CUSHMAN & WAKEFIELD
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CHINA'S TWO SESSIONS 2020

INTERPRETATION OF THE GOVERNMENT WORK REPORT

May 2020

KEY TAKEAWAYS

Key takeaways from the government work report for the 2020 “Two Sessions” included:

- In the residential market the government will maintain the principle of “houses are for living in, not for speculation,” and implement city-specific policies in the coming year. With a desire to promote steady and healthy development of the real estate market, the government will remain vigilant in restricting any major influx of capital into the residential market.

- Development of new infrastructure is considered by the government as conducive to boosting employment and consumption over the short term. This will support ongoing urbanization and the emergence of city clusters, and further advance real estate markets in core cities within these clusters. This will lead to further opportunities for the development of logistics, office buildings and retail environments that dovetail with new infrastructure.

- Promotion of greater consumer spending is a key focus for the government in 2020. This will be backed by an accelerated program of upgrading China’s pedestrian retail streets – a boost to the retail property market with a knock-on impact on logistics.

- With the TMT sector increasingly becoming a key economic driver, the government’s ongoing efforts to promote “Internet +” initiatives and expand the digital economy will further boost major office and data center markets.

INTRODUCTION

China's 'Two Sessions' for 2020 were postponed for more than two months due to the COVID-19 pandemic. The meeting finally commenced on May 22. The government work report, delivered by Premier Li Keqiang, reviewed China's social-economic development in 2019 and set economic development goals for 2020. Compared to prior years, the report pays only moderate attention to the real estate market. Nevertheless, in terms of the country's economic, industrial and regional planning for the coming year, we anticipate that the statements in the report will still have a significant impact on China's real estate market. In this update we interpret the report's key messages and the implications for China's real estate market, with excerpts from the full text of Premier Li's speech.

GDP Growth

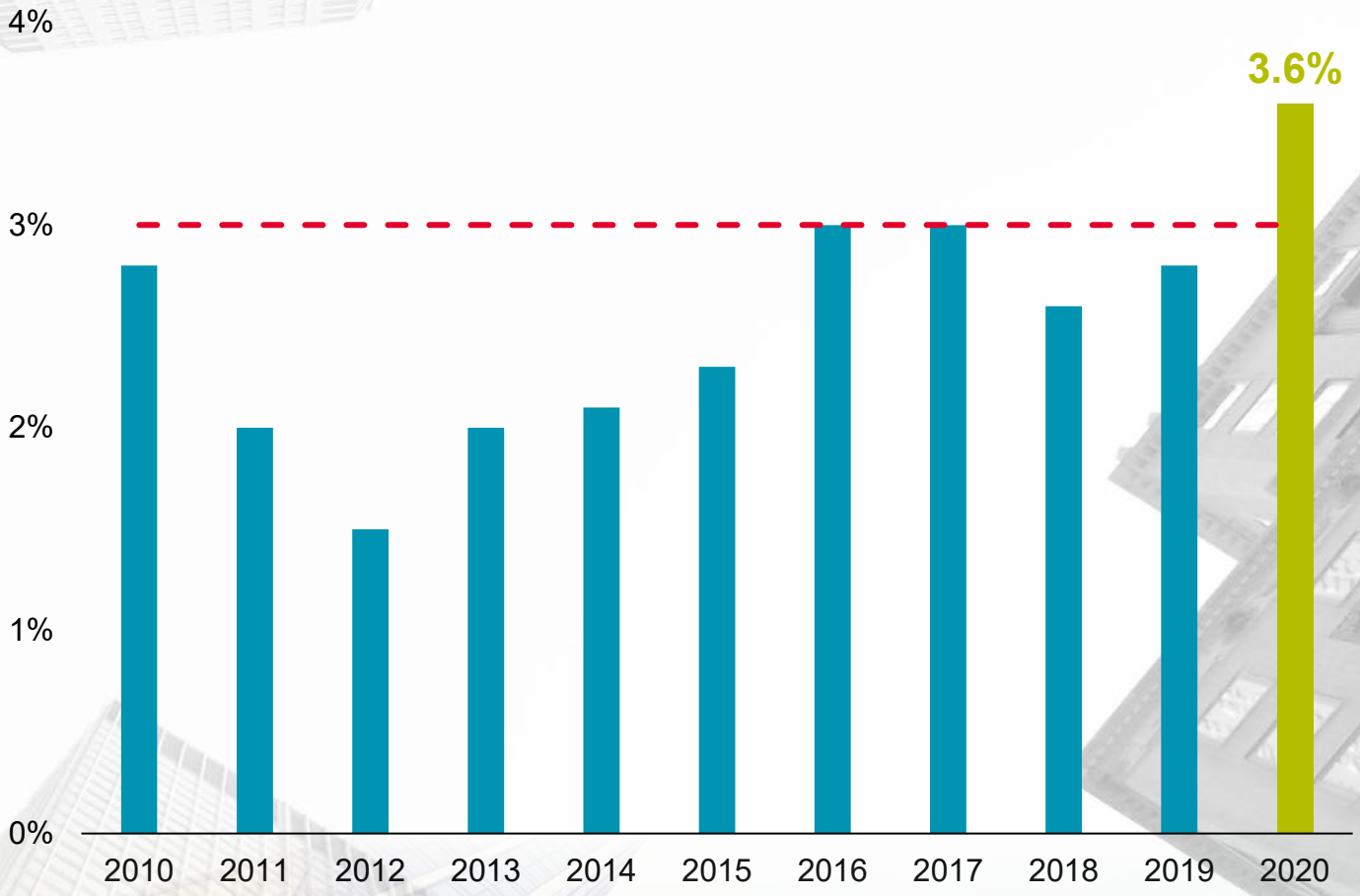
"I would like to point out that we have not set a specific target for economic growth this year. This is because our country will face some factors that are difficult to predict in its development due to the great uncertainty regarding the COVID-19 pandemic and the world economic and trade environment."

