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BMI Industry View

The China real estate report examines the commercial office, retail, industrial and construction sectors in the country from the perspective that the market, which has experienced exponential growth over recent years, is starting to succumb to the impending conflagration of market weakness.

With a focus on the principal and second-tier cities of Shanghai, Beijing, Wuhan and Shenzhen, the report covers the rental market performance in terms of rates and yields over the past 24 months and examines how best to maximise returns in the commercial real estate market, while minimising investment risk and exploring the impact of wider economic concerns on a market that is losing balance. As prices are wavering from historic stability and curbing measures continue, particularly in major cities in China, the overriding sentiment in the country's commercial and residential real estate market is that a slowdown is under way, and our latest data collection from H212, while not demonstrating a resounding contraction, has seen several negative indicators come to light, particularly in the Industrial sector. Many developers are struggling with liquidity issues, and many more have estimated a decline in earnings for 2012. There are some bright spots on the horizon, however. The retail market is showing strength amid the uncertainty, and the office market remains buoyant in the country's top-tier cities.

Key Points:

- **Construction:** We maintain our forecast for 2013 of higher construction industry value growth year-on-year, based on the growth trajectory anticipated for the wider economy. We have however intervened in our 2013 forecasts to moderate infrastructure industry value growth and increase residential and non-residential real growth, in line with trends we are expecting in the two sectors for 2013.
- **Residential/Non-Residential:** China's residential and non-residential sector was upwardly revised as the National Development and Reform Commission pushed for a fast-tracking of projects. Data from the national statistics for the fourth quarter shows a clear upturn in the residential and non residential segments, which we believe is going to continue throughout 2013. We have therefore revised our 2013 forecast to reflect a heavier weighting for residential and non-residential construction.
- **Economy:** Fears over China's shaky financial system, overvalued property market, and huge industrial overcapacity have been replaced by hopes that policymakers can engineer a recovery back above the 8% level. We maintain our view that the prospects for H113 look relatively bright. However, there may be some negative surprises in store as the year progresses as the recovery comes up against the country's structural hurdles. We are forecasting real GDP growth of 7.5% in 2013, versus the Bloomberg consensus of 8.1%.

SWOT

SWOT Analysis	
Strengths	▪ The number of urban dwellers is likely to grow by over 100mn in next 15-20 years. ▪ China is trying to introduce the best practices into its tendering and project management anti-corruption systems; the Chinese government has decided to blacklist contractors convicted of bribery and ban them from working on construction projects in five provincial areas. ▪ The country's long-term fundamentals are strong, indicating that China will be one the largest construction/ infrastructure markets for years to come.
Weaknesses	▪ Poor working conditions, especially low pay and abysmal safety standards, are the norm for millions of construction labourers. ▪ Corruption, bribery, embezzlement and fraud are widespread in the construction industry. The culture of *guanxi*, or connections, helps maintain corruption in the system, making it difficult for foreign companies to compete with local firms. ▪ Sales activity has decreased as continued curbing measures restrict prices in the residential and commercial markets. ▪ As a result of higher interest rates and restricted bank lending, many developers are finding access to funding a constraint. ▪ The liquidity provided by the Chinese government for infrastructure investment, which is fuelled by cheap credit thanks to strict controls on capital outflows, means there is the possibility of cost overruns and miscalculations on a massive scale. ▪ Opaque regulatory environment does not protect technological know-how of foreign companies; as a result, technology transfer erodes the advantage of foreign expertise.
Opportunities	▪ Competition and interest in the retail sub-sector remains buoyant.

SWOT Analysis - Continued

- Jones Lang LaSalle highlights a number of Chinese cities as some of fastest growing in the world by GDP, which should keep investment high even in the face of a slowdown.
- A number of foreign developers are looking to take advantage of the subdued market and low prices, which may lead to an influx of new multi-national investments.
- China is forecast to overtake the US as the largest construction industry globally by 2015.
- Deregulation in certain sectors where foreign expertise is needed has created opportunities for foreign investors in niche infrastructure areas, such as wind power and water.

Threats

- Demand in the industrial sub-sector exceeds supply. While this could lead to increased development, it may result in unavailable space causing players to look elsewhere.
- The economic picture may result in a hard landing for China, with GDP growth slowing every year through to 2014 alongside a continued deceleration in Gross Fixed Capital Formation.
- There is no guarantee that access to the market will get any easier for foreign firms if the government decides to protect its domestic industry from global competitive pressures.

