Asia-Pacific

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Economic reviews of Asia Pacific typically lead with the outlook for China. Hines believes there is much more to the regional story in 2024 and beyond. With shifts in global inflation dynamics, nominal GDP growth in developed Asia is ramping up, perhaps most surprisingly in Japan. The shift from globalization to "slowbalization" has likely yielded significant benefits for the country. For over 20 years, input costs in manufacturing centers such as the U.S. and Germany have steadily increased – since 1999, the U.S. Producer Price Index (PPI) has nearly doubled, and its German counterpart is up over 70%.[1] During this same 20-plus year period, Japan's PPI has virtually flatlined, creeping up only about 11%.[1] For companies, production and manufacturing in Japan has become considerably less expensive at the same time CEOs are seeking alternative (i.e., friendly, stable, and reasonably priced) locations for such facilities, and Japan's relative value appears attractive. At the same time, cheap costs of funding, a weak Yen and meaningful prospects of corporate reform have stimulated strong inflows into Japanese risk assets. With economic fundamentals on a positive trajectory, Hines is constructive on improved nominal GDP growth in coming years, with gradual reflation positive for real estate rents.

China remains the leading economy in Asia Pacific, but regional dynamics are clearly shifting. While its expansion has slowed from the blistering (17+%) annual pace of the 2000-2010 decade, China's nominal GDP growth is still expected to exceed 7% annually[2] through 2032. The size of China's economy and the depth of trading relationships means incremental gains cascade throughout the region and the world, while the increase in corporations investing in "China +1" strategies is benefitting other Asian economies (both developed and developing). Ongoing geopolitical tensions will create redundancy requirements outside of China as the ex-China Asian countries evolve to become even more intra-regionally entwined. Hines believes this will propel Asian economies to become even more interdependent, resulting in an increasingly Asia-centric economic universe, less correlated and reliant on the economies of US and Europe.

[1] CEIC, OECD, Hines Research as of Q422 using annual data.
[2] Oxford Economics and Hines Research as of Q223.

Within this regional context, secular growth opportunities in developing Asia, such as Vietnam and India, appear attractive. While urbanization continues to drive demand for real estate across the globe, Hines believes this trend will have the most impact in selected areas of Asia. The urban population of Vietnam is projected to increase by nearly 19%, or 20 million people[3] between 2022 and 2050. Similarly, the number of urban residents in India is likely to rise about 11% (160 million[3]) over the same period.

These new inhabitants will need to live, work, and shop nearby, likely creating opportunities for infill and new development. With lower correlations with China than most of developed Asia, real estate investing in Vietnam and India appears to offer the benefits of regional diversification, with access to differing demand drivers from developed Asia. However, deep local expertise is critical to navigate the specific risks inherent in less developed markets.

INVESTMENT OUTLOOK

One of the most dangerous statements in investing is "it's different this time." However, this may very well be true if referring to the evolving policy of global central banks in response to inflation. Hines believes real estate in Asia will benefit if central banks choose to inflate their way out of these debt loads, due to rental growth acceleration. There is a strong historical correlation between trailing annual rent growth and inflation in developed Asia (R^2= 0.77[4]). Contributing to the argument for rent growth is reduced supply, driven by higher costs for materials, insurance, labor, and financing. Combined with the likelihood of long-term Asian currency appreciation against the U.S. dollar,[5] Hines sees positive tailwinds for real estate in Asia.

Across the region, trailing rental growth over the last 12 months has been almost uniformly positive. In developed Asia, Warehouse rents are up 8.7% year to year as of Q3 2023, and Retail rents up 4.3%. Office rents are the laggard at -0.9% y/y but this masks strong growth in certain cities, particularly Seoul (up 7.4% y/y). Investors are still concerned about the Office sector, but it is worth repeating that the impact of work-from-home in Asia was fleeting. Since the first quarter of 2021, net office absorption in the region has been consistently positive, in stark contrast to North America (where 12 of the last 13 quarters have been negative[6]). This trend can be seen in the sector health scores calculated by Hines Research – Asia Office has been on the upswing since year-end 2020.