Previous government work reports have set GDP growth targets for the year, but the 2020 report does not put forward specific targets for annual economic growth. There are two key reasons. Firstly, China's government has now established a comprehensive economic development evaluation system – encompassing GDP, employment, price levels, balance of payments and other major measurements – as an assessment of economic development, rather than using GDP as the sole measure. And secondly, the COVID-19 pandemic has increased uncertainties in the external environment, which has made it more challenging to forecast GDP growth for 2020.

"We pursue a more proactive and impactful fiscal policy. The deficit-to-GDP ratio this year is projected at more than 3.6 percent, with a deficit increase of one trillion yuan over last year. On top of this, one trillion yuan of government bonds for COVID-19 control will also be issued. These are extraordinary measures for an unusual time."

Although no single growth target has been set, the government has clearly defined its objectives in key areas such as the deficit, scale of debt, and employment. Among these, the government deficit rate is forecast to rise to 3.6% in 2020 (Figure 1), which is the first time since 1994 that the financial risk warning red line has exceeded 3%. The jump in the deficit rate reflects the government 's expanded fiscal policy. An additional RMB 1 trillion of borrowing this year, and the RMB 1 trillion issue of special anti-pandemic government bonds, will be allocated to local governments to support fiscal and monetary relief measures, consumption stimulus efforts, and investment.

Figure 1: China's fiscal deficit rate 2010-2020



Source: 2020 government work report.

Promote Consumption Recovery

"We will promote the recovery of consumption. We will stabilize employment, promote income growth and ensure people's basic needs are met to encourage and enable consumer spending. We will support the recovery and development of food and beverage, brick and mortar shopping, culture, tourism, domestic services, and other consumer services, and promote the integration of online and offline consumption. Elderly and childcare services will be developed. Pedestrian streets will be upgraded. "

The COVID-19 outbreak exerted a heavy blow to consumption. Pandemic containment measures meant that home isolation became the new normal, and consumer spending plummeted nationwide. In February, March and April of 2020, the cumulative year-on-year growth rate of total retail sales of consumer goods was at -20.5%, -19% and -16.2% respectively (Figure 2) – the first negative consumption growth figures since China commenced its reform and opening up.

Figure 2: **Monthly accumulative growth rate of total retail sales of consumer goods**

Source: National Bureau of Statistics

The overall consumer market is expected to rebound as the pandemic continues to come under control. Despite this, total consumption for the year will still be severely affected, impacted now by the weakened economy and consumers' reluctance to spend. In the past two years, domestic demand has become the main driver of China's economic growth, with consumption contributing 57.8% of growth in 2019 and 78.2% in 2018. To mitigate the ongoing impact of the pandemic, promoting greater consumer spending will be an important issue for overall economic growth in 2020.

