Southeast Asia
set for further outperformance

Southeast Asia 2H 2018 Outlook | 30 July 2018

Regina Lim

Key investment themes in Southeast Asia

1 | Faster economic growth but weaker currencies
In 1H18, Southeast Asia's economies grew faster, expanding by 5.2% year-on-year (yoy), prompting upgrades for the GDP forecasts for Thailand, Malaysia and Singapore. However, the risk of capital outflows weighed on emerging Southeast Asia currencies, particularly the Indonesian Rupiah and Philippines Peso. We expect investors to focus on the more developed markets Singapore, Malaysia and Thailand for the short term.

2 | Elections matter
Malaysia's surprise election results in May is likely to result in positive changes to the property market, in our view. The removal of goods and services tax should boost retail sales, while stricter planning approval processes should curb oversupply. However, upcoming elections in Indonesia and Thailand in 2019 may move some investors to defer their investment decisions in these countries.

3 | Thailand's Eastern Economic Corridor (EEC)
The Thai government announced a five-year plan with infrastructure spending of about USD 45bn and tax incentives to attract advanced industries and logistics operators. The EEC project is well placed to link up with China's Belt and Road Initiative and lift Thailand's growth trajectory materially by 2020. Ease of doing business in Thailand has improved significantly and foreign direct investments have increased.

4 | E-commerce operators continue to expand, set up physical stores in Southeast Asia
Alibaba continues to expand with a third global e-hub in Bangkok after Kuala Lumpur and Hangzhou. JD.com teams up with Central in Thailand. Online retailers, including fashion brands Pomelo and Love, Bonito are setting up physical stores.

5 | Strong tourist arrivals to boost hotel investments
Tourist arrivals into Southeast Asian cities rose 9% yoy in 1Q18 accelerating from 6% in 2017. Hotel RevPar rose 3% yoy in 1Q18 following a 6% yoy improvement in 2017. Investor interest in hotels is rising and we expect more transactions in developed markets over the next 24 months.

6 | Office take-up continues to surprise on the upside, especially in Manila, Singapore and Jakarta
Office take-up in Southeast Asia continues to accelerate, rising to 7% yoy in 1H18 as technology, e-commerce and coworking companies expand. Despite record supply in Manila, the vacancy rate has stayed at 2.2% in 2Q18 and we expect it to stay below 4% by the end of 2018, compared to our earlier forecast of 5.3%.

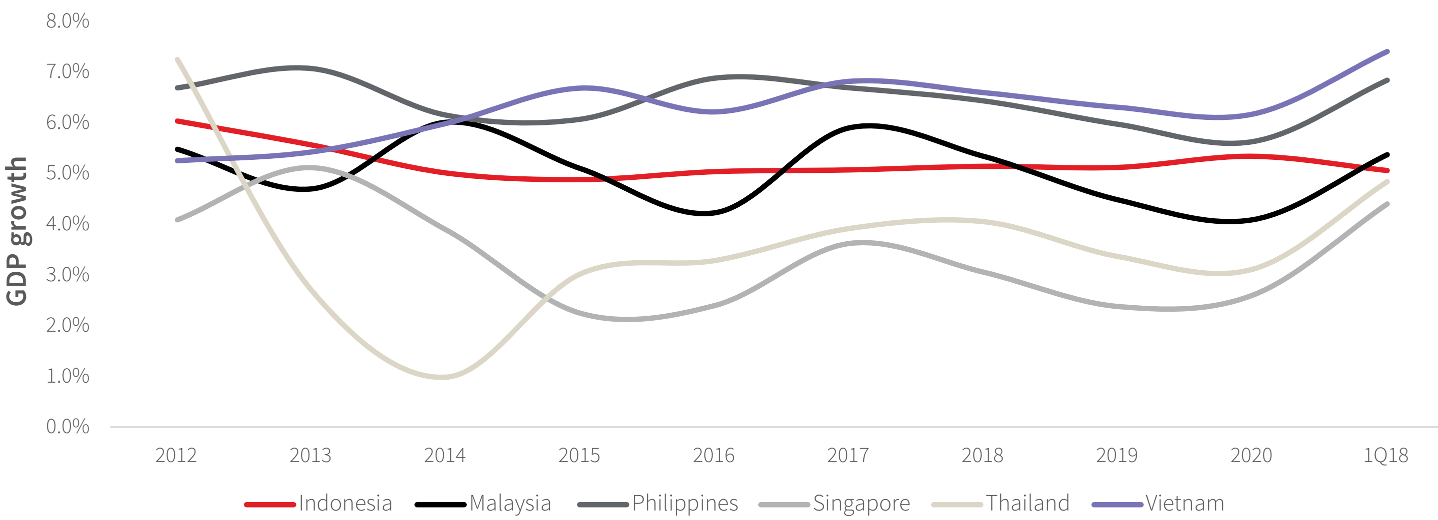
7 | Changes to our view
We have upgraded Singapore CBD office rent forecasts for 2019, as the potential redevelopment/retrofitting of aging stock could boost occupancy. For Jakarta, we expect rents to fall by another 2-3% in 2H2018 before recovering in 2019. We raised our office rent forecasts for Kuala Lumpur (KL) fringe due to strong demand, but downgraded our forecasts for KL City Centre due to significant supply. Prime retail rents expanded in Singapore for the first time in four years and we expect retail rents to rise 0.5-1.0% p.a. for the next four years.

Faster economic growth but weaker currencies

Southeast Asia's economies grew faster at 5.2% in the first quarter of 2018

In 1Q2018, Southeast Asia's economies grew faster by 5.2% yoy. **Thailand**'s economic growth of 4.8% was the fastest pace in five years. **Singapore and Malaysia** also expanded slightly faster than expected at 5.4% and 4.4% respectively in 1Q18.

