June 2019

Keppel Capital watch

Southeast Asia

Growing consumer class

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Executive Summary

Southeast Asia (SEA) is collectively the world's 5th largest economy and is expected to outperform global growth. Main economic drivers include rising urbanisation levels and the region's strong demographics. SEA is the world's 3rd largest consumer market, with a combined population that will exceed 700 million by 2030 and has the highest proportion of working-age population.

Private consumption fuels economic growth in most SEA countries and in the largest country Indonesia, it makes up more than 50% of GDP. Consumer spending in SEA is driven by increased urbanisation levels, a rising middle-class and affluent population, higher disposable income, and increased access to the internet which has underpinned e-commerce growth.

In this paper, we focus on why we think the logistics sector will benefit from SEA's consumption potential. Domestic and international distribution are both demand drivers for the logistics sector. Manufacturers' and retailers' demand for industrial and logistics space will increase as they expand in SEA to cater to the growing domestic market, while increased trade flows could lead to a higher volume of physical goods that need to be stored in warehouses and transported across local and international distribution networks.

Manufacturing investments and activity in SEA could increase further going forward. Manufacturers had relocated some production facilities to SEA even before the US-Sino trade war. The shift out of China towards SEA is likely to continue even if trade tensions die down. Besides reducing their reliance on China and vulnerability to future tariffs, companies will plan such moves in line with longer-term strategies such as tapping on the relatively lower labour costs in SEA and supplying more directly to SEA's large domestic markets.

Demand for warehousing and logistics space will also increase due to the rapid growth of the e-commerce market. E-commerce tenants tend to demand three times more the amount of warehouse and logistics space than that of traditional retailers.

Notwithstanding the strong demand, there is currently a limited supply of modern warehouses to handle large volumes of goods efficiently in SEA or urban logistics facilities that cater to consumers' need for faster delivery. This positive demand-supply dynamic presents possible investment opportunities.

However, challenges remain due to inadequate infrastructure and difficulty in assessing suitable industrial and logistics land and assets. Successful implementation of the various SEA governments' infrastructure spending plans will improve infrastructure in the region. New road and railway links will help the movement of goods across the region and augment the future demand for industrial and logistics facilities.

Author

Lee Lay Keng
Head, Research

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Introduction

With an economic size of approximately US$2.9 trillion[1], Southeast Asia (SEA) is collectively the 5th largest economy in the world. The region is also expected to outperform global growth with GDP growing at an average 5.1% p.a. in 2019-2024[2]. Main drivers of the region's fast growth include rising urbanisation levels and the region's strong demographics.

Consumption fuels SEA's economic growth

Strong demographics

SEA is the world's third largest consumer market, after China and India, with a combined population of more than 650 million. Apart from Singapore, private consumption is a major economic driver for most SEA economies.

There is significant potential for further consumption growth in SEA, with the total population projected to increase to 726 million by 2030. SEA has the highest proportion (more than 67%) of working-age population and the world's second largest population below 15 years old[3]. Total population growth will be led by the working-age population, which is forecasted to grow at a compound annual growth rate (CAGR) of 0.8% (3.9 million persons p.a.) between 2018 and 2030. Indonesia's working-age population is projected to increase at a faster CAGR of 1.0% over the same period.

The largest country within SEA is Indonesia, with a population of ~267 million, making up 40% of the total SEA population. The population in Indonesia is expected to reach ~300 million in 2030, with the population in urban agglomerations such as Jakarta and Surabaya projected to increase by more than 25% between 2018 and 2030. Private consumption accounts for about 55% of GDP in Indonesia and has been relatively stable, growing at about 5% every year. In Vietnam, private consumption has also grown to become a larger part of the economy, reaching about 68% of GDP in 2017[4].

Drivers of consumer spending

Rise in urbanisation to raise income levels

Only half of SEA's population currently live in urban areas, but this will rise over the next decade. More than 90 million people in SEA are expected to move into urban areas by 2030[5]. Increased urbanisation and the shift of workers from agriculture to manufacturing and services industries will raise income levels and consumer spending in the region.