In 2019 the Ministry of Commerce released a "Notice on carrying out pilot work of pedestrian street renovation and upgrading" with the objective of establishing a group of world-class pedestrian streets, by upgrading the most well-known and most promising pedestrianized areas in the country. The government work report places additional emphasis on this project for 2020. As a result, we anticipate such upgrading work will be accelerated, thereby generating new retail development opportunities this year.

The following key pedestrian streets were selected for a pilot upgrading program in 2019

Beijing Wangfujing Walkway

Tianjin Jinjie Pedestrian Street

Shanghai Nanjing Road Pedestrian Street

Chongqing Jiefangbei Pedestrian Street

Shenyang Middle Street Pedestrian Street

Nanjing Confucius Temple Walking Street

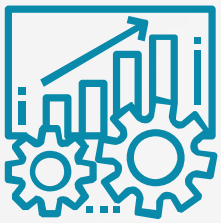
Hangzhou Hubin Pedestrian Street

Wuhan Jianghan Road Pedestrian Street

Guangzhou Beijing Road Pedestrian Street

Chengdu Kuanzhai Alley Walking Street

Xi'an Datang Everbright City New Chinatown Pedestrian Street



Expand Effective Investment

"Priority will be given to new infrastructure and new urbanization initiatives and major projects, which not only boost consumption and benefit the people, but also facilitate structural adjustments and enhance the sustainability of growth. Specifically, efforts will be made mainly in the following three areas: First, we will step up the construction of new types of infrastructure. We will develop next-generation information networks and expand 5G applications. We will build more charging facilities and promote wider use of new-energy automobiles. We will stimulate new consumer demand and promote industrial upgrading. Second, we will strengthen the development of a new type of urbanization. We will do more to improve public facilities and services in county seats, so as to meet the growing demand to work and settle in them among rural residents."

Historically, the government's fiscal policy-directed investments have been concentrated on high-speed rail, ports, and airports. In 2009, for example, in order to hedge against the negative impact of the global financial crisis on China's economy, a massive round of infrastructure investment was launched by the government, focusing on railways, highways and airports, uplifting the country's infrastructure significantly.

From 2008 to 2018 the number of civil aviation routes in China grew by a multiplier of 3.2, rail network distances grew 1.63 times, and the highway network grew 2.36 times. These infrastructure achievements have provided a solid foundation for China's continuing rapid economic development.

Now, with the further development of the national economy, infrastructure investment will focus more on the development of cutting-edge science and technology, promoting higher-quality economic development, and enhancing social satisfaction and wellbeing through technological innovation. As China's economy transitions from rapid growth to an emphasis on high-quality development, the industrial supply chain is also moving higher up the value chain, creating new infrastructure requirements for a new era of growth.

The development and application of new technologies will create new industrial value, driving related industries and the economy.

In the United States, according to the 2018 report "How the Wireless Industry Powers the U.S. Economy" from Accenture Strategy, every US$ 1 of the wireless industry's direct contribution to GDP drives US$ 3.20 of GDP to the U.S. economy as a whole. The report estimates that 4G technology has driven 4.8 million jobs in the U.S. adding US$ 475 billion annually to the economy. Each job in the 4G industry is estimated to generate a further 7.7 jobs across related industries, compared to a less attractive multiplier of 3.9 in hardware manufacturing and 1.5 in the restaurant industry (Figure 3).

Figure 3: Comparison of the number of jobs generated by different industries in the United States

Source: How the Wireless Industry Powers the U.S. Economy, Accenture Research

The development of 4G technology drove significant economic benefits in the U.S., further supporting the economic case for China's development of a 5G network. China may have missed out on some of the benefits of the development of 2G and 3G networks, but kept up with the global pace of 4G development and is now fully committed to development of a 5G network to regain a competitive advantage and reap the economic rewards.

The China Academy of Information and Communications Technology (CAICT) estimates that the value of information consumption driven by 5G commercialization will exceed RMB 8 trillion from 2020 to 2025, directly boosting total economic output by RMB 10.6 trillion. According to the Academy's white paper on 5G's economic and social impact, by 2030, 5G will generate a direct economic output of RMB 6.3 trillion, an economic value- add of RMB 2.9 trillion, and eight million new jobs. Indirectly, by 2030 5G is forecast to contribute a further RMB 10.6 trillion to total economic output, generating around RMB 3.6 trillion of economic value-add, and a further 11.5 million jobs.

