Asia Pacific - August 2023

SPOTLIGHT
*Savills Research*

# Asia Pacific Retail

# Finding a new normal in the post-pandemic landscape

## UNCERTAIN OUTLOOK CLOUDS RETAIL REVIVAL

The global retail industry has faced immense challenges over the past three years and although market conditions have improved as the pandemic recedes, 2023 is shaping up to be another tough year due to the global economic slowdown, elevated interest rates and persistent inflationary pressure.

The good news is that Asia Pacific is a relatively bright spot globally, albeit growth is moderating. Real GDP is forecast to reach 4.3% YoY in 2023, driven by China's reopening and resilience in India and ASEAN (Association of Southeast Asian Nations). Inflation should ease to 2.9% in 2023 as the supply chain crisis resolves and energy prices cool. Nonetheless, pricing pressure is still near decade-highs in major APAC economies like Australia and Singapore, limiting consumer purchasing power. As such, retail sales growth should slow in 2023 across the board, except for Japan, China, and Hong Kong SAR, which are benefitting from a low base effect.

**The question arises - how will recovery progress across the region's prime retail markets? will pre-pandemic growth patterns resume or will a new normal emerge?**

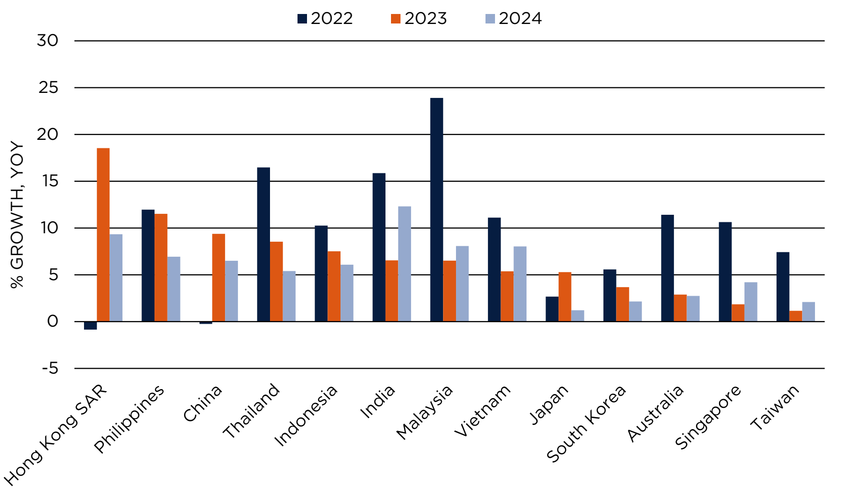
In terms of rents, most prime Asia Pacific retail markets bottomed out in 2H/2022 after three years of declines and have since gained momentum in 1H/2023. Stable domestic consumption, returning tourists, and constrained prime property availability supported mild rental rebounds with rental movements ranging from 0.5% to 5.7%. Among regional markets, Hong Kong SAR (5.7%), Singapore (3.1%) and Taipei (2.6%) registering the highest rental growth. The exceptions were Chinese cities like Shenzhen and Guangzhou, where ample new supply and softening local demand weighed on rents.

## A FULL TOURISM RECOVERY WILL TAKE PLACE BEYOND 2024

As more destinations have reopened in Asia Pacific from 2022 onwards, international arrivals volumes soared by 306% YoY to 101 million, forging ahead amid strong pent-up demand and excess household savings. According to Oxford Economics, Asia Pacific international tourism volumes are projected to reach 56% of 2019 levels in 2023 and 84% in 2024, though a full recovery will hinge on the return of mainland Chinese travellers Since the end of pandemic restrictions, Chinese tourists have mainly stayed at home or travelled within Asia, though visa restrictions and high travel costs have delayed China's outbound travel recovery, limiting the recovery of destinations highly dependent on Chinese visitors compared to less exposed ones.