Fig 1: GDP growth in Southeast Asia

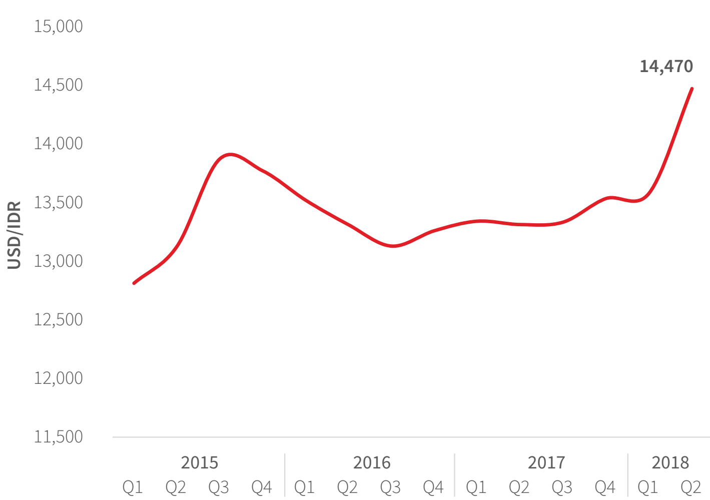


Source: Oxford Economics

Central banks raised rates to stabilise currencies, curb inflation

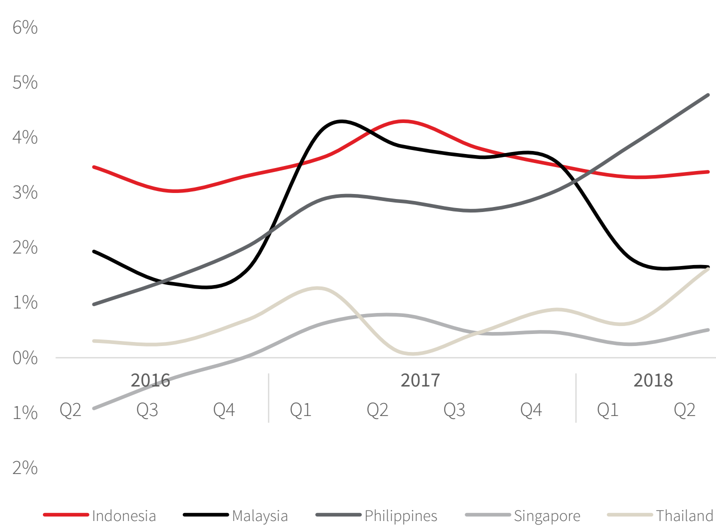
Indonesia raised interest rates by 100bps to 5.25% over three hikes in 2Q2018 in a bid to stabilise the rupiah, which had depreciated 5% against the US dollar year-to-date. This could affect exports and slow growth. The rest of the Southeast Asian currencies were relatively stable. Philippines raised rates twice in June to curb inflation, which rose to a 5-year high of 4.6% caused by implementation of changes to the tax law and rising food and fuel prices.

Fig 2: USD/IDR



Source: Oxford Economics

Fig 3: Inflation in Southeast Asia



Source: Oxford Economics

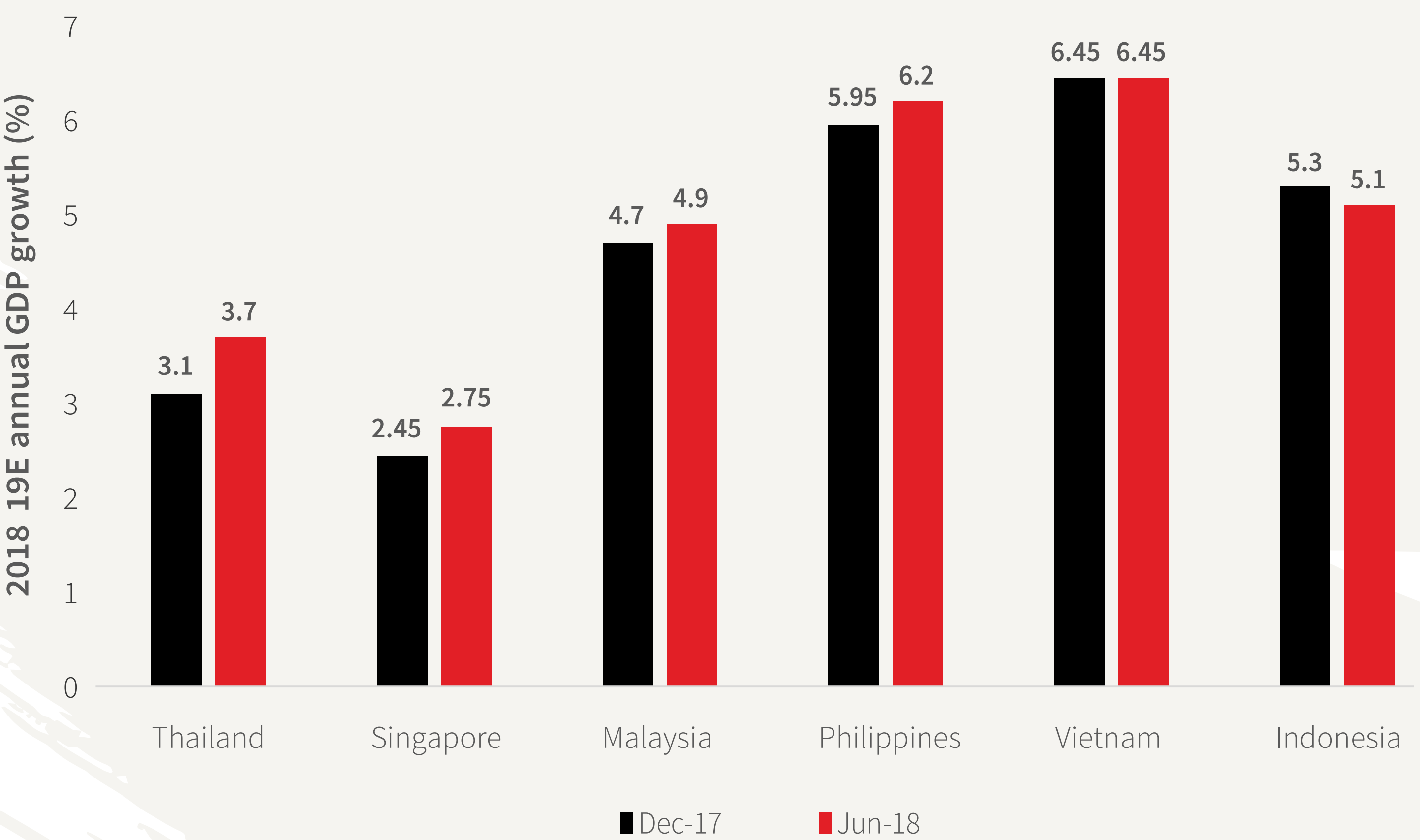
Central banks raised rates to stabilise currencies, curb inflation (cont.)

Thailand's central bank also intervened to stabilise the Baht. The Central Banks of Malaysia and Singapore mildly tightened monetary policy as well. The risk of further outflows will likely to continue to weigh on the currencies of developing Southeast Asia countries in the next 6-12 months.

Economic outlook for Thailand and Malaysia improved significantly

The strength of the Thai economy prompted economists to upgrade GDP growth forecast for 2018-19 to 3.7% from 3.1% previously. Outlook for the Singapore and Malaysia economies also improved. For Indonesia, growth expectations for 2018-2019 were moderated slightly.