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Business Environment

Business Environment SWOT Analysis

Strengths	▪ China is continuing to open up various sectors of its economy to foreign investment. ▪ With its vast supply of cheap labour, the country remains the top destination for foreign direct investment in the developing world.
Weaknesses	▪ Foreign companies continue to complain about the poor protection of intellectual property in China. ▪ Chinese corporate governance is weak and non-transparent by Western standards. There is a considerable risk for foreign companies in choosing the right local partner.
Opportunities	▪ China's ongoing urbanisation and infrastructure drive will provide major opportunities for foreign investment in landlocked provinces as well as the transfer of skills and know-how. ▪ The Chinese government is giving more protection and encouragement to the private sector, which is now the most dynamic in the economy and accounts for most of the country's job growth.
Threats	▪ China's government will block attempts by foreign firms to take over assets of national importance. • China is experiencing rising labour costs, prompting some investors to turn to cheaper destinations such as Vietnam.

Political

Political SWOT Analysis

Strengths	▪ The CPC, which has governed for over 60 years, remains secure in its position as the sole political party in China. • China's expanding economy is gradually giving it greater clout in international affairs, which will allow it to build politically important ties, especially with the developing world.
Weaknesses	▪ As with any other one-party state, China's political system is inherently unstable and unable to respond to the wider changes taking place in society. Provincial governments often fail to enforce central government directives. ▪ Although bilateral ties have warmed in recent years, China's relationship with Taiwan remains problematic, with Beijing refusing to rule out the threat of force in the event of a declaration of independence by Taiwan.
Opportunities	▪ China is actively expanding its political and economic ties with major emerging markets such as Latin America, Africa and the Middle East. • A new generation of leaders (the so-called 'fifth generation') took power in 2012. This should ensure the continuation of reform and modernisation.
Threats	▪ Growing corruption, widening inequalities, increasing rural poverty and environmental degradation have led to an increase in social unrest in recent years. ▪ The Communist Party is facing increasing factional rifts based on ideology and regionalism. While greater political debate would be welcomed by many, internal regime schisms could prove politically destabilising.

Economic

Economic SWOT Analysis

Strengths	▪ China is the fastest-growing major economy in the world, and this has lifted hundreds of millions of people out of poverty over the past generation. ▪ China has a massive trade surplus and its huge foreign exchange reserves serve as a major cushion against external shocks. ▪ China's economic policymakers are committed to continuing their gradual reform of the economy.
Weaknesses	▪ China's economic growth boom has led to major imbalances and environmental degradation. ▪ The country's dependency on exports to boost growth has made it vulnerable to the global recession. Private consumption remains weak at less than 40% of GDP. ▪ The close relations between provincial leaders and local businesses are fostering corruption, making it harder for the central government to enforce its policies.
Opportunities	▪ China's economic growth is slowly becoming more broad-based, with domestic consumption likely to rise in importance vis-à-vis exports, thanks to a middle class of 200-300mn people. ▪ China's ongoing urbanisation will be a major driver of growth, and new cities will emerge in less developed inland provinces. The UN forecasts China's urban population rising from 40% in 2005 to 73% in 2050: a gain of 500mn people. ▪ As China moves up the value chain, it will develop its own global brand name companies, fostering innovation and growth.

Economic SWOT Analysis - Continued	
Threats	▪ We believe that we have witnessed a permanent end to China's double-digit annual growth rate. • The economy will face difficulty in continuing to increase its share of the global export market, and efforts to move up the value chain will be fraught with difficulty.

Industry Forecast

Office

We believe that the weakness seen in the Chinese economy in 2012 is highly unlikely to mark the low point in China's economic cycle. Rather, the downturn was likely a taste of what is in store as the economy rebalances away from its investment-driven growth model.

Although on the whole the results remain in positive territory for the Chinese office market, there are signs that the sector is not immune to weakness. We would anticipate Shanghai and Beijing to remain steadfast as international commercial hubs, but the second-tier cities that have recently come to prominence may well suffer should economic woes come to a head. In the short term, we are forecasting marginal growth over 2013, as increments slow in line with the economy.