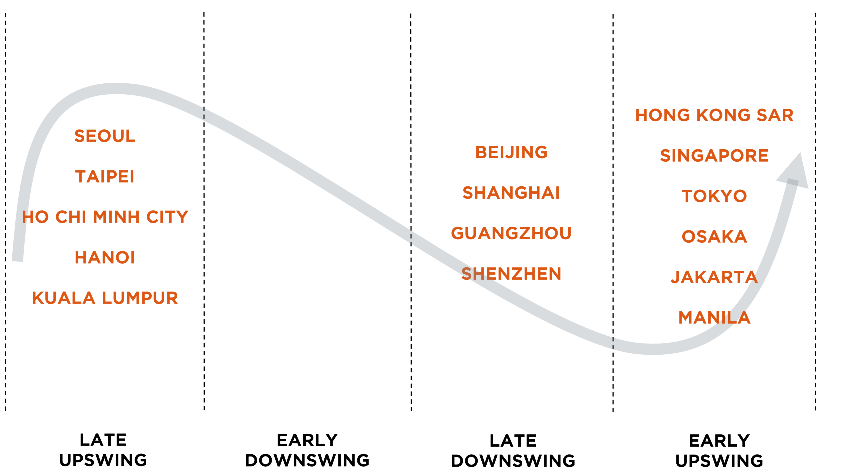
In Q1/2023, India saw international arrivals recover to 80% of pre-pandemic levels, while most other major destinations ranged between 60% and 70%. Looking across the region, Hong Kong SAR has historically relied most on mainland Chinese arrivals which accounted for 78% of the city's inbound travellers in 2019, and the city is therefore the worst performing market currently. Taiwan has also been adversely affected by geopolitical tensions and mainland Chinese have been reluctant to

**GRAPH 1: Retail Sales Growth by Market, 2022 to 2024F**




**Source** FocusEconomics, Oxford Economics

**GRAPH 2: Prime Retail Rental Market Cycles, 1H/2023**



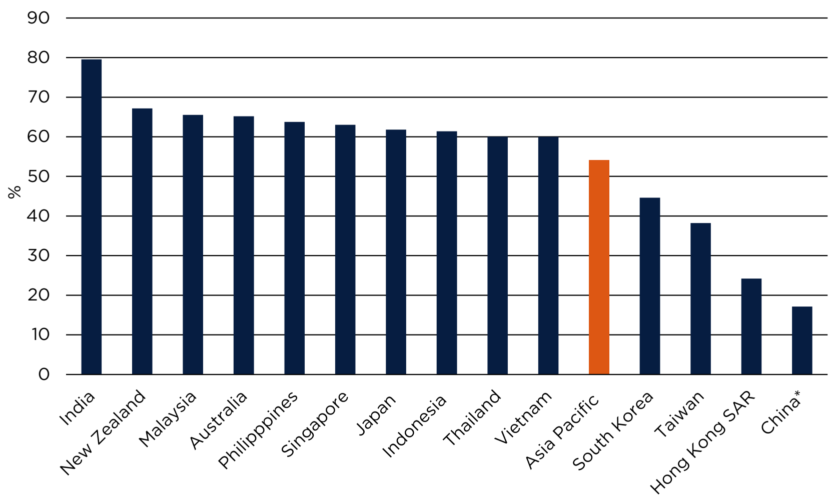

**Source** Savills Research & Consultancy
**Note** Late upswing: rental values rising, but growth is slowing.
Early downswing: rental values falling.
Late downswing: rental falls accelerating, close to reaching bottom.
Early upswing: rental values rising.

visit. Major destinations in the region such as Thailand, Japan, South Korea, and Taiwan all used to report around 30% of total arrivals from China.

Thailand and Japan are likely to benefit from more diverse source markets, meanwhile currency depreciation in the Baht and Yen has also added to the countries' appeal, partially offset rising travel costs compared to pre-COVID times. Thailand and Japan have seen tourist numbers recover to 60% of pre-pandemic numbers whereas South Korea and Taiwan are at 45% and 38% respectively. As a result, Thailand and Japan prime retail rents are likely to climb on the back of higher international tourist spending.