Fig 4: : 2018-19 GDP forecasts were upgraded in 1H18



Source: Oxford Economics

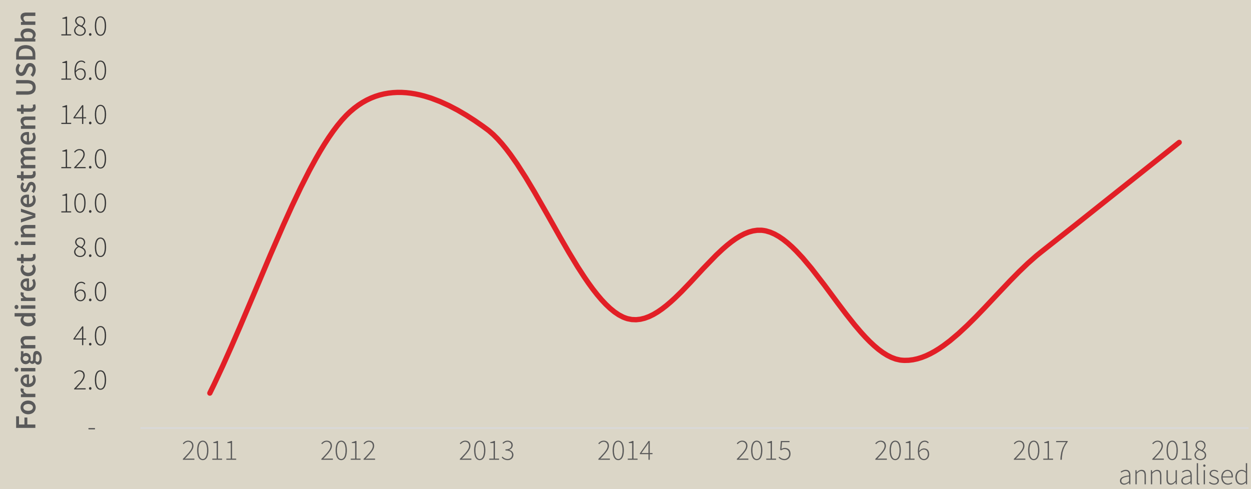
Over the next twelve months, the possibility of further interest rate hikes in Indonesia to defend the currency remains, due to the high ownership of local bonds by non-residents and pressure on the current account from higher oil prices. Portfolio outflows from the Philippines could also be a risk to the peso and further interest rate increases from its central bank.

Thailand

shines on foreign direct investments and ease of doing business

Thailand has been attracting more direct foreign investments (FDI) over the last 18 months due to relative political stability. New policy changes helped to improve the ease of doing business. In the first four months of 2018, FDI rose 62% yoy to USD 5.3bn.

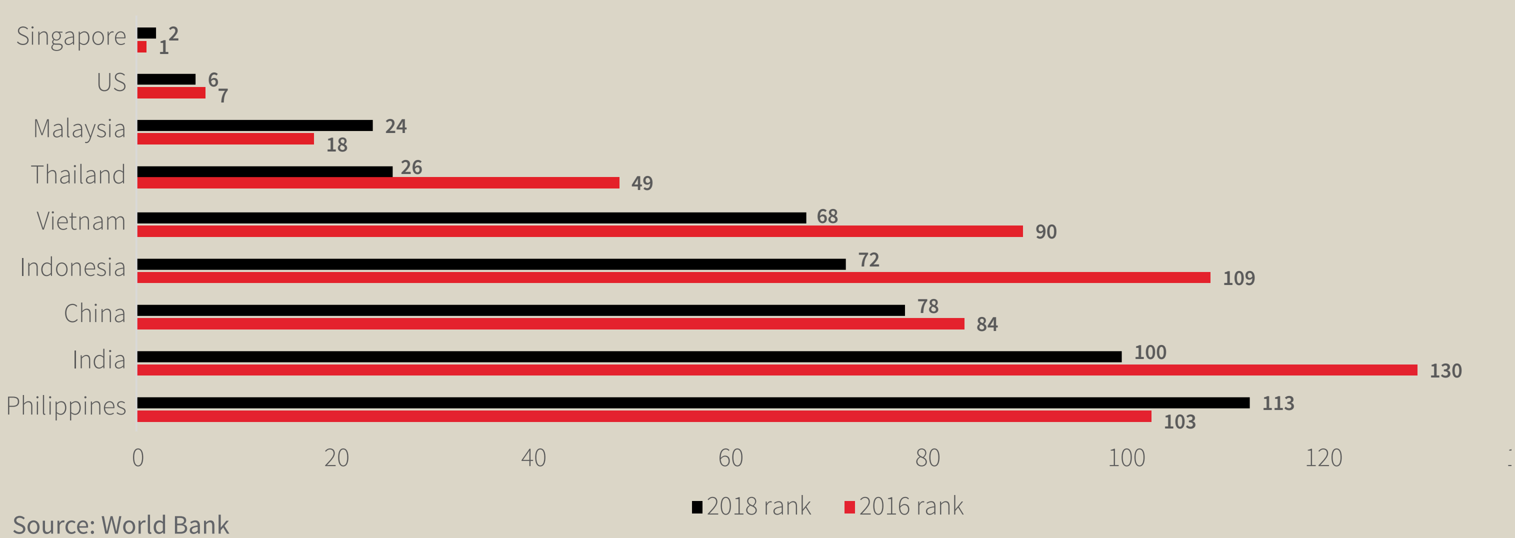
Fig 5: Foreign direct investments into Thailand



Source: Bank of Thailand

Thailand's ranking on the World Bank's Ease of Doing Business index for 2018 moved up 20 positions to 26th among 190 economies worldwide. Restrictions for foreign entrants have been eased in a number of industries, including insurance and commercial banking and there are plans to extend the business license waiver to more service industries.

Fig 6: Foreign direct investments into Thailand



Source: World Bank

In 1Q18, the Thai government announced the Eastern Economic Corridor (EEC) project, with planned infrastructure spending of about USD 45bn. The five-year plan for the corridor covers 2017 to 2021 and includes adding infrastructure and advanced industries, such as biotechnology, robotics and aircraft maintenance, in the provinces of Rayong, Chachoengsao and Chonburi. The Thai government hopes the project could lift Thailand's annual economic growth to 5% by 2020, from 3.9% in 2017.

Investors in the economic corridor enjoy tax breaks and can rent land parcels for up to 99 years.

The EEC project is well placed to link up with China's Belt and Road Initiative. China's Alibaba Group pledged circa USD 350m to build a distribution hub in the corridor and Airbus SE signed a joint venture agreement with Thai Airways International to construct an aircraft maintenance, repair and overhaul facility. Other investors, including those from Japan, Europe and the U.S. are also being approached for the project.