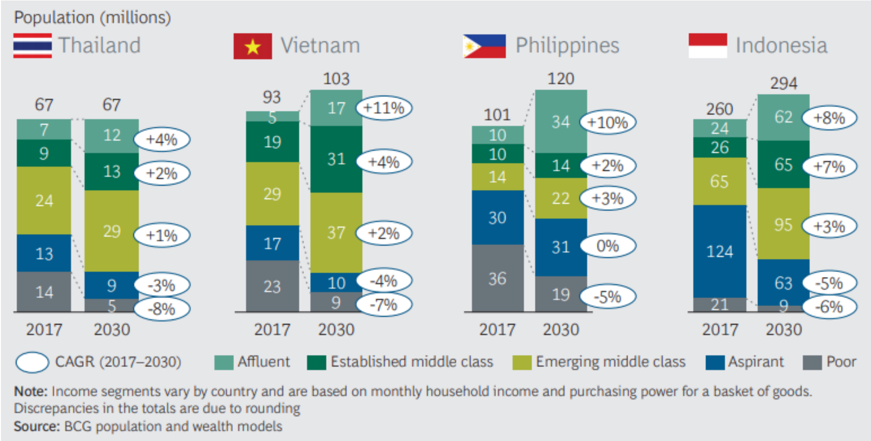
Rising middle-class and affluent population

The percentage of Southeast Asians with middle-class or affluent incomes is projected to increase from 40% in 2017 to 64% in 2030[6]. In the four most populous SEA countries (Indonesia, Vietnam, Philippines and Thailand), the affluent population is estimated to grow at 8% p.a, with an additional 78 million consumers regarded as affluent by 2030 (Figure 1). In absolute terms,

[1] IMF World Economic Outlook, Apr 2019
[2] IMF World Economic Outlook, Apr 2019
[3] UN, World Population Prospects: The 2017 Revision
[4] Latest available data
[5] UN, World Urbanisation Prospects: The 2018 Revision
[6] Boston Consulting Group, How the Digital Revolution is Integrating SEA's Consumers, Sept 2018

the largest increase is in Indonesia, where an additional 38 million people will be considered as affluent.

Figure 1: Middle Class and Affluent Population in Selected SEA Countries

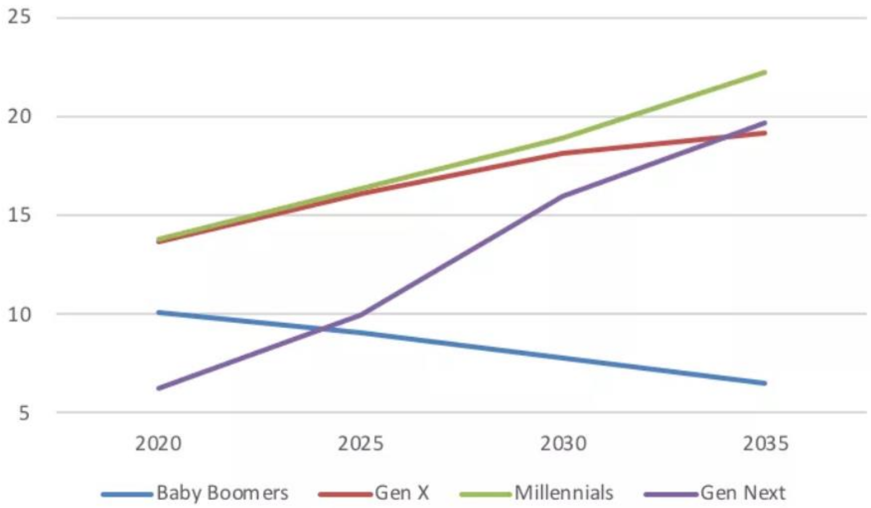


Higher disposable income

As the larger middle class gets exposed to a wider variety of products, there is an increased propensity for them to spend more. Higher consumer spending is also facilitated by higher disposable income. Disposable income is expected to increase in all SEA markets until 2030, with the highest growth over 2016-2030 in Vietnam (9.6% CAGR), Indonesia (8.7% CAGR) and Philippines (8.4% CAGR)[7].