Table: Forecast Rents - (CNY per m2/month)

	2013 (Jan-Jun)		2013	
	Min	Max	Trend	(% change)
Shanghai	127.50	485.00	Increase	3-5%
Beijing	142.50	705.00	Increase	5-10%
Wuhan	42.50	127.50	Increase	1-5%
Shenzhen	92.50	297.50	Increase	3-10%

Source: BMI

Table: Forecast Net Yield, 2010-2017 (%)

	2010	2011	2012	2013	2014	2015	2016	2017
Shanghai	8-9%	3-8%	2-8%	2-8%	2-8%	2-8%	2-8%	2-8%
Beijing	7%	6-10%	3-10%	3-10%	3-10%	3-10%	3-10%	3-10%
Wuhan	7%	5-6%	7-9%	7-9%	7-9%	7-9%	7-9%	7-9%
Shenzhen	6%	5-7%	4-7%	4-7%	4-7%	4-7%	4-7%	4-7%

Source: BMI

Retail

Strong underlying economic growth, population expansion and the increasing wealth of individuals are key factors behind the forecast for growth in China's retail sales, and subsequently prospects for retail space. Regulatory reform following its accession to the WTO in 2001 has allowed foreign retailers to make significant inroads into the market, satisfying demand from young and aspirational consumers and contributing to a trend that is likely to see the value of the retail segment increase significantly.

The rental market for retail space remains steadfast owing to the underlying strength of the Chinese consumer story as the market continues to attract retailers and investors. We are therefore forecasting marginal to moderate growth for 2013.

Table: Forecast Rents - (CNY per m2/month)

	2013 (Jan-Jun)		2013	
	Min	Max	Trend	(% change)
Shanghai	304.50	1175.00	Increase	3-5%
Beijing	310.00	1000.00	Increase	5-10%
Wuhan	102.50	252.50	Increase	1-3%
Shenzhen	105.00	412.50	Increase	3-10%

Source: BMI

Table: Forecast Net Yield, 2010-2017 (%)

	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Shanghai	4%	3-6%	2-8%	2-8%	2-8%	2-8%	2-8%	2-8%
Beijing	7%	6-8%	3-7%	3-7%	3-7%	3-10%	3-7%	3-7%
Wuhan	6-7%	6-7%	7-8%	7-8%	7-8%	7-8%	7-8%	7-8%
Shenzhen	6%	6-7%	2-5%	2-5%	2-5%	2-5%	2-5%	2-5%

e/f = BMI estimate/forecast. Source: BMI

Industrial

Industrial rents have suffered in recent months. Because of the low base that even low-end rents are currently at, we anticipate a short-term rebound over 2013.

Risks to forecasts: We acknowledge that there are significant upside risks. Domestically, the housing market has shown tremendous resilience in recent quarters, despite the large inventory overhang, and another leg-up in property prices on the back of continued strong credit growth (which itself is being driven largely by the shadow banking system) could see a revival in a number of downstream industries. Externally, we harbour expectations that developed world economies will begin to find their footing this year, which could provide some crucial support to Chinese exports. It is not therefore difficult to envisage a rebound to 8%-plus growth this year.

That said, while upside risks certainly cannot be ignored, downside risks appear much more salient, in our view. The unpredictable nature of the shadow banking system poses perhaps the greatest downside risk. Credit continues to flow worryingly freely into capital destructive pursuits. The proliferation of wealth management products and build-up of an opaque credit guarantee system is reminiscent of the US banking boom that precipitated the global financial crisis. There is a huge mismatch between the maturity of investment products (typically very short term) and the maturity of the loans that back them (typically long term). This creates a major risk for banks in the event that investors do not roll over their investments, triggering a liquidity crisis. Any weakness in property prices has the potential to act as a catalyst. Should the shadow baking system implode, it would be likely to result in a major credit crunch, undermining economic activity across the board.

Externally, despite current stability in the global economy, China is also at risk from its huge trade imbalance with the US. Once considered to be the major threat to the global economy, the bilateral surplus that China runs with the US continues to balloon. Should we see a rise in the personal savings rate in the US, this could trigger a sharp drop in consumer goods imports, undermining China's overall trade surplus, with negative implications not only for export growth but also for domestic liquidity conditions.