Map: Foreign direct investments into Thailand

Source: Strait Times

Elections matter

In the last quarter, elections in Southeast Asia have heightened investors' awareness of political risks that may increase market uncertainty and volatility. Most investors viewed Malaysia's surprise election results positively, and investor interest in Kuala Lumpur increased. However, political changes in Indonesia and Thailand could delay some investors' decisions until late 2019.

Malaysia

The surprise election results in May will result in positive changes to the property market, in our view. The new government has announced that approval for new developments are frozen, reinforcing the policy introduced in November 2017. This will allow gradual absorption of commercial and residential oversupply in Kuala Lumpur and support rents and capital values. We expect the development of essential infrastructure to continue. While the MRT line 3 and the high speed rail to Singapore are being reviewed, MRT line 2 is expected to proceed as planned, which would enhance connectivity within Klang Valley. Since the elections, enquiries and interest in residential properties in Kuala Lumpur, including from foreign investors, have picked up in July 2018.

Indonesia

The regional elections in June 2018 passed without major incident and, politically, all eyes are now on the presidential election in 2019. Current opinion polls suggest that President Jokowi will be re-elected for another year and the completion of high profile infrastructure projects, such as the Mass Rapid Transit (MRT) and Light Rail Transit, (LRT) in early 2019 should bolster his position.

Thailand

We expect Thailand's military government to defer elections again till beyond 2018. The military-written constitution, passed with 60 percent support in a 2016 referendum, suggests that despite the army's desire for 'democracy', their influence will be entrenched in Thai politics, regardless of the result of the upcoming election.

E-commerce operators continue to expand, launch physical stores in Southeast Asia

Southeast Asia continues to attract investments from e-commerce companies, which seek to expand in the region due to the strong consumption growth and young, technology savvy population. For instance, Vietnam's e-commerce portal Tiki received USD 44m funding from JD.com from China in 1H18. Furthermore, more established online retailers are launching physical stores, as traditional offline operators, like Matahari in Indonesia and Central in Thailand, set up their online presence.

Love, Bonito, a seven-year old online fashion brand in Singapore opened its flagship store on Orchard Road in late 2017. Pomelo launched its largest pop-up store in Siam Square in Bangkok, which has a click-and-collect scheme. These stores also function as fulfilment and returns centres. Potentially, Lazada and Alibaba may set-up physical stores as well in the near term.

Malaysia

In June 2018, Alibaba Group opened its first Southeast Asia office in Kuala Lumpur. The office serves as a 'one-stop solution centre' to help Malaysian exporters enter the China market, offering export facilitation services, including marketing, customs clearance, streamlined permit application procedures and tax declaration. The company also provides training opportunities to help local businesses take advantage of digital innovations and trade opportunities with China. Alibaba also launched 'Malaysia Week' in China from 6 July to 12 July 2018 across Alibaba's platforms. This online promotion initiative sought to attract Chinese consumers to buy all-things Malaysian, including tourism products.

In 2017, DFTZ, the Alibaba Group and the Malaysia Digital Economy Corporation (MDEC) also set up an e-hub. This was Alibaba's first Electronic World Trade Platform (eWTP) hub outside of China. Malaysia Airports Holdings Bhd's wholly-owned subsidiary MA eLogistics Sdn Bhd formed a joint venture (JV) with Cainiao Smart Logistics Network (Hong Kong) Ltd (Cainiao HK) for the development of a Digital Free Trade Zone (DFTZ) within KLIA Aeropolis. Cainiao HK owns a 70% stake in the JV, which will be named Cainiao KLIA Aeropolis Sdn Bhd, while MA eLogistics owns the remaining 30%. Cainiao HK is an affiliate of Alibaba Group Holding Ltd.

Thailand

In Thailand, Lazada continues to expand its online retail business, while Tencent and Amazon are in the process of establishing offices. JD.com has also entered Thail and and announced a USD 500m partnership with the Central Group.

In April 2018, Alibaba launched their third eWTP hub in Bangkok (after Hangzhou, China and Kuala Lumpur, Malaysia). Users of the hubs will enjoy minimal tariffs, speedy customs clearance as well as state-of-the-art logistical support. Alibaba committed to a USD 350m investment in the digital free trade zone in Thailand's upcoming EEC. The DFTZ is aimed at facilitating more agricultural exports from Thailand to China. For instance, Alibaba's Tmall e-commerce portal launched an initiative to sell Thai rice, durians, and other agricultural products in China.

Philippines

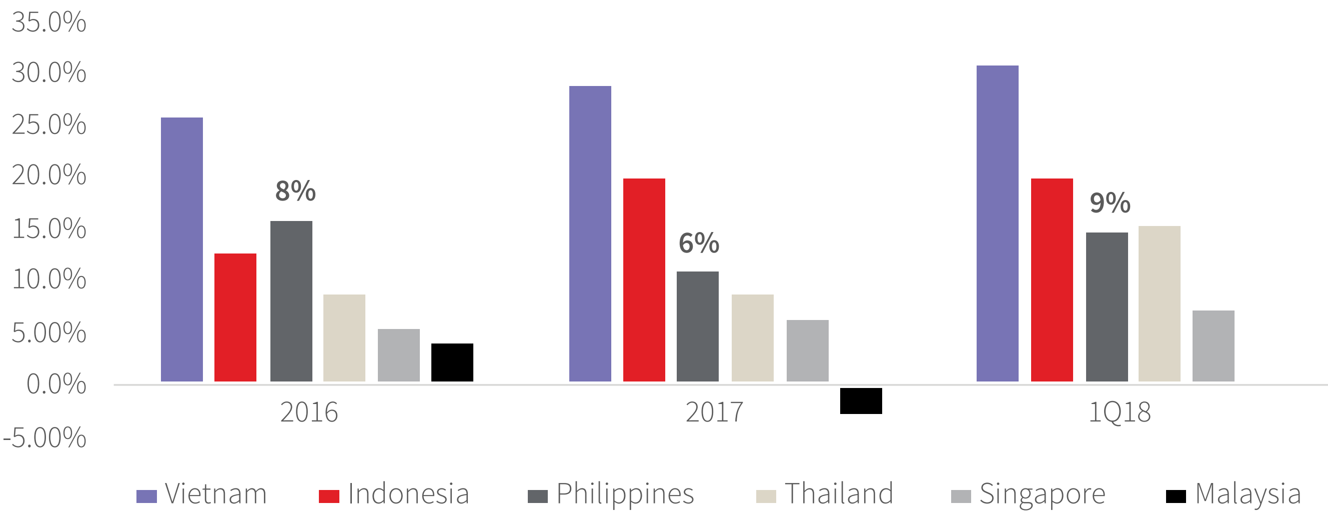
Though internet and credit card penetration are growing from a nascent stage, the young and tech savvy population is driving the growth of the sector. For instance, Lazada is set to extend its 30,000 sqm plant in Cabuyao, Laguna to 60,000 sqm this year. By 2019, Zalora is targeting to move to a four-storey warehouse facility in Cavite that can accommodate 5 million product inventory or five times more than the 1 million product inventory capacity of its existing warehouse.