The millennial population (those born between 1980 and 2000) in SEA already outnumbers the baby-boomer population. Globally, the aggregate income of millennials is expected to increase in the near term (Figure 2). Millennials tend to spend more on eating out, travelling aboard and are more tech-savvy, having grown up in the age of the Internet.

Figure 2: Global Annual Aggregate Income by Generations (US$ trillion)



Source: Brookings, How to Harness the Spending Power of Millennials: Move Beyond the US, Apr 2018

[7] PwC, The Future of ASEAN – Time to Act, May 2018

Increased access to the internet and alternative payment options
The number of internet users in SEA has increased from 260 million in 2015 to more than 350 million[8]. Unsurprisingly, Indonesia has the largest internet user base in SEA with 150 million users in 2018.

Besides the growth in the internet user base, increased adoption and acceptance of digital payment solutions will help boost consumption and e-commerce growth in SEA. In most SEA countries, credit card ownership is low, so the population is likely to move directly from cash to digital payments, which are experiencing fast growth.

For instance, there are 26 digital payment accounts per 100 people in Thailand (higher than in Singapore), registering growth of 17% p.a. from 2014 to 2017. Digital accounts in Indonesia, Malaysia and Vietnam also saw growth of 75-80% p.a. in the same period[9]. In Indonesia, ride-hailing application Go-Jek has its own mobile payment platform and wallet Go-Pay to allow its users to transfer money peer-to-peer, pay for products and services and to top up their mobile wallets by giving cash to Go-Jek drivers who act like mobile ATM machines.

Real estate implications

While SEA's consumption potential will underpin the growth of the residential and retail sectors, we think the logistics sector could also benefit. We outline the reasons why below:

Domestic distribution as a demand driver

The users of logistics space include end-retailers, wholesalers, manufacturers and third-party logistics providers. In countries such as Indonesia, where the export sector is small, domestic demand drives manufacturing activity (Box 1). Manufacturers and retailers' demand for warehousing space and distribution networks is expected to increase as they expand in SEA to cater to the growing domestic market.

Box 1: Domestic demand drives manufacturing activity in Indonesia
Manufacturing is the single largest industry in Indonesia and accounts for ~21% of Indonesia's GDP. Food products and beverages are the largest contributor to manufacturing output, account for more than 30% and has grown the fastest at a CAGR of 8.5% over 2010-2018.

Further impetus for manufacturing activity could come from the government's roadmap "Making Indonesia 4.0" that was launched in April 2018. The government intends to leverage on Industry 4.0 (supported by key technological changes such as Internet of Things and artificial intelligence) to make Indonesia a global manufacturing player in five priority sectors: food and beverages, automotives, textiles, electronics and chemicals. The roadmap initiatives are expected to boost manufacturing output to more than 20% of GDP by 2030 and could improve real GDP growth from ~5% to 6-7% yoy between 2018 and 2030.

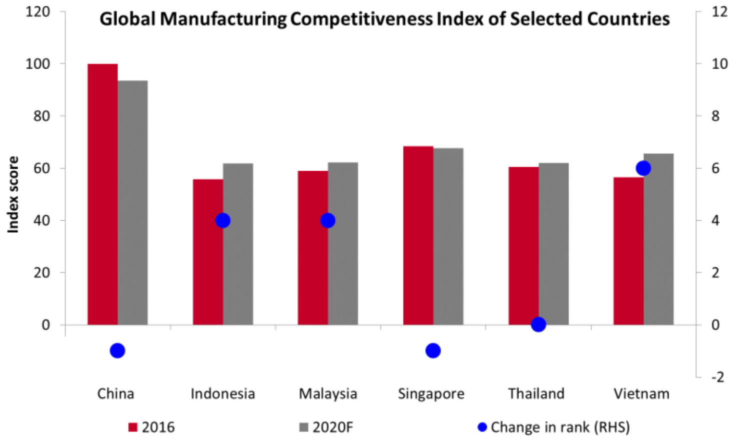
For instance, Japanese apparel retailer Uniqlo intends to double its store network in SEA to about 400 stores by 2022 while Swedish furniture retailer IKEA also has plans to open more stores in SEA, with the world's largest IKEA store slated to open in Philippines in 2020.