Finally, widespread adoption of 5G, big data, cloud computing and complimentary technologies is also expected to greatly promote development of 'smart' industries, including smart buildings, logistics, transportation and medical sectors.

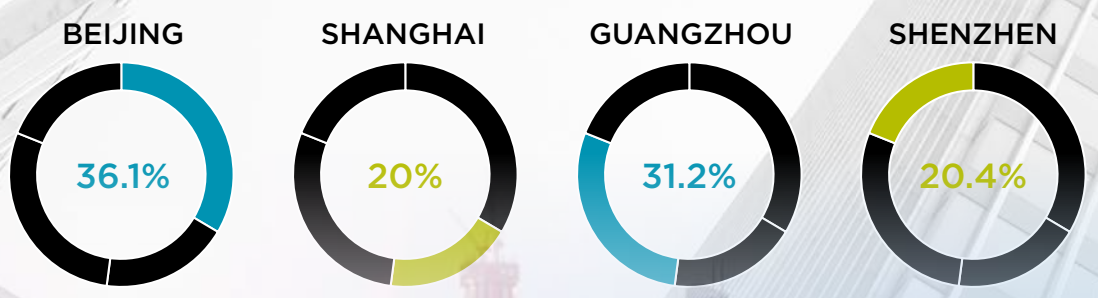
Encouraging Growth of Emerging Industries

"We will encourage the upgrading of manufacturing and the growth of emerging industries. We will promote the industrial internet and boost smart manufacturing. New forms of business such as e-commerce, online shopping, and online services have played an important role during the COVID-19 response and more policies will be introduced in support of such businesses. We will advance Internet Plus initiatives across the board and create new competitive strengths in the digital economy."

As an important component of China's economic structural transformation, emerging industries have flourished in recent years. In the period following Premier Li Keqiang's proposal to vigorously develop the "Internet +" sector, China's internet industry has seen strong development, with the internet penetration rate rising from 44.1% in 2013 to 57.7% in 2018, an increase of 13.6 percentage points in five years. The development of internet sector companies has been rapid, with enterprises scaling up and generating strong demand for office space and data centers. The sector has gradually become a key driver of the office market. In 2019, Cushman & Wakefield observed that the Technology Media Telecommunications (TMT) sector's share of total office demand by total area leased was approximately 36% in Beijing, 20% in Shanghai, 31% in Guangzhou and 20% in Shenzhen.

With the further advancement of the Internet + space, we can expect the TMT demand for office space to remain strong into the future.

Figure 4: Share of TMT sector office demand in mainland China's Tier One cities, 2019