E-commerce companies are also partnering with offline stores to complement their online operations, offering pick-up and return locations. In 2017, Zalora launched its pop-up stores in Ayala malls to allow clients to physically transact in the pick-up and return of items.

Strong tourist arrivals to boost hotel investments in the coming 24 months

In 1Q18, tourist arrivals surged across Southeast Asia, growing 9% yoy. The number of tourists visiting Vietnam and Indonesia rose 30% yoy and 20% yoy respectively, while Thailand and Philippines attracted 15% yoy more tourists in 1Q18. Investor interest in hotels is rising and we expect more hotel assets to be sold in the coming months in the more developed Southeast Asia markets.

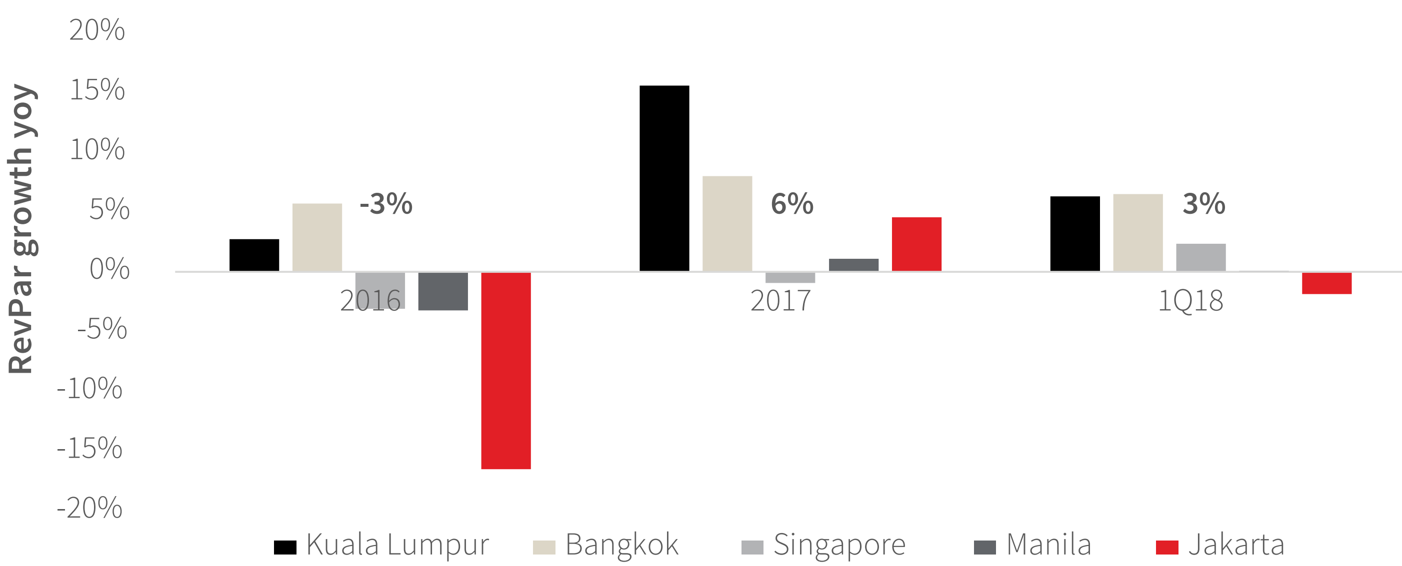
Fig 7: Tourist arrivals grew 9% yoy in Southeast Asia 1Q18



Source: JLL estimates and various country tourism boards

Upscale hotel revenue per available room (RevPar) also grew by 3% yoy in 1Q18, after rising 6% yoy in 2017. Over the last five quarters, hotel RevPar rose 23% and 15% in Kuala Lumpur and Bangkok respectively. Singapore's hotel RevPar finally recovered in 4Q17, after declining for five years, and grew 2% yoy in 1Q18.

Fig 8: Change in hotel revenue per available room yoy

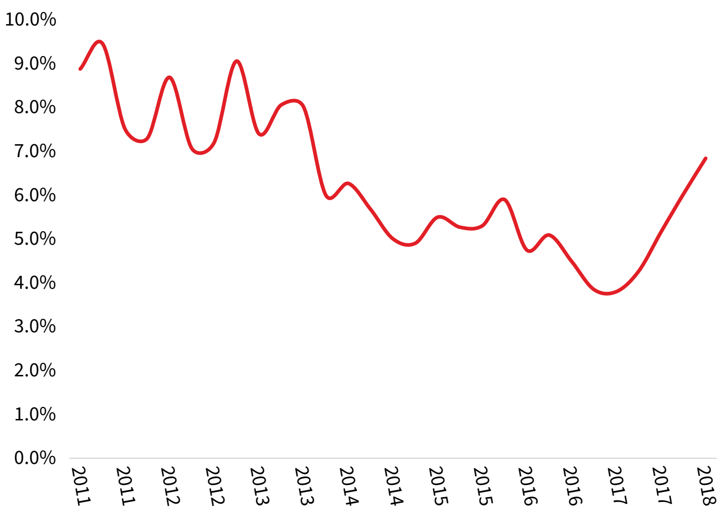


Source: JLL estimates

Office take-up continues to surprise on the upside, especially Manila, Singapore and Jakarta

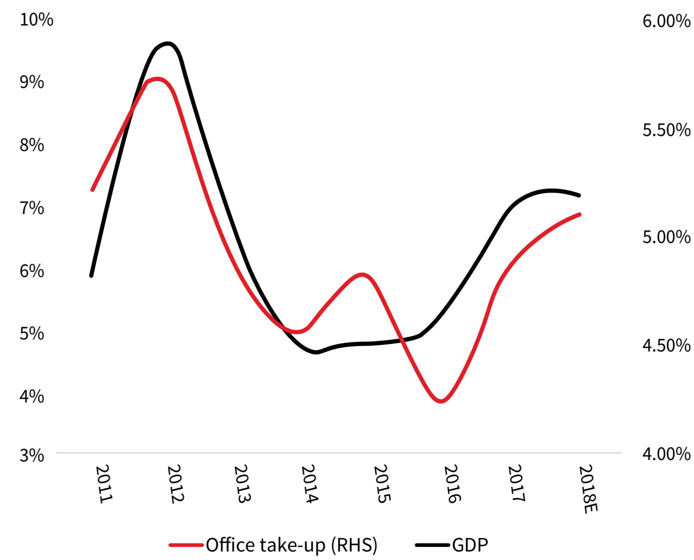
Office take-up in Southeast Asia accelerated over the last six quarters. In 1H18, office take-up in the region grew by 7% yoy. Office demand is well correlated to GDP growth in Southeast Asia and is expected to grow by 6% annually in 2018-2021. Office demand was the strongest in Manila, Singapore and Jakarta, where occupiers moved into new supply. Technology, e-commerce and flexible space operators were key demand drivers. Looking forward to 2018-2022, we expect office take-up in Southeast Asia to stay strong, growing at 6% annually, amid GDP growth of 5% p.a.