[8] Google and Temasek, e-Conomy SEA 2018, Southeast Asia's Internet Economy Hits an Inflection Point. SEA here refers to Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam
[9] Boston Consulting Group, How the Digital Revolution is Integrating SEA's Consumers, Sept 2018

Increase in manufacturing activity

The manufacturing competitiveness of SEA countries such as Indonesia, Vietnam and Malaysia is projected to improve and attract more global manufacturers by 2020 (Figure 3).

Figure 3: Manufacturing Competitiveness of SEA Countries to Improve by 2020



Source: Deloitte Global CEO Survey, 2016

Even before the US-Sino trade war, manufacturers had already started to relocate their China-based production facilities to SEA, as labour costs became uncompetitive in China. For instance, there have been growing foreign direct investments into the manufacturing sector in Vietnam, with manufacturers such as Samsung, Olympus, Foxconn and Hasbro moving or planning to move some of their production facilities from China to Vietnam. Shoe manufacturers Adidas and Nike now produce more shoes in Vietnam than in China.

Escalation of the US-Sino trade tensions could see more manufacturing activity relocated to SEA. In a survey by the American Chamber of Commerce in China and Shanghai last year, SEA was the top choice for companies who are thinking of relocating their China-based manufacturing facilities out of China.

This diversification out of China towards SEA is likely to continue even if trade tensions die down. Besides reducing their reliance on China for goods to be exported to the US which may be threatened by future tariffs, companies will plan such moves in line with longer-term strategies such as tapping on the relatively lower labour costs in SEA and supplying more directly to SEA's large domestic markets. However, moving supply chains will take time. Depending on the complexities of the manufacturing process, the scale of production in these alternative facilities in SEA will have to be phased in according to the quality of the infrastructure networks, skill levels of the local workforce and the availability of suppliers to support the rerouted supply chains.

Increase in trade flows

Trade flows in SEA are projected to increase over the next few years, with goods exports and imports growth averaging 7-8% p.a. in 2019-2024. Amongst the larger SEA economies, Vietnam is projected to register the highest growth in trade volumes (Figure 4). In contrast to Indonesia, Vietnam has a large export sector. Goods exports from Vietnam have risen at a CAGR of 13% in the last five years and accounted for ~100% of GDP in 2018.

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Regional integration efforts such as the ASEAN Economic Community, the Regional Comprehensive Economic Partnership (RCEP) and China's Belt and Road initiative will further boost trade flows. With a higher volume of physical goods being stored in warehouses and transported across local and international distribution networks, demand for industrial and logistics space is expected to increase.

Figure 4: Volume of SEA Exports & Imports to Increase over the Next Few Years

Source: IMF World Economic Outlook Apr 2019

E-commerce in SEA to grow further

Against the backdrop of a rising middle class and growing number of internet and smartphone users, the e-commerce market in SEA is expected to grow rapidly at a CAGR of 34% between 2015 and 2025 to reach a size of US$102 billion [10]. In the largest economy Indonesia, the e-commerce market is expected to grow exponentially in size, from US$1.7 billion in 2015 to US$53 billion (CAGR of 41%) by 2025. The revocation of the e-commerce tax regulation in Indonesia which was supposed to have taken effect on 1 April and required online sellers with revenues above IDR4.8 billion to charge a 10% VAT to customers, provides a further boost to e-commerce growth.

As more retail moves online, the demand for warehouse and logistics space will increase. It is generally thought that e-commerce tenants require up to three times more the amount of warehouse and logistics space than that of traditional retailers because customers seek a greater variety of goods. CBRE Research estimated that an additional 1.25 million sq ft of logistics space is required for every incremental US$1.0 billion of online sales. Using these estimates, an additional 100 million sq ft of logistics space across SEA could be required by 2025.

Consumer demand for wider variety of goods, fast delivery and return options ("reverse logistics") also changes the nature of logistics space required. Coupled with the increase in automation and use of technology to raise productivity, the demand for modern warehouses and logistics facilities will increase. To cater to the consumer requirement for faster delivery, there will also be higher demand for distribution and fulfilment centres in urban areas near to population centres, which are typically in scarce supply and hence command higher rents.