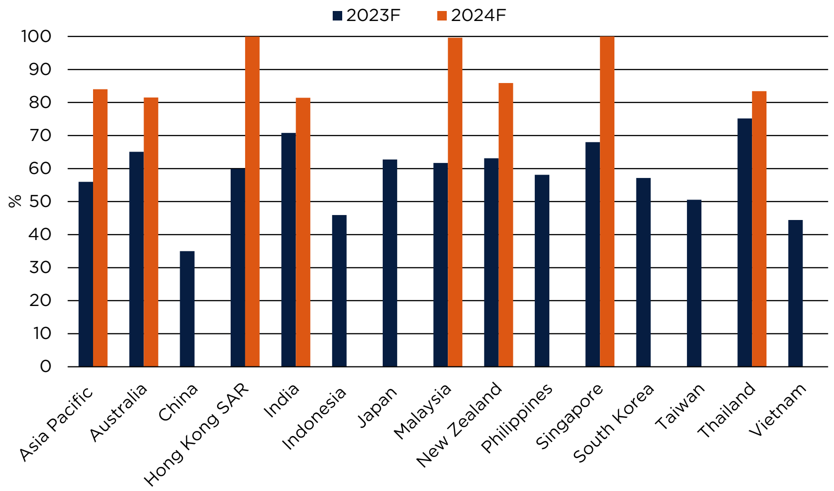
## Asia Pacific's prime retail markets are set to rebound, albeit recoveries may take place at very different speeds.

**GRAPH 3: International Tourist Arrivals Against 2019-levels, Q1/2023**




**Source** Government sources, Savills Research & Consultancy
**Note** *China only includes Shanghai and Shenzhen figures.

**GRAPH 4: Estimated International Tourist Arrivals Against 2019-levels, 2023F to 2024F**



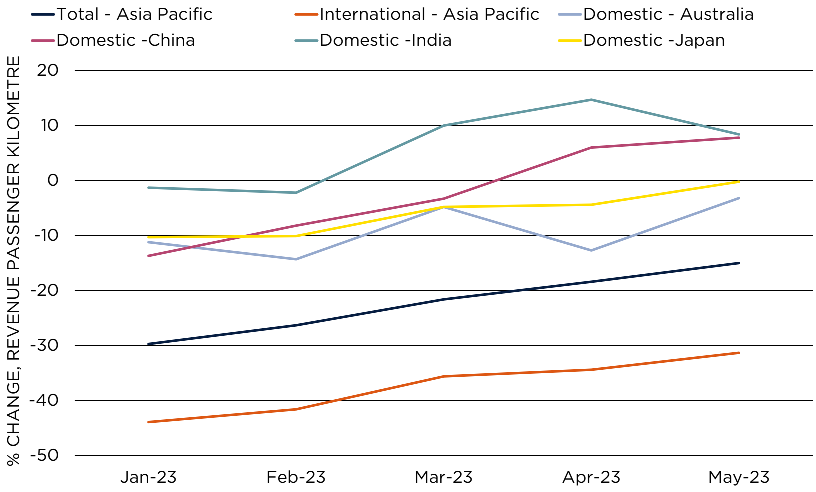

**Source** Government sources, Savills Research & Consultancy

Traditionally, outbound tourism in the region has been dominated by East Asian markets and Australian tourists. But in recent years, we have started to see Indian and Southeast Asian travellers play a bigger role while higher volumes of domestic travellers are also notable across Asia Pacific. China and India both have enormous domestic markets, receiving over 6.0 billion and 2.3 billion domestic visitors respectively in 2019 prior to the pandemic making them easily the two largest domestic tourism markets in the region. According to data from the International Air Transport Association (IATA), monthly domestic air passenger traffic volumes in India exceeded pre-pandemic levels from March 2023 onwards, with China following suit in April 2023. This strong domestic demand is helping to make up for some of the shortfalls in international flows, especially in less inbound-dependent locales. Domestic retail markets are also getting a boost from softening currencies, which makes local travel more appealing to price-sensitive travellers.