Fig 9: Office net absorption in Southeast Asia (yoy)



Source: JLL Research

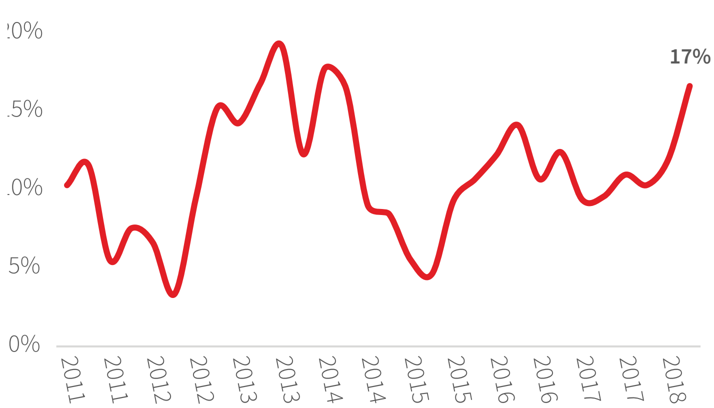
Fig 10: Office net take-up and GDP growth in Southeast Asia (yoy)



Source: JLL Research

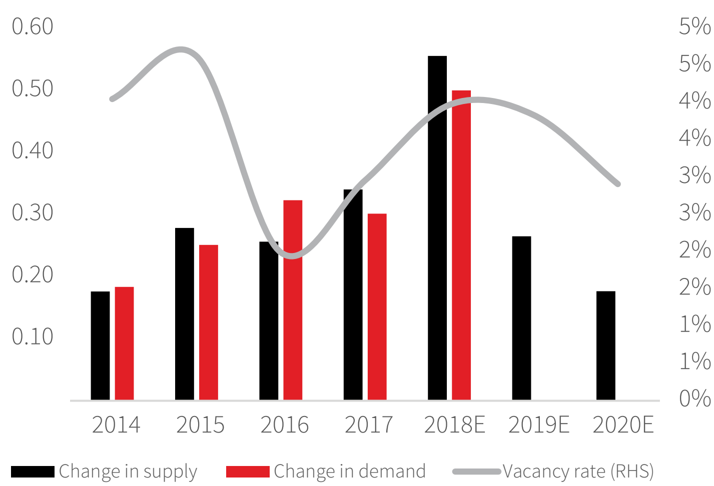
The biggest upside surprise in 2Q18 was the strong office take-up in Manila, where net absorption increased by 222,000 sqm (NLA) in 2Q18, with stronger demand from Outsourcing and Offshoring companies, online gaming operators and business services firms in travel, marketing and IT. Despite the record volume of office completions in 2018, vacancy rate has stayed at 2.2% in 2Q18 as the take-up of the new buildings was stronger than expected. We now expect occupancy to stay above 96% by 4Q18, compared to our previous forecast of 94.7%.

Fig 11: Office net absorption in Manila (yoy)



Source: JLL Research

Fig 12: Manila office supply, demand and vacancy rate



Source: JLL Research

Flexible work spaces are expanding rapidly in Asia

The flexible space sector in Southeast Asia is expanding rapidly in line with growth in Asia Pacific, which grew at a compound annual rate of 35.7% in the last five years. In Singapore, flexible work space already take up 2.8% of office space, after growing over 30% CAGR in the last three years. In Jakarta, flexible work space is estimated to take up about 2% of occupied office space. Flexible space appears to be just as cost-effective as traditional office space in Singapore, after accounting for the lower rent and higher density for flexible space.

Operators are still fragmented across the region. With Wework setting up in several more locations in Singapore and Jakarta from 2018, we expect penetration to accelerate over the next few years. We expect coworking and serviced offices to take up 10-15% of occupied office space in 2030.