[10] Google & Temasek, e-Conomy SEA 2018, Southeast Asia's Internet Economy Hits an Inflection Point

Positive demand-supply dynamics in the logistics sector

While demand is expected to be strong, there is currently a limited supply of modern new warehouses in SEA to handle large volumes of goods efficiently or urban logistics facilities that cater to consumers' need for faster delivery. Most of the logistics markets in SEA are still in the nascent growth stage compared to more mature markets such as Singapore and Australia (see Box 2 for an overview of Indonesia's logistics market). The positive demand-supply dynamic presents possible investment opportunities.

Box 2: Indonesia's sheer size, growing middle class and rapid growth in e-commerce will drive the future growth of the logistics sector

Greater Jakarta logistics market overview and outlook

Existing warehouse space is limited in Greater Jakarta. Logistics properties in Indonesia are typically located in Greater Jakarta and West Java, as economic activity is mainly concentrated in these two areas, which necessitates the need for faster delivery of goods in larger volumes to be able to meet demand in these areas.

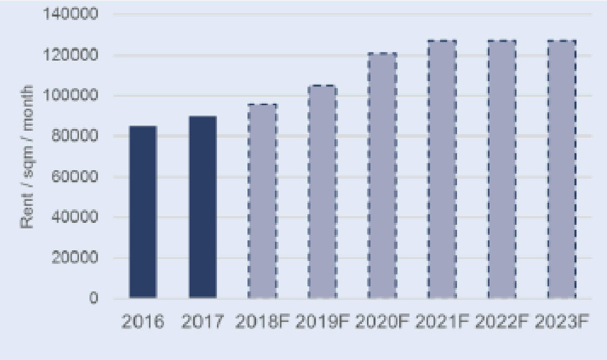
JLL estimated that the current stock of modern warehouses in Greater Jakarta is around 1.3-1.5 million sq m, with an estimated 225,000 sq m in the pipeline in 2019. More than 90% of modern warehouses are in Jakarta or in the Bekasi and Karawang areas, due to the accessibility to Jakarta and other related infrastructure such as ports and toll roads.

Demand for logistics space in Greater Jakarta is expected to be robust, coming from third-party logistics providers (3PLs), fast-moving consumer goods, automotive manufacturers and increasingly, from e-commerce retailers. Catering to increased consumer demand, logistics operators are seeking delivery sites in and around dense urban areas, particularly Jakarta. Given the current underdevelopment of the logistics market, two-thirds of current properties in Greater Jakarta are mostly built-to-suit (BTS) by developers to individual tenants' requirements. The BTS nature of the market is such that most modern warehouses are already fully or almost fully occupied while other projects that have been built speculatively for lease are also reporting high occupancies.

Stable land prices; rents to increase

Industrial land prices rose more than 300% between 2010 and 2015, but rental growth was more moderate. However, land prices have flattened since and are expected to remain stable while rental growth could pick up on the back of strong demand and limited supply of modern warehouses. Savills estimates average rental growth for modern logistics properties in Greater Jakarta at 5-7% p.a. between 2018 and 2023 (Figure 5) while current yields are estimated at 8-9%.

Figure 5: Asking Rents for Modern Logistics Properties in Jabodetabek



Source: Savills Research & Consultancy

But challenges remain

Inadequate infrastructure and difficulty in accessing suitable industrial and logistics land and assets could temper the growth of the logistics sector in SEA. Logistics costs in Indonesia (~24% of GDP) and Vietnam (~21% of GDP) are higher compared to other countries in the region and more developed economies such as Singapore and Japan (both less than 10% of GDP).

