Keppel Capital
ResearchCOMMENTARY

10 November 2017

China 19th Party Congress: Policy Implementation to Strengthen

- Consolidation paves way for more effective execution of policies
- Credit conditions to tighten but risks to be managed to maintain growth
- Positive for real estate, with new opportunities in rental housing

Watershed Party Congress

Stronger policy execution can be expected

The much anticipated 19th Chinese Communist Party (CCP) National Congress concluded with President Xi Jinping effectively consolidating his position as the "core" leader going into his second term in office. The line-up of the seven-member 19th Politburo Standing Committee comprises five new faces, three of whom are Xi's allies. This is expected to pave the way for more alignment of interests within the party and state organs, thus facilitating more effective execution of his desired policies.

Implications on the economy

Implicit growth target of 6.3% p.a. till 2020

Numerical growth targets were absent during the congress as this is a visioning exercise; the growth target for 2018 is expected to be discussed at the annual Central Economic Work Conference in December and announced in March next year at the National People's Congress. Details of the reform agenda are expected to be crystallised and announced at the Third Plenum in Oct/Nov 2018.

Nevertheless, Xi's reiteration of China's aim to become a moderately prosperous society by 2020 tacitly affirms the 13th Five-Year Plan's target to double 2010 GDP by 2020. Mathematically, this would require an average GDP growth of 6.3% p.a. in 2018-2020, compared with 6.8%[1] expected in 2017. The government also has strong motivations to maintain stability over the next 4-5 years due to upcoming milestones, namely the 40th anniversary of China's Open Door policy in 2018, the 70th anniversary of the founding of the PRC in 2019 and the CCP's 100th anniversary in 2021. Xi's long-term vision for China to further progress into a fully modern economy and society by 2035, before becoming a global leader by 2050, implies sustained growth beyond 2020 which will benefit the rest of the Asia Pacific region.

Leverage may still rise short-term

Central to the economic rebalancing is the need to deepen supply-side structural reform, which encompasses reducing excess capacity and inventory, deleveraging, cost reduction and more efficient allocation of resources.

Credit conditions are expected to become more stringent. There will be more experimentation with mixed-ownership of SOEs, similar to China Unicom's private placement of a 35.3% stake to 14 private enterprises in August 2017. More "zombie companies" may be allowed to fail or be disposed of by the state. Nonetheless, these steps are unlikely to reduce corporate leverage immediately and most economists still expect China's debt-to-GDP ratio to creep up from the 258% as of 1Q2017[2] in the near-term, albeit at a gentler rate. Sustained economic growth, financial reforms and equity and bond market liberalisation will help in the deleveraging process over the medium to long-term and reduce the over-reliance on bank lending.

Economists expect the PBoC to allow for more market-pricing of the Chinese Yuan (CNY) in the near-term, before settling on a managed-float regime in the longer run. The CNY also needs to gain more international acceptance before the capital account can be fully-open, meaning capital controls are likely to remain to maintain the stability of the CNY. Over the medium-term, stronger confidence in the Chinese economy, greater market participation by foreigners and wider international acceptance of the CNY should dispel depreciation concerns.

Implications on real estate

"New economy" drives office demand

China aims to create new economic drivers by promoting entrepreneurship and innovation. More financial support will be extended to private enterprises and SMEs. Domestic firms, particularly those in the tertiary sector like tech companies, professional services and financial institutions, will continue to grow and support office demand particularly in the Tier-1 and larger Tier-2 cities where talent is more readily available.

Xi's intent to allow more foreign capital participation and progressively open up market access will see more MNC office occupiers eventually. One example is the financial sector, where China has loosened regulations for the local subsidiaries of foreign banks to invest in domestic ones from July 2017, limited to a 20% stake. We therefore remain positive on the office and business park markets in Tier-1 cities particularly Shanghai and Beijing. However due to oversupply in certain areas, location remains a critical criterion.