Fig 13: Flexible space penetration rates in key Asia Pacific markets (%) | 4Q17

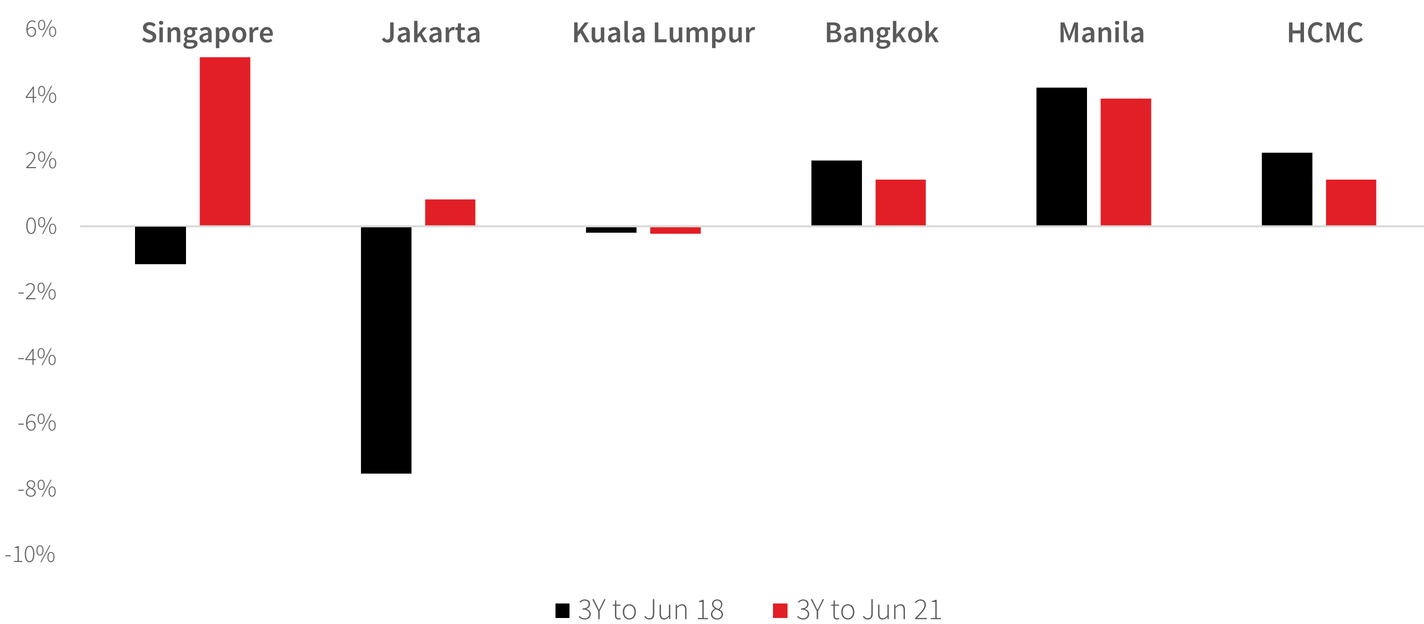
Source: JLL Research

Key changes to our views in 1H18

Singapore prime office rents started to recover in 1H2017 and are forecast to rise 20-25% over 2018-2020, the fastest pace of growth amongst global cities. In 1H18, we have marginally upgraded Singapore CBD Grade A office rents and capital values for 2019, as some aging stock may be withdrawn for retrofitting/redevelopment, boosting occupancy rates. Forecasts for the remaining years have been kept unchanged from three months ago.

Jakarta: we have slowed the pace of office rental recovery in Jakarta. While 2018 is expected to be another record supply year, we continue to expect extremely strong net absorption levels as technology, coworking and other CBD tenants continue to expand. We expect rents to fall another 2-3% in 2H18 before recovering gradually from 2019.

Fig 14: Office rental compound annual growth rate (%)



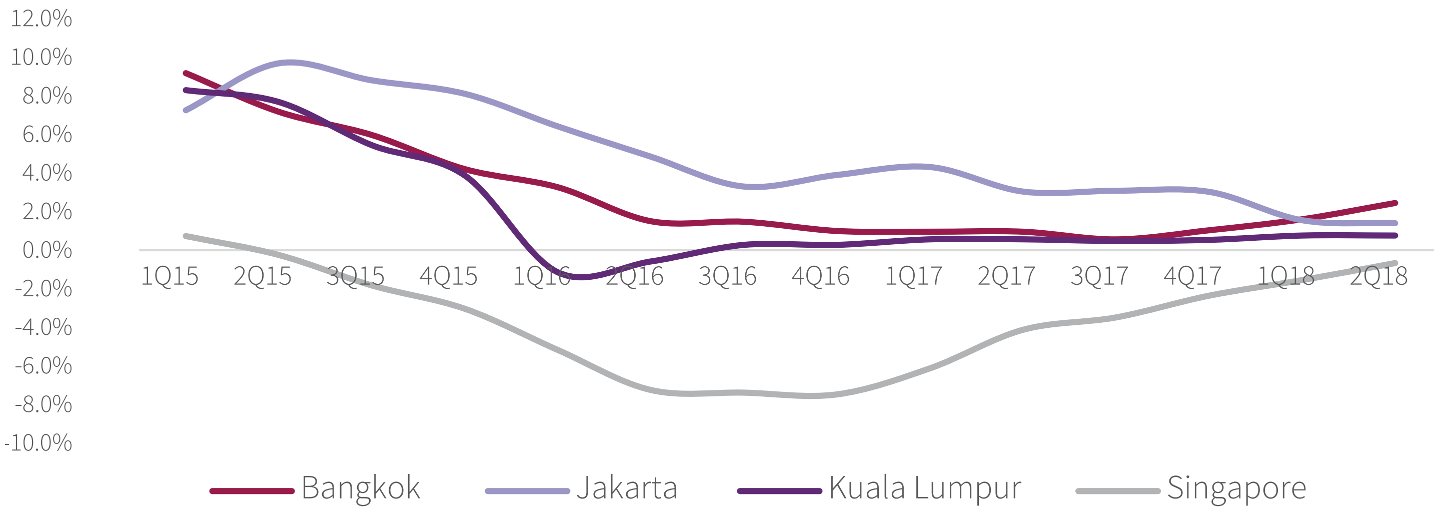
Source: JLL Research

Kuala Lumpur (KL) office rents in KL fringe are stronger than expected: While we expect office rents in KL City to take longer to recover due to the significant new supply from PNB and TRX, we think KL Fringe will do better with limited supply coming on stream and strong demand due to its excellent connectivity. We downgrade our prime office rent and capital value forecasts for KL City by -2.3% and -6.0% respectively; and raise forecasts for KL Fringe by 2.6% and 0.6% respectively.

We maintained our retail rent forecasts for Kuala Lumpur City Centre, but have downgraded that for suburban KL as high supply has put more downward pressure on rents. For Jakarta, there is risk to our forecast of 5% rental growth in 2018, as rents only grew 1.4% in 1H18 due to a slowdown in consumer sentiment.

Singapore residential price growth downgraded after fresh government cooling measures: We have downgraded our capital values forecasts for 2018-2022 after the government introduced fresh market cooling measures from 6 July 2018. We now expect luxury and prime home capital values to rise 23% by 2018-2022, lower than the 30% forecast previously. As prices have already increased by 5%-7% in 1H2018, we now expect price growth to moderate to between 2% and 4% per annum, in line with the government's desire to ensure private home prices grow in line with economic fundamentals.

Fig 15: Prime retail rental growth yoy



Source: JLL Research

Investment activities likely to increase in Indonesia over next 12 months

In 1H18, investment activities continue to be focused on land acquisitions with the bulk of the appetite coming from domestic developers. Significant transactions include Bloombery Resorts acquisition of a 16-ha site in Entertainment City, a gaming hub by Manila Bay for US$709mn and Vingroup's acquisition of the Vietnam International University Township project from Berjaya Corp.