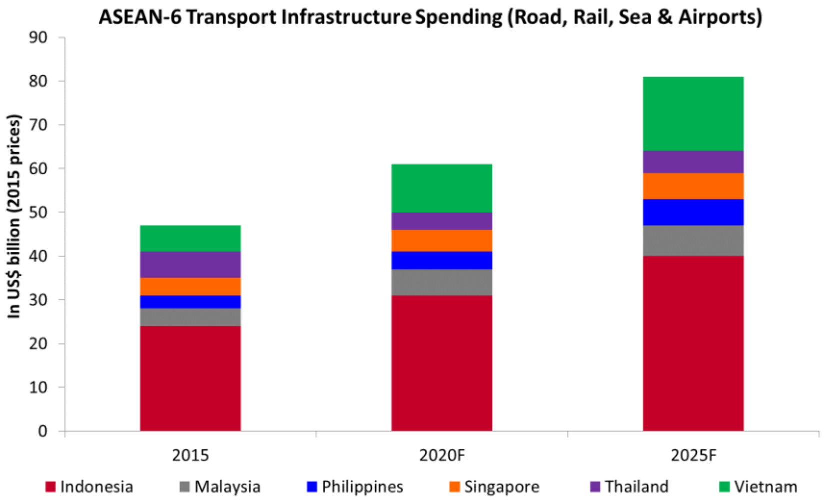
While we expect infrastructure in SEA to improve in future, boosted by government support and China's Belt and Road initiative, this is also dependent on the successful implementation of the governments' infrastructure spending plans.

Infrastructure spending as a share of GDP in Indonesia has increased significantly since 2015, with total spending averaging 3.7% of GDP p.a. in 2015-2018, compared to the average spending of 2.7% of GDP in the previous period 2010-2014[11]. In Vietnam, up to ~US$920 million of spending has been approved for infrastructure development, including building 250 km of new roads around economic zones and industrial parks by 2020. Infrastructure investments saw Indonesia's ranking in World Bank's Logistics Performance Index (LPI) improve from 53rd in 2014 to 46th in 2018; while Vietnam's rank improved from 48th to 39th over the same period.

Amongst the ASEAN-6 countries, spending on transport infrastructure (road, rail, sea and airports) is highest in Indonesia and Vietnam and is expected to increase further by 2025 (Figure 6). The two countries also have the highest number of pipeline road and bridge projects in the region (Figure 7).

The building of more seaports, airports, toll roads and railways will help to reduce traffic on existing toll roads and seaports and speed up transportation times and lower transportation costs. For instance, in Indonesia, the Patimban seaport is expected to commence operations in December this year and will help relieve traffic at Jakarta's Tanjung Priok port (Indonesia's busiest port, which handles 65% of the nation's trade).

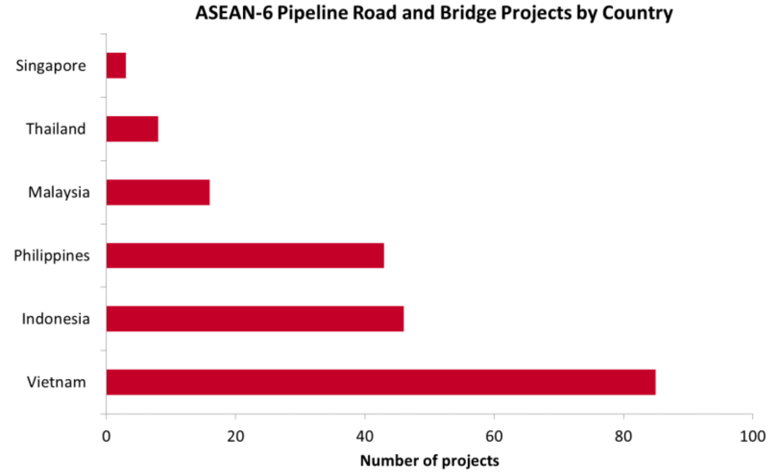
Figure 6: ASEAN-6 Transport Infrastructure Spending to Increase



Source: PwC, The Future of ASEAN: Vietnam Perspective, 2018

[11] HSBC, Indonesia Elections, Jokowi, Round 2, Apr 2019

Figure 7: Highest Pipeline of Road and Bridge Projects in Vietnam and Indonesia



Source: PwC, The Future of ASEAN: Vietnam Perspective, 2018

Conclusion

A growing middle-class population creating more disposable income and growth in manufacturing activity, trade flows and e-commerce will increase demand for industrial and logistics facilities in SEA. While there are still some challenges, the successful implementation of infrastructure plans with new road and railway links will help the movement of goods across the region and augment the future demand for industrial and logistics facilities in SEA.

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