### DOMESTIC STRENGTH

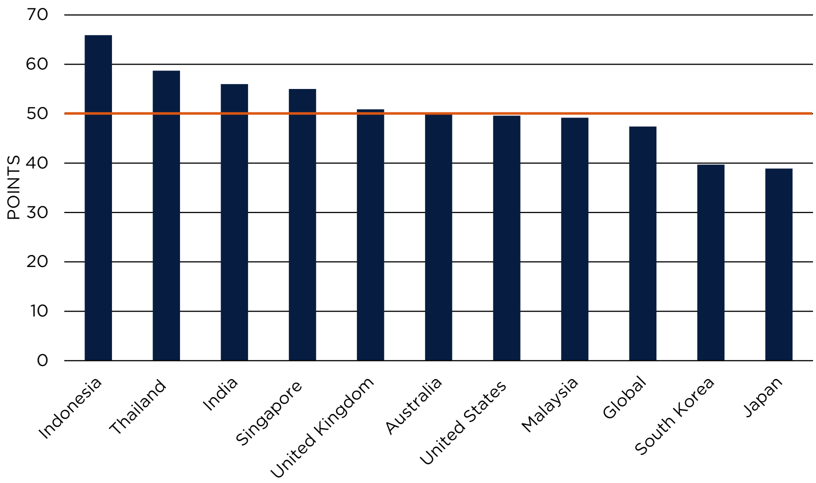
The pandemic drove household savings to record highs across Asia Pacific. While some drawdowns occurred in the wave of 'revenge spending' and inflation, bank deposit levels accelerated further in markets like China, Hong Kong SAR, and Taiwan during Q1/2023. While excess savings provide a buffer in challenging times, the overall mood remains cautious across most of Asia Pacific as economic uncertainty continues to undermine sentiment. The only markets exhibiting optimistic sentiment are Indonesia, Thailand, India, and Singapore, whereas Australia, Malaysia, South Korea, and Japan are all pessimistic in terms of consumer confidence.