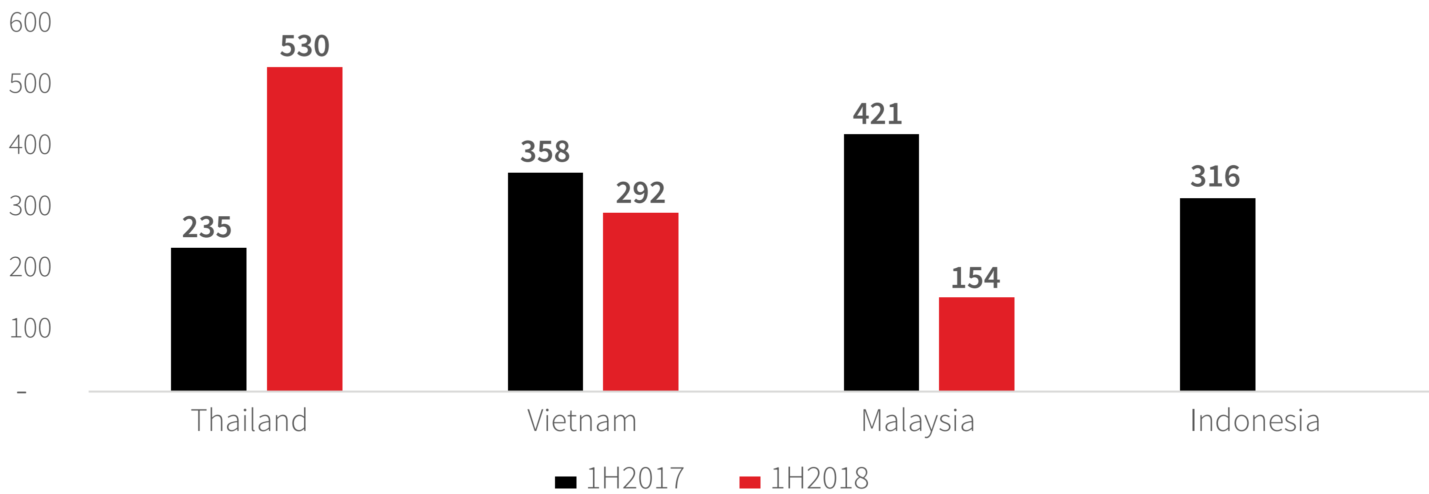
Fig 16: Significant transactions in 1H18

Asset	Location	Price (US$ mn)	Buyer	Buyer Country
Entertainment City Complex Land Plot	Philippines	710	Bloomberry Resorts	Domestic
British Embassy	Thailand	584	JV Central Group/ Hongkong Land	Domestic/ Hong Kong
Vietnam International University	Vietnam	515	Vingroup JSC	Domestic
Land plot (Sukhumvit Soi 6)	Thailand	142	Thai Obayashi	Japan
Eco-Green Saigon	Vietnam	136	Xuan Mai Corp	Domestic
Royal Orchid Sheraton Hotel & Towers	Thailand	115	Grande Asset	Domestic
Setia Federal Hill	Malaysia	112	SP Setia	Domestic
Outrigger Laguna Phuket Beach Resort	Thailand	101	Boon Rawd Brewery	Domestic
Central Azucarera de Tarlac land plots	Philippines	100	Ayala Land	Domestic
Future Transpark Bintaro Condo	Indonesia	97	Metro Holdings	Singapore

Foreign capital inflow

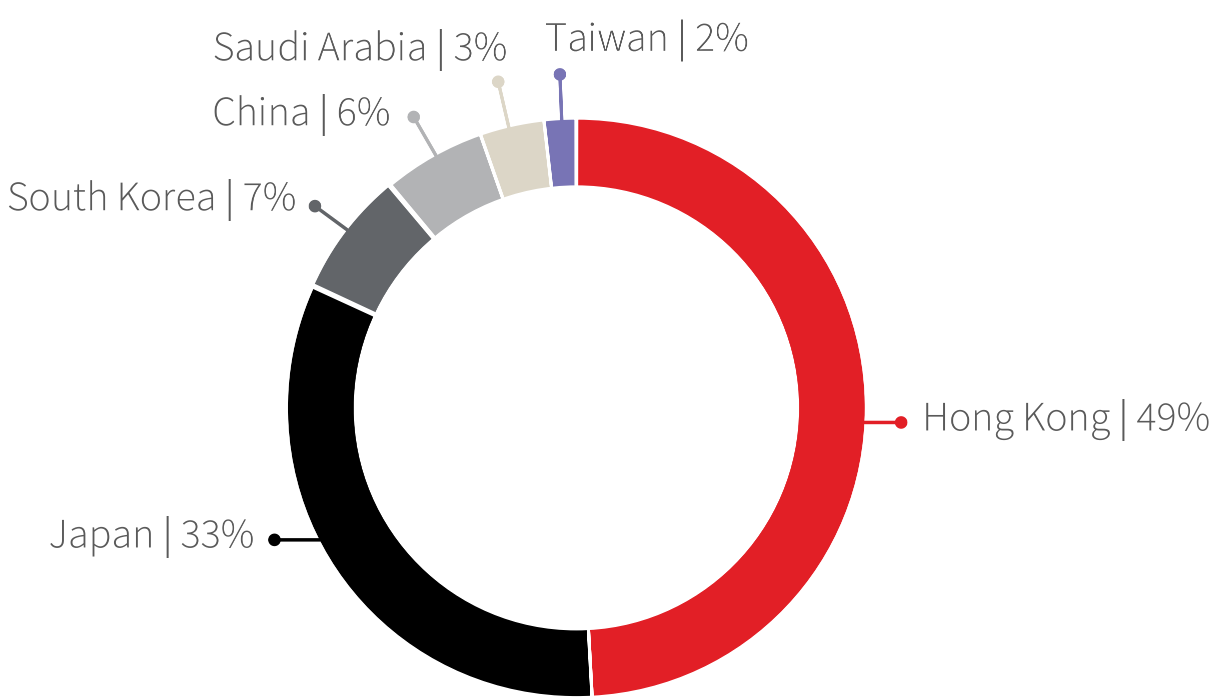
Following the trend of 2017, Thailand, Vietnam and Malaysia continue to be the top receivers of capital in Southeast Asia, with Thailand being the largest receiver with US$530mn. Significant appetite from investors from China, Hong Kong, Japan and South Korea was seen in 2017 and is confirmed again in 1H2018. We expect this trend to continue for the rest of 2018 but expect to see more transactions in Indonesia in the second half.

Fig 17: Foreign Capital Inflows 1H2018 vs. 1H2017



Source: JLL Research

Fig 18: Capital source by country (1H18)



Source: JLL Research

Author

Regina Lim

Head of Capital Markets Research, Southeast Asia

Regina.lim@ap.jll.com

With contributions from:

James Taylor

Head of Research, Indonesia

James.taylor@ap.jll.com

Le Trang

Head of Research, Vietnam

Trang.le@ap.jll.com

Janlo de los Reyes

Head of Research, Philippines

Janlo.Delosreyes@ap.jll.com

Tay Huey Ying

Head of Research, Singapore

Hueyying.tay@ap.jll.com

Veena Loh

Head of Research, Malaysia

Veena.loh@ap.jll.com

Andrew Gulbrandson

Head of Research, Thailand

Andrew.gulbrandson@ap.jll.com