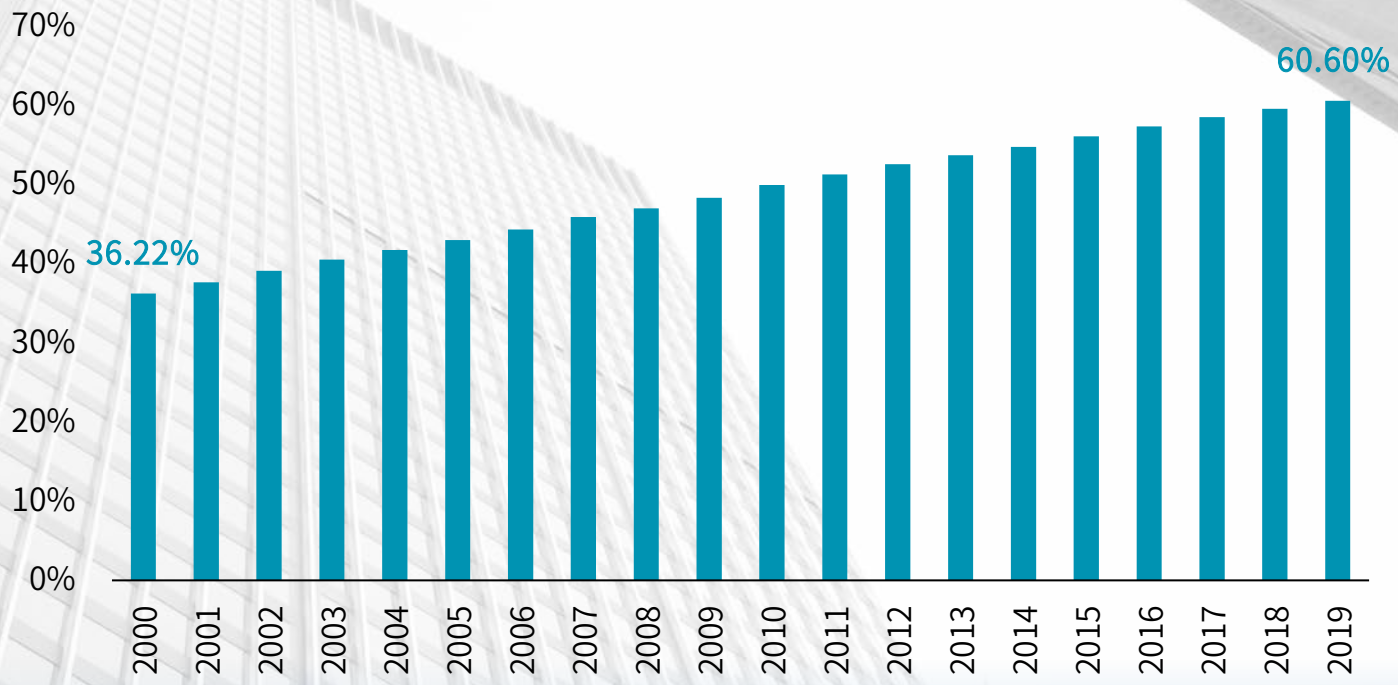
Source: Cushman & Wakefield Research

New Urbanization

"We will steadily advance new urbanization. We will leverage the role of leading cities and city clusters in driving the overall development of their surrounding areas, in an effort to foster new industries and increase employment."

In 2019, China's urbanization rate surpassed the 60% milestone to reach 60.6%, a rise of 24 percentage points since 2000 (Figure 5). The new government work report highlights the promotion of new urbanization, indicating that the country's rate of urbanization will continue. With integration between urban and rural areas becoming ever tighter, urbanization will continue to be a driving force for China's real estate market into the future.