**GRAPH 5: Passenger Traffic Against 2019-levels by Air Route , January 2023 to May 2023**



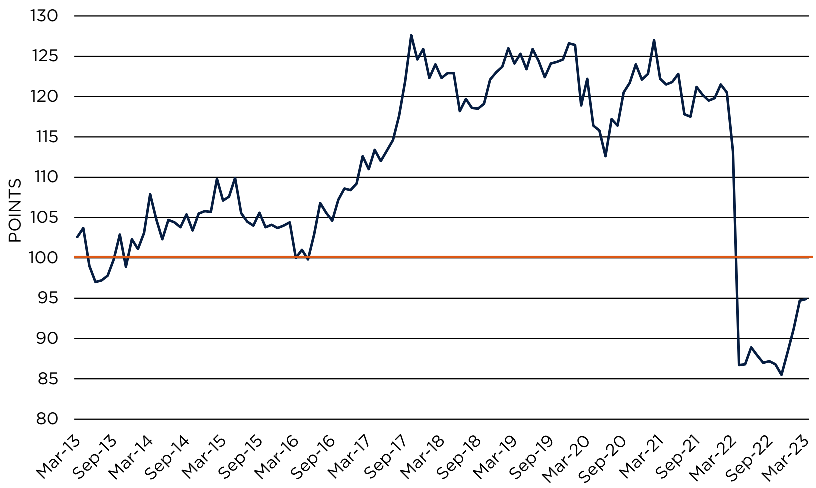

**Source** IATA, Savills Research & Consultancy

**GRAPH 6: Consumer Confidence Index by Market, June 2023**




**Source** Ipsos, Savills Research & Consultancy

**GRAPH 7: Chinese Consumer Confidence Index, March 2013 to March 2023**




**Source** National Bureau of Statistics, Savills Research & Consultancy

China is experiencing its most downbeat consumer confidence since the 2022 lockdowns, remaining at a decade low. Softer-than-expected economic growth, a debt crisis, falling house prices and an alarming youth unemployment rate are all key concerns weighing heavily on sentiment and luxury brands are likely to suffer more than other types of retailer. Major groups like LVMH, Richemont, Kering and Hermes experienced stronger sales growth in Q1/2023 in Japan than in their other Asian markets, which is typically led by Chinese consumption. With luxury sales faltering amid the weakening sentiment in China, many brands have come to realise that they need to broaden their portfolios and Southeast Asia is the natural choice for this diversification. Stand out markets in this region include Singapore, Thailand, and Vietnam.

Despite private consumption growth tapering in most Asia Pacific markets during 2023, it has remained more resilient and has outperformed other regions. Australia and Northeast Asia will face more headwinds, whereas Hong Kong SAR and China should see stronger expansion in 2023 than last year, albeit more due to low bases for comparison than underlying demand strength.

## NEAR TERM OUTLOOK

Despite varying macroeconomic conditions, most Asia Pacific retail rental markets have bottomed out and are trending upwards. On the supply side, the picture is mixed across major regional markets. Tier-1 cities in China and Hong Kong SAR are contending with supply pressures, as many projects scheduled for completion during the pandemic were delayed. Overall, Asia Pacific prime shopping centre new supply across the 12 markets we track is projected to reach 9.5 million sq m between 2023 and 2025. This equates to around 3.2 million sq m of new additions annually, surpassing the prior 3-year average of 2.7 million sq m.

Of this incoming supply, 80% is concentrated in the four tier-1 Chinese cities, led by Beijing with 2.7 million sq m. In contrast, key markets like Taipei, Bangkok, Ho Chi Minh City and Manila face limited new supply, keeping vacancies tight and supporting rents.

Most prime Asia Pacific shopping center markets should see 0 to 5% rental increases in 2023, with Hong Kong SAR and Ho Chi Minh City as standouts with 10% upside potential. Rents in top-tier Chinese cities are likely to remain mostly flat, with more downside risks in Shenzhen. Prime high street rents are also projected to rise in 2023, with Hong Kong SAR rents increasing by 5% to 10%. Tokyo and Osaka are also looking to rise by a similar amount. Looking beyond 2023, prime shopping centre rents are set to rise by 0 to 5% across the board, except in Chinese markets which are expected to remain subdued.

## LONG TERM DRIVERS

While near-term conditions are largely dictated by supply and demand dynamics, the pandemic has spurred some longer-term structural changes. As COVID-19 has subsided and mobility has normalized, many people are returning to their normal lives.

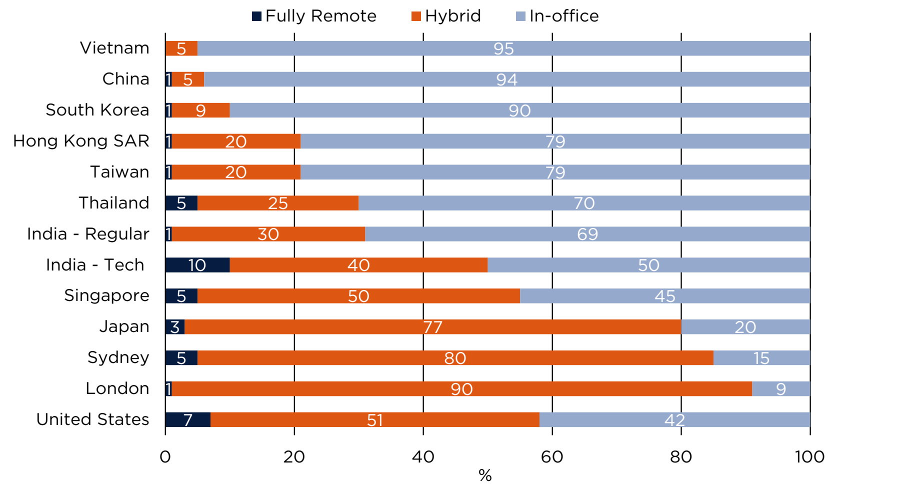
However, some lifestyle changes triggered by the pandemic are here to stay. Hybrid or remote working arrangements, which previously left downtown office and retail strips deserted, are now being gradually wound back or phased out altogether. In Asia Pacific in 2023, much more so than in the US or Europe, most people are returning full time to the office, with some residual hybrid work patterns persisting in major metro areas. Mass transit volumes have reverted to pre-pandemic levels in most cities but remain at approximately 80% in cities with lengthier commutes such as Tokyo, Seoul, and Beijing. The balance of hybrid working versus a full return will determine whether traditional downtowns reestablish, or more retail opportunities emerge in suburban neighbourhoods or adjacent satellite cities.