Retail asset quality remains critical

China's goal of being a moderately prosperous society bodes well for overall domestic consumption and the retail sector, despite challenges from e-commerce. More focussed and better-planned urbanisation in the key regions such as Xiong'an New Area, the Greater Bay Area (GBA) and the Yangtze River Economic Belt (YREB) will also generate the need for high-quality retail and lifestyle offerings.

As pointed out in our earlier report titled "Rethinking Retail: Lesson from China", retail is becoming omnichannel and retail landlords are putting more emphasis on place-making to cater to the social aspects of the consumer experience. Malls serving large population catchments and near transportation nodes continue to have an edge over the rest.

Residential remains policy-driven

Xi reiterated that housing is for living and not for speculation, underlining the government's intent to keep residential prices under control. The current approach of differentiated property policies is expected to continue. Xi's consolidation of power could lead to an eventual imposition of a property tax system, which is seen by some as a long-term solution to reducing speculative demand.

Urbanisation particularly led by the development of the three city clusters (Jing-Jin-Ji, YREB and GBA) and the Belt and Road Initiative (BRI) means housing demand will remain robust in the Tier-1 and larger Tier-2 cities. However, demand and prices will be controlled at the local level, constraining developers' ability to sell more and at higher prices.

More recently, the Chinese government has been encouraging the development of rental markets to provide affordable housing. While this presents new investment opportunities, the nascent rental market is largely dominated by domestic players and SOEs. To facilitate the market's development, China is opening up financial participation to instruments such as asset-backed securities (ABS), which will see more investment opportunities in the equity arena as well. A couple of rental apartment-based ABS by domestic-issuers were approved in October 2017.

Rural land reforms will be accelerated to preserve the land rights of farmers and allow them to unlock land value, for example by leasing their land out to others, mortgage the land or invest in a cooperative in exchange for shares. Unlocking land wealth will boost rural household wealth and consumption. With their rural rights protected, more migrant workers may be incentivised to move into the cities, particularly if accompanied by progress in the rental housing market or hukou reform.

Boon for data centres

The push for advanced technologies like cloud computing, big data analytics and artificial

intelligence bodes well for data centre demand. China already leads the way in revolutionising e-commerce (e.g. Alibaba's New Retail concept) and social commerce (e.g. WeChat), but these ecosystems are still growing and will continue to generate more data centre workloads in the future.

Data centre demand will also be derived from the needs of tech-savvy consumers, including social media, e-payments and online entertainment. Nonetheless, foreign investors have to navigate the complex regulatory and licencing landscape. Based on the current regulations, a company operating and providing value-added data services through a data centre in China is required to hold an Internet Data Centre (IDC) licence, and foreign ownership of the operating company is limited to 50%.

Quality industrial & logistics space needed

As China moves up the manufacturing value-chain, industries will have to increase automation and R&D. This will boost demand for high-quality industrial space, potentially more so in the inland cities as led by the BRI. Cities along the BRI will also see increased demand for logistics space to facilitate trade. In addition, urbanisation and the growing middle class will underpin demand for high-quality logistic space from e-commerce players, particularly in the three city clusters of Jing-Jin-Ji, YREB and GBA.

Conclusion

We expect more coordinated policy implementation and credit tightening to control the debt level than in the last five years. However, these will be carefully managed to ensure a smooth transition to a moderately prosperous society.

The "new economy" will be positive for the office sector, particularly in the key city clusters. The growing middle-class will also drive the demand for high-quality retail and lifestyle offerings notwithstanding the growth of e-commerce. The residential market will remain policy-driven. Efforts to develop the rental market are expected to be the main focus over the next few years, where more investment opportunities may open up in the rental housing market. Demand for data centres, industrial and high-quality logistics space will also increase with the continued push towards high-tech adoption and the continued growth of e-commerce.

[1] IMF, World Economic Outlook, October 2017
[2] Bank for International Settlements

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