Figure 5: China's urbanization rate, 2000-2019

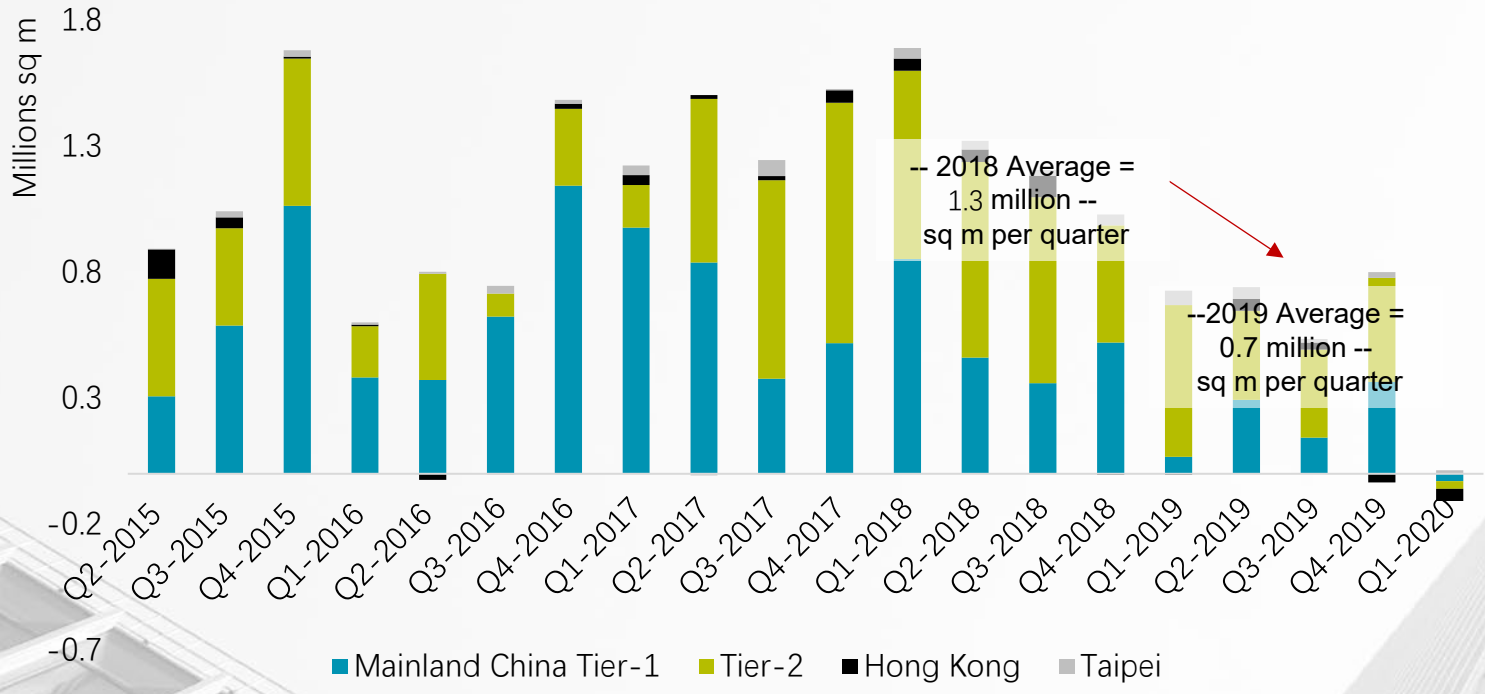


Source: National Bureau of Statistics

With the development of city clusters, infrastructure networks such as transportation and communications will become more well-connected, economic ties will be closer, and homogeneity and integration will be a key development trend. In such city clusters, bigger labor markets and improvements in productivity and innovation will bring greater development opportunities for core cities. Intercity high-speed rail and rail transit projects will facilitate the flow of people and resources, stimulating further development of office, retail, logistics and residential markets across core cities.

Taking the office market as an example, with the restructuring of local economies and the rapid growth of the tertiary industry sector, demand for office buildings in Tier Two cities has risen consistently over recent years. In 2019, Cushman & Wakefield data reveals that Tier Two cities accounted for around 66.4% of China's Grade A office market demand, up from 55.4% in 2018 (Figure 6).