Table: Forecast Rents - (CNY per m2/month)

	2013 (Jan-Jun)		2013	
	Min	Max	Trend	(% change)
Shanghai	34.00	62.50	Increase	5-8%
Beijing	31.50	92.50	Increase	5-10%
Wuhan	9.25	22.50	Increase	1-3%
Shenzhen	25.00	107.50	Increase	3-10%

Source: BMI

Table: Forecast Net Yield, 2010-2017 (%)

	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Shanghai	7%	6-8%	7-9%	7-9%	7-9%	7-9%	7-9%	7-9%
Beijing	7%	6-8%	2-5%	2-5%	2-5%	2-5%	2-5%	2-5%
Wuhan	6%	6-7%	1-10%	1-10%	1-10%	1-10%	1-10%	1-10%
Shenzhen	6%	6-7%	2-10%	2-10%	2-10%	2-10%	2-10%	2-10%

e/f = BMI estimate/forecast. Source: BMI

Construction and Infrastructure Forecast Scenario

Table: China Construction And Infrastructure Industry Data, 2011-2016

	2011	2012e	2013f	2014f	2015f	2016f
Construction industry value, CNYbn	3,194.0	3,449.5	3,760.0	4,104.6	4,454.7	4,806.5
Construction industry value, US$bn	494.1	544.1	587.5	626.7	675.0	728.3
Construction industry, real growth, % y-o-y	9.7	5.0	6.4	6.3	5.7	5.2
Construction industry, % of GDP	6.9	6.7	6.6	6.6	6.5	6.5
Total capital investment, CNYbn	21,519.7	23,118.4	24,739.4	26,729.7	28,714.6	30,669.5
Total capital investment, US$bn	3,328.9	3,646.4	3,865.5	4,080.9	4,350.7	4,646.9

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China Construction And Infrastructure Industry Data, 2011-2016 - Continued						
	2011	**2012e**	**2013f**	**2014f**	**2015f**	**2016f**
Total capital investment, % of GDP	46.2	44.8	43.5	42.8	42.2	41.4
Capital investment per capita, US$	2,470.3	2,693.9	2,843.6	2,990.1	3,176.3	3,381.4
Real capital investment growth, % y-o-y	10.7	4.3	4.3	5.0	4.5	4.0
Construction industry employment, '000						
Construction industry employment, % y-o-y						
Total workforce, '000	976,993.0	983,381.7	989,132.0	993,407.4	995,819.1	996,269.9
Construction industry employees as % of total labour force						
Infrastructure Industry Value As % of Total Construction	31.9	31.6	31.6	31.4	31.2	31.0
Infrastructure Industry Value, CNYbn	1,018.5	1,091.7	1,189.0	1,289.2	1,391.7	1,489.0
Infrastructure Industry Value, US$bn	157.6	172.2	185.8	196.8	210.9	225.6
Infrastructure Industry Value Real Growth (%)	9.2	4.2	6.3	5.5	5.2	4.3
Infrastructure Industry Value as % of GDP	2.2	2.1	2.1	2.1	2.0	2.0
Residential and Non-residential Building Industry Value As % of Total Construction	68.1	68.4	68.4	68.6	68.8	69.0
Residential and Non-residential Building Industry Value, CNYbn	2,175.5	2,357.8	2,571.0	2,815.5	3,063.0	3,317.5
Residential and Non-residential Building Industry Value, US$bn	336.5	371.9	401.7	429.8	464.1	502.7
Residential and Non-residential Building Industry Value Real Growth (%)	16.7	5.4	6.4	6.6	6.0	5.6
Residential and Non-residential Building Industry Value as % of GDP	4.7	4.6	4.5	4.5	4.5	4.5

China Construction And Infrastructure Industry Data, 2011-2016 - Continued

	2011	2012e	2013f	2014f	2015f	2016f
Cement production (including imported clinker), tonnes	2,006,391,750	2,080,208,127	2,146,792,036	2,229,804,604	2,309,472,217	2,383,982,851
Cement production (including imported clinker), tonnes, % y-o-y	6.6	3.7	3.2	3.9	3.6	3.2
Cement consumption, tonnes	2,015,660,894	2,089,070,892	2,156,036,969	2,242,171,121	2,326,299,862	2,405,326,496
Cement consumption, tonnes, % y-o-y	6.9	3.6	3.2	4.0	3.8	3.4
Cement net exports, tonnes	-9,269,144	-8,862,765	-9,244,933	-12,366,517	-16,827,644	-21,343,645
Cement net exports, tonnes, % y-o-y	122.5	-4.4	4.3	33.8	36.1	26.8

e=estimate, f=forecast. Source: National Bureau of Statistics, Bloomberg, USGS, UN, BMI