Another significant retail shift, which came to prominence during the pandemic, is the rise of e-commerce, particularly online grocery sales, which became essential during lockdowns. Currently, China and South Korea boast some of the world's highest e-commerce penetration rates in 2022 at 27%, well above the 22% global average. At the same time, earlier-stage markets like the ASEAN region are on the cusp of rapid digitalisation, propelled by the area's younger populations and their swift adoption of tech. The area should see the fastest growth globally, with the penetration rate set to leap from 21% to 28% between 2022 and 2026, reflecting a 17% CAGR (Compound Annual Growth Rate) over the period. By 2026, e-commerce is expected to contribute to 29% of Asia's retail sales and 26% in the ASEAN region. Retailers and property owners should increasingly integrate online experiences into their strategies, particularly in emerging markets which are poised to capitalise on the e-commerce windfall. Omnichannel capabilities and localisation could be key differentiators. Omnichannel retail strategies remain a key driver for promote both online and brick-and-mortar sales.

We are also seeing rising concern for environmental, social, and governance (ESG) credentials among retail operators, with luxury retail leading the way. High-end retailers tend to face more public scrutiny, so many have set ambitious net-zero targets. According to the United Nations Environment Programme, building operations alone accounted for about 31% of global final energy consumption, and 28% of energy-related $CO_2$ emissions in 2020. One way these high-end brands can effectively improve their ESG metrics would be to occupy green certified properties for their stores and offices. As an example, Prada Group has pledged to reduce greenhouse gas emissions throughout their operations by 29% by 2026 and 42% by 2029. The group has also obtained 171 LEED (Leadership in Energy and Environmental Design) certifications on operations and maintenance for their stores worldwide and is aiming to certify 300 stores by 2024.

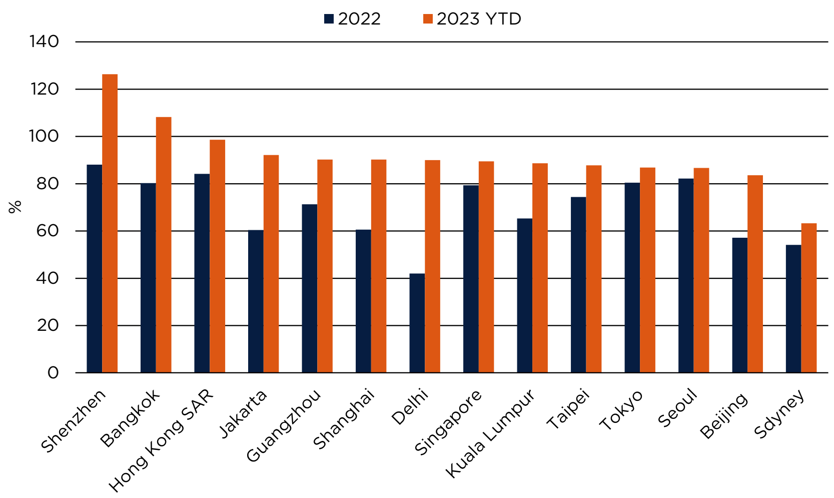
While Asia Pacific has been a slow adopter of ESG, we foresee growing demand for green retail stock going forward. Along with meeting their green targets, having eco-friendly storefronts will also help luxury

