectors — to consider India. Bangalore ranked #1, ahead of Singapore and Shenzhen in our “Top Locations in Asia – Technology report”, which also highlighted the increasing attractions of Hyderabad.

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¹ #2 after Hong Kong and ahead of Singapore in Colliers’ “Top Locations in Asia – Finance” report
Tougher outlook for Hong Kong SAR financial tenants

For now, the U.S. and China have declared a truce in their trade war. However, if the war restarts, it is very probable that financial markets will react negatively. In Asia, we would expect to see both the CSI 300 Shanghai/Shenzhen stock index and Hong Kong’s Hang Seng stock index (which is dominated by mainland Chinese shares) decline again after recent recovery.

For Hong Kong, the possibility of a renewed downturn in stock prices poses risks for the finance sector. As shown in our report “Hong Kong and Seoul Rents Vulnerable to Falling Stock Markets” (November 5, 2019), among Asia’s leading financial centers, the relationship between the level of the equity market and Grade A office rents is closest in Hong Kong. The high correlation reflects the fact that financial stocks have a 49% weighting in the Hang Seng Index, while financial tenants occupy 51% of Grade A office space in the central business district (CBD).

So far in 2019, there have been certain positive developments for Hong Kong financial occupiers: the 15% recovery in the Hang Seng index from its low point last October, the truce in the trade war, and the turnaround in expectations for interest rates from hikes to stability. Low interest rates are usually seen as positive for investment banks and asset managers, although they hurt profits for commercial banks. This background may explain the positive attitude towards expansion expressed by banking and finance tenants in our annual Hong Kong Occupier Survey (June 26, 2019). However, we have been concerned by news of recent job losses by non-U.S. investment banks in Hong Kong, which in our view reflect structural shifts in the sector that are likely to persist. We expect that these job losses will be reflected in pressure on rents in Hong Kong’s CBD.

Shanghai, China’s leading financial center, is less vulnerable in this respect than Hong Kong. The finance sector accounts for 32% of the Shanghai Composite Index and for 40-41% of Grade A office stock in the city’s CBDs. However, as shown in our report of last November, the relationship between the stock market and rents in the key area of Lujiazui is not close. Our cautious forecasts for rent growth in Shanghai reflect concerns about trade tension and rising supply, but not specifically any assumption about pressure on financial tenants from falling share prices.

Figure 6: Hong Kong SAR’s Hang Seng Index and Grade A office rents in Central

Source: Bloomberg, Colliers International
SECTION 4: TRADE TENSION WILL IMPACT U.S. INDUSTRIAL MARKET

Minimal impact from trade war on U.S. office leasing

In contrast to Asia, the impact of U.S.-China trade tension on U.S. office occupiers, and financial occupiers in particular, is likely to be minimal. While there may be implications for specific buildings housing offices leased by firms whose business is centered on trade with China, the collective impact should not be sufficient to cause them to reduce staffing or leasing.

However, the trade war does have implications for U.S. industrial property. The movement of goods from sea, air and inland ports to their final destination is a key driver of the U.S. industrial market, but the now arguably full-scale trade war with China could undermine industrial demand, especially in port and manufacturing markets. China, which was the top trading partner of the U.S. — for both imports and exports — has reduced the amount of American-made goods purchased and has seen a fall in exports to the U.S. Mexico has taken over as the top trading partner of the U.S. in recent months.

Tariffs have hurt the Chinese economy and reciprocal tariffs have lowered Chinese demand for American-made goods. If this trend continues, demand from manufacturing occupiers, which accounted for nearly 13% of total industrial transactions in the U.S. during the first half of 2019, could decline and hurt regions in the Midwest and Southeast.

The possible rise in prices for goods in the U.S. could also hurt consumer spending, which will have an overall negative effect on distribution in the coming quarters. The upcoming holiday shopping season will paint a picture of if and how much the trade war with China will impact Americans’ spending habits and thus the industrial real estate sector.

These hits to the U.S. industrial markets could be offset by any “reshoring” of manufacturing from China back to the U.S., as several leading firms have planned. But with manufacturing activity in the U.S. and worldwide already shifting down and expected to slow down further, the near-term prospects for new manufacturing plants would seem to be limited.
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Colliers International (NASDAQ, TSX: CIGI) is a leading global real estate services and investment management company. With operations in 68 countries, our 14,000 enterprising people work collaboratively to provide expert advice and services to maximize the value of property for real estate occupiers, owners and investors. For more than 20 years, our experienced leadership team, owning approximately 40% of our equity, have delivered industry-leading investment returns for shareholders. In 2018, corporate revenues were $2.8 billion ($3.3 billion including affiliates), with more than $26 billion of assets under management.

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