Table: China Construction And Infrastructure Long Term Forecasts, 2017-2022

	2017f	2018f	2019f	2020f	2021f	2022f
Construction industry value, CNYbn	5,185.8	5,594.7	6,035.6	6,510.9	6,958.3	7,505.8
Construction industry value, US$bn	785.7	847.7	914.5	986.5	1,054.3	1,137.2
Construction industry, real growth, % y-o-y	5.2	5.2	5.2	5.2	4.2	5.2
Construction industry, % of GDP	6.4	6.4	6.4	6.3	6.2	6.2
Total capital investment, CNYbn	32,757.5	34,987.7	37,369.6	39,913.7	42,631.1	45,533.4
Total capital investment, US$bn	4,963.3	5,301.2	5,662.1	6,047.5	6,459.3	6,899.0
Total capital investment, % of GDP	40.7	40.0	39.3	38.7	38.0	37.4
Capital investment per capita, US$	3,601.0	3,836.2	4,088.0	4,357.7	4,646.6	4,956.2
Real capital investment growth, % y-o-y	4.0	4.0	4.0	4.0	4.0	4.0

China Construction And Infrastructure Long Term Forecasts, 2017-2022 - Continued						
	2017f	**2018f**	**2019f**	**2020f**	**2021f**	**2022f**
Construction industry employment, '000						
Construction industry employment, % y-o-y						
Total workforce, '000	995,153.6	993,019.8	990,772.7	988,938.3	987,495.9	986,205.9
Construction industry employees as % of total labour force						
Infrastructure Industry Value As % of Total Construction	30.7	30.5	30.2	29.9	30.0	29.7
Infrastructure Industry Value, CNYbn	1,593.4	1,704.7	1,823.3	1,949.7	2,084.4	2,227.9
Infrastructure Industry Value, US$bn	241.4	258.3	276.3	295.4	315.8	337.6
Infrastructure Industry Value Real Growth (%)	4.3	4.3	4.3	4.2	4.2	4.2
Infrastructure Industry Value as % of GDP	2.0	1.9	1.9	1.9	1.9	1.8
Residential and Non-residential Building Industry Value As % of Total Construction	69.3	69.5	69.8	70.1	70.0	70.3
Residential and Non-residential Building Industry Value, CNYbn	3,592.3	3,890.0	4,212.3	4,561.2	4,873.9	5,277.8
Residential and Non-residential Building Industry Value, US $bn	544.3	589.4	638.2	691.1	738.5	799.7
Residential and Non-residential Building Industry Value Real Growth (%)	5.6	5.6	5.6	5.6	4.2	5.6
Residential and Non-residential Building Industry Value as % of GDP	4.5	4.4	4.4	4.4	4.3	4.3
Cement production (including imported clinker), tonnes	2,461,699,879	2,542,772,812	2,627,359,214	2,715,625,229	2,907,432,293	3,085,453,737

China Construction And Infrastructure Long Term Forecasts, 2017-2022 - Continued

	2017f	2018f	2019f	2020f	2021f	2022f
Cement production (including imported clinker), tonnes, % y-o-y	3.3	3.3	3.3	3.4	7.1	6.1
Cement consumption, tonnes	2,487,985,678	2,574,467,692	2,664,974,864	2,759,749,020	2,957,576,260	3,117,533,797
Cement consumption, tonnes, % y-o-y	3.4	3.5	3.5	3.6	7.2	5.4
Cement net exports, tonnes	-26,285,799	-31,694,880	-37,615,650	-44,123,791	-50,143,967	-32,080,060
Cement net exports, tonnes, % y-o-y	23.2	20.6	18.7	17.3	13.6	-36.0

e=estimate, f=forecast. Source: National Bureau of Statistics, Bloomberg, USGS, UN, BMI

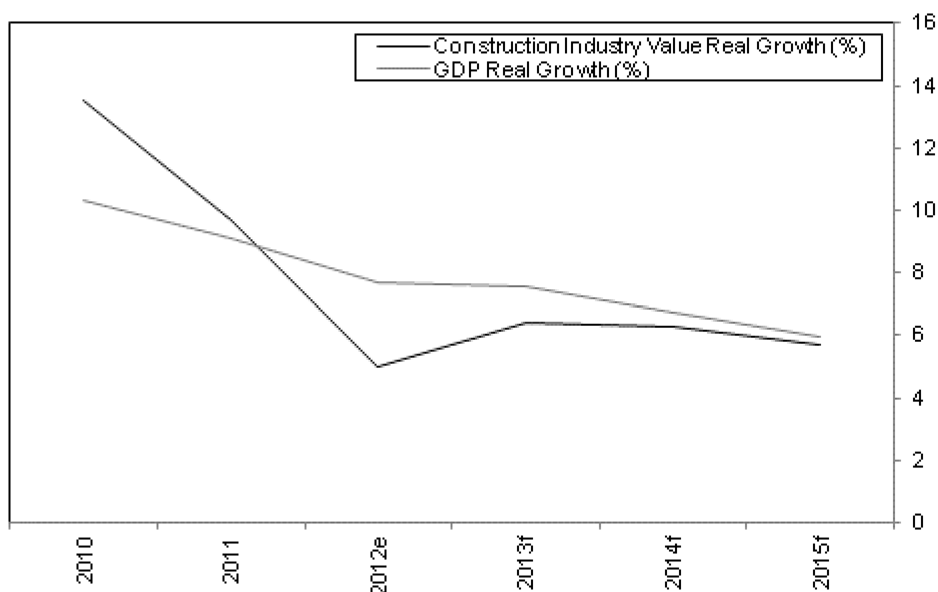
Construction and Infrastructure Forecast Scenario