Looking just at developed Asia, Hines Research believes demand is running at around 90% of the long-term average. Excluding Hong Kong (still very weak due to structural changes), demand is tracking above average. Vacancies are very low in Singapore, Japan, and South Korea, and solid rental growth is reflecting a limited supply pipeline. Australia (where WFH is having the most impact regionally) will likely need some time to absorb new supply, but with new starts falling due to inflated construction costs and the challenges of securing construction financing (and at higher interest rates), we expect supply to tick down over next two to three years.

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[3] Oxford Economics, World Bank, Hines Research as of Q422 using the most recent data for 2022 as the base year.
[4] Oxford Economics, JLL, CBRE, Hines Research as of Q223. The period covers 1981 to present, though data availability differs by market. Developed Asia excludes China, India, and Vietnam. The R^2 represents the percentage of the response variation reflected by the model – the higher the percentage, the higher the correlation.
[5] Oxford Economics, Hines Research as of Q223.
[6] JLL, CBRE, Hines Research as of Q223, Asian markets include the developed economies of Australia, Hong Kong, Japan, Singapore, and South Korea.

Multifamily fundamentals remain positive in the region's key markets of Japan and Australia. In Japan, Hines Research's view is that inflation is going to maintain, with positive wage growth leading to continued rental growth. In Australia, healthy population growth, underpinned by immigration and a structural undersupply of housing has supported very strong rental growth. Opportunities to develop into these tailwinds remain attractive.

Industrial fundamentals have eased from 30-year highs.[7] Medium term demand and supply fundamentals seem balanced, but near term we have observed some supply challenges in Korea, China, and to a lesser extent, Japan. Australia warehouse demand has been incredibly strong with rents up 15% year to year. This pace will likely ease but we don't anticipate a major slowdown. In Singapore, a combination of high yield and healthy rental growth is attracting increased investor interest.

The strength of rents has mitigated regional price corrections though 2023, even as regional cap rates have continued to move out. Aggregate moves are modest at around 35 basis points year-over-year as Q3 2023 but this masks significant variations across economies due to different interest rate environments, with cap-rates flat or falling in Japan while cap-rates in Pacific markets have risen around 75 bps. We expect some further cap-rate increases into 2024 and for pockets of value to increasingly emerge in those markets where cap-rate corrections were greatest.

In this inflationary environment, development strategies are likely to remain somewhat challenging in 2024 and we see the best relative opportunity in value-add strategies, given potential price corrections, the ability to acquire existing assets at below replacement costs, and positive expectations of rent growth. We see structural support for the industrial sector in developed Asia, some near-term supply challenges in certain markets and cap rate corrections starting to create better entry points for acquisition. In the office sector, we believe improving demand and contained medium term supply will create compelling opportunities in "brown to green," and in finding undervalued buildings in excellent locations to take advantage of flight to quality. With repositioning and upgrading, we expect good performance leasing into (what we expect to be) improved 2025 and 2026 markets.

CONCLUSION

Asian real estate markets enter 2024 boasting several strong growth drivers. Regional growth is robust and urbanization continues to drive demand for real estate in Asia. Indeed, according to the International Monetary Fund, growth in emerging and developing Asia will be three times the rate of the G7 nations.[8] With COVID (and work-from-home) fading from view, and inflation expected to be higher for longer, the case for real estate in this region, in our view, becomes even stronger. In developed Asia, particularly Australia, South Korea and Japan, a positive combination of healthy demand and supply fundamentals supporting rental growth and price corrections will, in our view, provide compelling opportunities for investors to increase their exposure to this dynamic region.

[7] JLL, CoreLogic, ARES, Hines Research as of Q223. The Leasing Environmental Health Score measures the relative health of a market's current leasing conditions compared to its own history.
[8] International Monetary Fund, Real GDP Growth, October 2023