**GRAPH 8 : Share by Working Model across Major Grade A Office Tenants, Q2/2023**



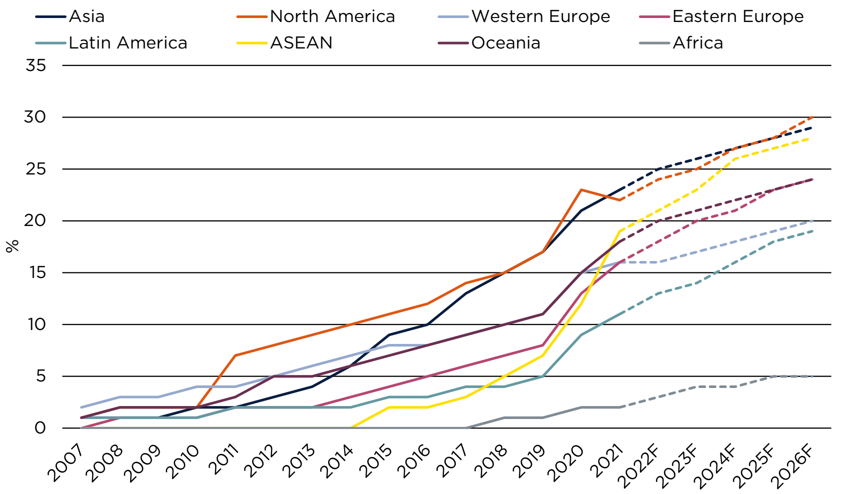

**Source** Scoop Flex Index, Savills Research & Consultancy

**GRAPH 9: Passenger Ridership Arrivals Against 2019-levels, 2022 to 2023**




**Source** Market sources, Savills Research & Consultancy
**Note** *Tokyo 2023 YTD figure is a forecast passenger volume for the full year 2023 of the JR Kanto Area Network.
Shenzhen Line 6 extension, 12, 14 and 16 started operation in Q4/2022.
Guangzhou Line 22 started operation in Q1/2022.
Hong Kong MTR East Rail Line cross-harbour extension started operation in Q2/2022.
Seoul Metro Sillim Line started operation in Q2/2022.
Rapid KL's Putrajaya Line started operation in Q2/2022.
Singapore figures do not include the ridership figure of Thomson-East Coast Line.

**GRAPH 10: E-commerce Penetration Rate by Region, 2007 to 2026F**




**Source** Euromonitor, Government sources, Morgan Stanley Research, Savills Research & Consultancy

brands to curate a progressive, sustainable image. Consumers are also becoming more sustainability-focused, especially the younger millennial and Gen Z markets, and this will mean that, for example, green leases are likely to expand from luxury retailers to the wider retail sector over the next few years. The growing number of ethical consumers will eventually shape the future of retail landscape.

## CONCLUSION – UNDERSTANDING THE NEW NORMAL

Overall, the Asia Pacific prime retail markets are past their troughs with a steady multi-speed recovery anticipated with China's turnaround delayed by domestic economic woes. While risks remain, the region's strong fundamentals will underpin long-term development especially in areas such as India and Southeast Asia with their youthful populations and emerging middle classes. As the sector navigates towards a new normal, flexibility and agility will be vital to capture the rebound potential for both retailers and landlords in the post-pandemic era.

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For more information about this report, please contact us

**Savills Research**

**Simon Smith**
Regional Head of Research & Consultancy, Asia Pacific
+852 2842 4573
ssmith@savills.asia

**Nancy Wong**
Senior Manager, Regional Research & Consultancy
+852 2842 4281
naywong@savills.asia