Figure 6: Greater China Grade A office absorption

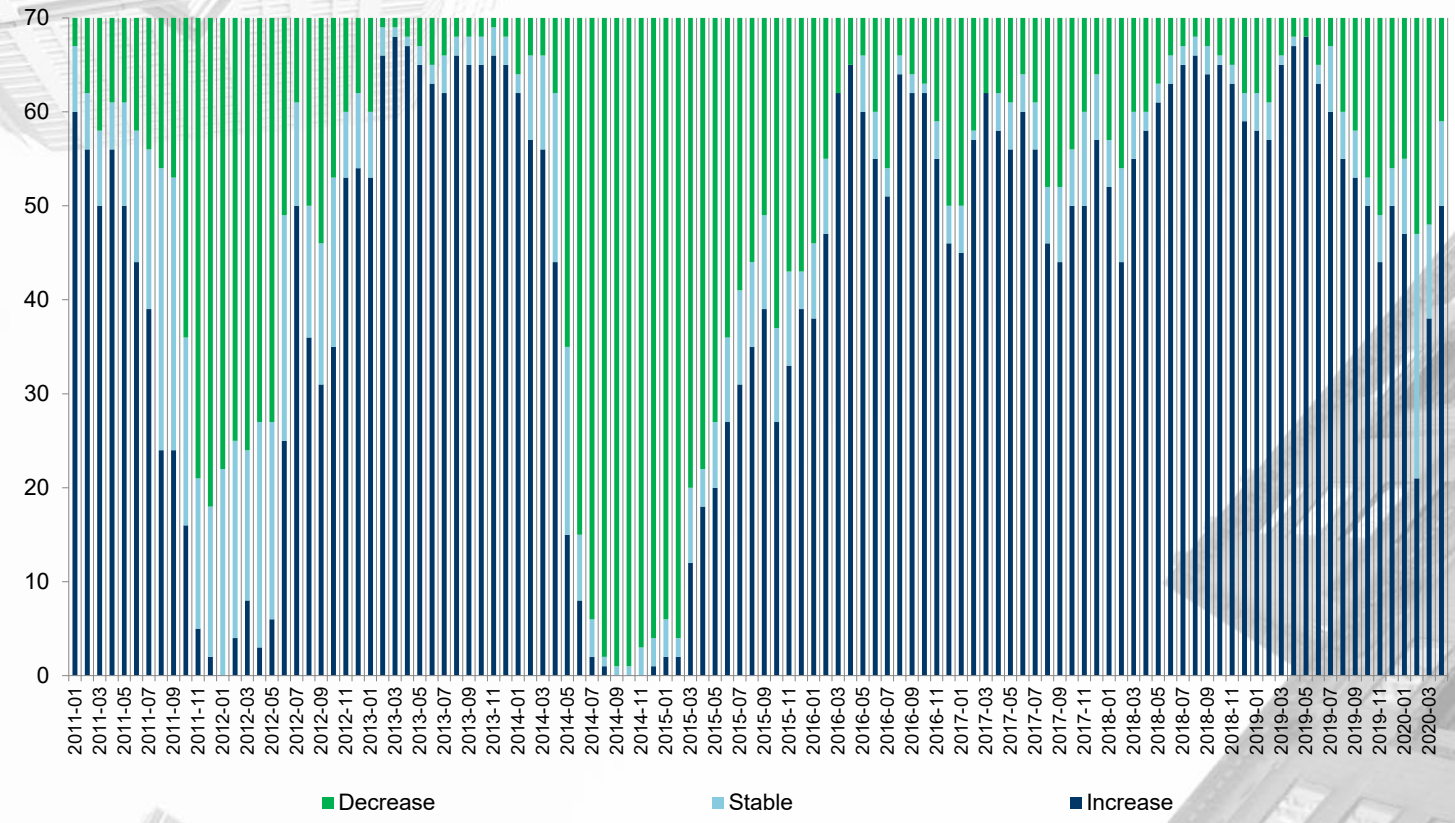


Source: Cushman & Wakefield Research

> **"Acting on the principle that houses are for living in, not for speculation, we will implement city-specific policies to promote steady and healthy development of the real estate market. We will improve urban amenities, and make our cities places that people enjoy living and working in."**

The COVID-19 outbreak also took its toll on the residential property market. Only 21 of the 70 large and medium-sized cities in the housing index saw prices rise in February this year. However, the containment of the pandemic

Figure 7: Residential sales price index by city



Source: National Bureau of Statistics, Cushman & Wakefield Research

led to a strong rebound: 50 large and medium-sized cities witnessed price increases in April (Figure 7).

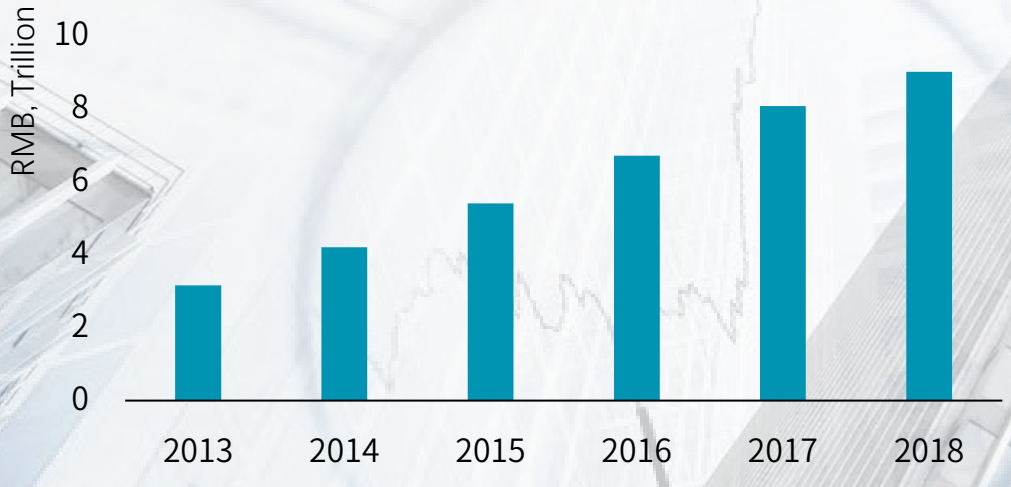
According to the government work report, the guiding principle that homes are for living in and not for speculation will remain unchanged, and the policy orientation is to continue to stabilize the housing market. Past experience has all too clearly demonstrated that increased market liquidity can immediately re-ignite the residential market, and the government work report's commentary on promoting stable and healthy development of the real estate market confirms that the government will remain vigilant in controlling capital targeting the sector. With individual cities facing different challenges in this regard, so city-based governance will have more room on local policy direction, allowing them to regulate markets appropriately and in a timely manner according to local circumstances.

