Real Estate

The Chinese consumer

Rising affluence, favourable policies and currency arbitrage are driving the phenomenal growth of Chinese outbound tourism, benefiting the retail markets of key global cities.

Anne Breen
Head of Real Estate Research and Strategy

The Chinese consumer and tourism

One of the key drivers of real estate markets in several countries is the rise of the Chinese consumer. Wealth in China grew by over 200% between 2000 and 2008, while China's share of the global middle class population has doubled since 2000 and is currently about one-third of the total. With this new-found wealth, luxury brands flocked to China. More recently, as Chinese consumers became more sophisticated, world travel became more alluring. While Chinese now represent close to a third of all luxury sales around the world, about two-thirds of their spending is overseas.

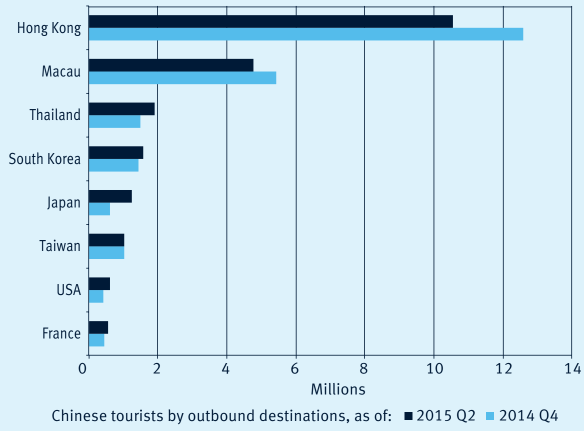
Key drivers that facilitated the expansion in Chinese outbound travel were policy changes and currency movements. For example, there has been a steady easing of visa restrictions by the Chinese government for outbound travel, in tandem with countries such as Japan, the EU and the US easing restrictions on inbound travel. Weaker currencies in Japan and the Eurozone versus a stronger renminbi have also underpinned the growth in Chinese tourism.

By far the top destination for Chinese tourists is Hong Kong; while South Korea, Thailand and Taiwan have seen their share of Chinese arrivals rise and Japan is becoming a preferred destination (see Chart 1). Together with the US, France, Singapore, Malaysia, Germany and Australia these countries complete the most popular destinations for Chinese tourists. The growth in outbound tourism from China to these destinations was over 12% in the 18 months to June 2015. Globally, of all outbound tourism, China is the world's top spender with a 28% increase in expenditure in 2014, reaching a total of $165 billion.

The implications for global real estate

The retail offering in China is improving but lacks critical mass and e-commerce is often hampered by a lack of infrastructure. International retailer expansion in China has reached a point of saturation. While China did not feature in the top target markets for new retail entrants in 2014, made up of Japan, Singapore, Germany, Taiwan, Hong Kong and France according to CBRE, there is in fact a strong correlation with those destinations where Chinese tourist numbers grew substantially in the past 18 months.

Chart 1
Seeing the world



Source: Bloomberg, Standard Life Investments (as of Q2 2015)

Real estate markets are reacting to these trends. Hong Kong, with its well-developed retail infrastructure, has long been reliant on mainland Chinese tourists. As sales have fallen sharply, partly due to the clampdown on corruption, so retail rents have plummeted. Conversely, Japan had the highest number of foreign visitors in its history in 2014, and inbound tourism from China has grown 26% per quarter in the last six quarters. The Japanese government is targeting 20 million foreign visitors per year by 2020 in the run up to the Tokyo Olympics and has eased visa restrictions and duty-free rules to facilitate this. Retail rents have grown by an average of 3% per quarter over the past six quarters and increased demand is expected to drive rents further.

Europe has also benefited: Chinese tourists now account for 40% of all luxury sales in France, 35% of luxury sales in Italy and 25% of luxury sales in the UK, according to HSBC. France, especially Paris, is by far the most popular European destination for Chinese tourists; departures to France from China totalled over one million in the first half of 2015 and inbound tourism from China has grown 17.5% per quarter in the last six quarters. Retail rental growth has historically been limited by lease structures with a strong tenant bias, but a recent change in legislation helped high street rents grow by 16.7% in Q1 2015, according to CBRE.

Our strategy within global real estate

Generally, we have a preference for prime and good secondary assets in a range of different countries. In the UK, Grade A Regional and South East offices remain attractive in the near term, as well as higher-yielding assets in core areas. In Continental Europe, a fundamental recovery within peripheral markets is expected to drive the best performance. Expectations for continued US economic expansion amid low supply growth will drive sturdy growth in cyclical office markets. 'Gateway' office markets continue to attract well-heeled foreign buyers and support pricing. Monetary policies are driving performance in the Asia-Pacific region. High interest rates in Australia are supporting double-digit returns in non-commodity based cities. Prime Minister Abe's policies are propping up Japan's relative performance in the region by bolstering asset values and reviving occupier demand from cash-rich corporations.