A Higher Standard Opening Up

"We will accelerate the growth of cross-border e-commerce and other new forms of business, and enhance our international shipping capacity. We will work with the United States to implement the phase one China-US economic and trade agreement. We will promote higher-standard opening up and stabilizing the overall performance of foreign trade and foreign investment."

Although cross-border e-commerce transaction values are much smaller than domestic e-commerce values, the trade has maintained a high annual average growth rate of 22% over the past five years. Cross-border e-commerce transactions reached RMB 9 trillion in 2018, up by a factor of 1.14 from 2014 (Figure 8). In today's era of rapid global e-commerce development, the widespread application of new technologies such as cloud computing, big data and artificial intelligence has greatly improved the efficiency of cross-border trade services, production, logistics and payment. In turn this will usher in new development opportunities for China's cross-border e-commerce industry and will help further support the development of the country's logistics real estate market.

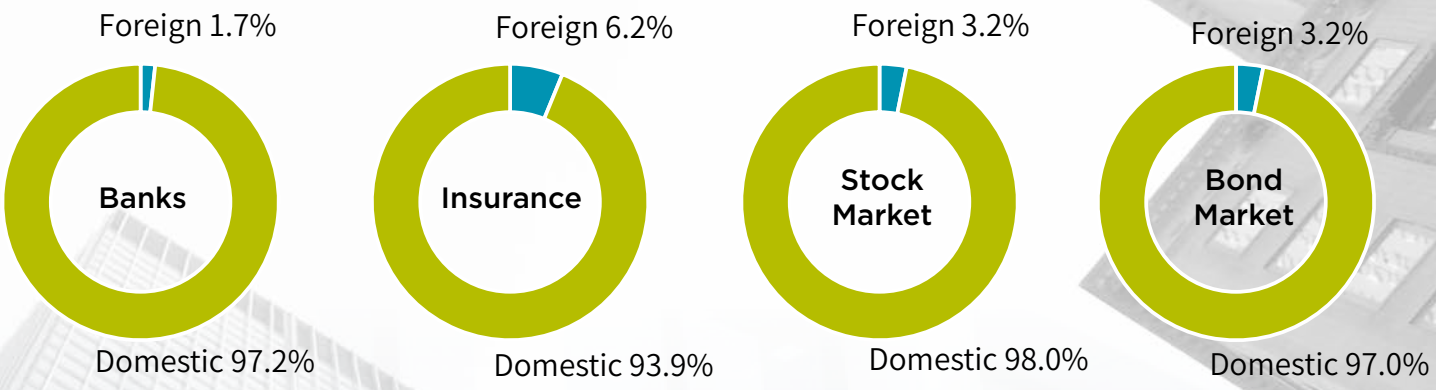
Figure 8: Transaction volume of China's cross-border e-commerce market, 2013 – 2018



Source: E-Commerce Service Platform: 2018 China's cross-border e-commerce report.

The government's work report proposes to actively make use of foreign investment. China will significantly shorten the negative list for foreign investment and draw up a negative list for cross-border trade in services. Although there is no mention of financial openness, the State Council detailed the specific timetable for the opening of China's financial market in the Notice on Promoting Steady and Healthy Development of the Real Estate Market ("11 measures of the FSDC") issued in July 2019. The pace of foreign financial institutions entering China has slowed due to the impact of the COVID-19 pandemic, but 2020 is still expected to see new international entrants as the impact of the pandemic subsides.

Figure 9: Share of foreign investment in key financial markets



Note: Stock and bond market data as of 2019 Q3, and bank and insurance market data as of the end of 2017

Source: National Bureau of Statistics, The People's Bank of China, China Banking and Insurance Regulatory Commission.

CONCLUSION

Despite the impact of the unprecedented confluence of events that have led the central government to abstain from setting a specific target for economic growth this year, we believe that plentiful signs of positivity remain for the healthy development of China's real estate markets in the future. The retail property market will benefit greatly from concerted recovery efforts to boost consumer spending, backed by a pedestrian infrastructure program designed to help get people back shopping. The logistics sector can expect a boost from the knock-on effects of the retail recovery. Office and data center markets are set to ride the wave of renewed promotion of the digital economy, and all commercial real estate sectors will gain from uninterrupted urbanization and the emergence of city clusters. And finally, the residential market continues to be underpinned by an anti-speculative ideology and bolstered by a capability for government market intervention in the name of stability.

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