***BMI View**: New data from the national statistics on fixed asset investments across sectors dating up to November 2012 verify our forecasts and expectations on how different segments in construction would perform, and along with that, the entire construction segment. We maintain our forecast for 2013 of higher construction industry value growth year-on-year, based on the growth trajectory anticipated for the wider economy. We have however intervened in our 2013 forecasts to moderate infrastructure industry value growth and increase residential and non-residential real growth, in line with trends we are expecting in the two sectors for 2013.*

According to **BMI**'s China Country Risk analysts*, the prospects for H113 look relatively bright. However, there may be some negative surprises in store as the year progresses and the recovery comes up against the country's structural hurdles, such as overcapacity in industry and redundant and expensive infrastructure build-up. For this reason we maintain our forecast of construction industry real growth of 6.4% in 2013, up from an estimated 5% in 2012; we note some risks to the upside if the Chinese economy shows a full year of strong growth as opposed to only the first half that is currently built into our forecast scenario (*see our online service, January 11, Is The Growth Boom Back On Track?*).*

Strength In 2013

China Real GDP Growth And Construction Industry Value Real Growth, % change Y-o-Y

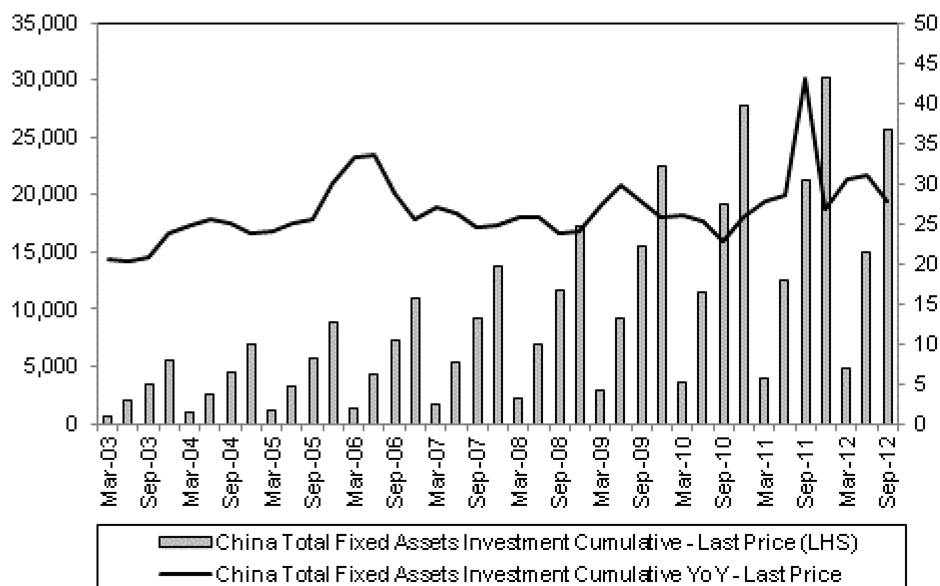


e=estimate, f=forecast. Source: China National Statistics, BMI

The clearest proxy we have to China's infrastructure and construction data is the fixed asset investments figures published by the national statistics. They give us a strong indication of trends that we then apply to our historical data across construction segments, as well as the trends that are developing for the coming quarters. According to the latest available data, total fixed asset investments continued along the downward growth trajectory it has been on since the peak in mid-2009. We have monitored this indicator for several years, and correctly identified its movements thus far, which have in turn been reflected in the trajectory we set for our construction industry value real growth forecast.

Q4 2012 Shows Signs of Life

China Total Fixed Asset Investment



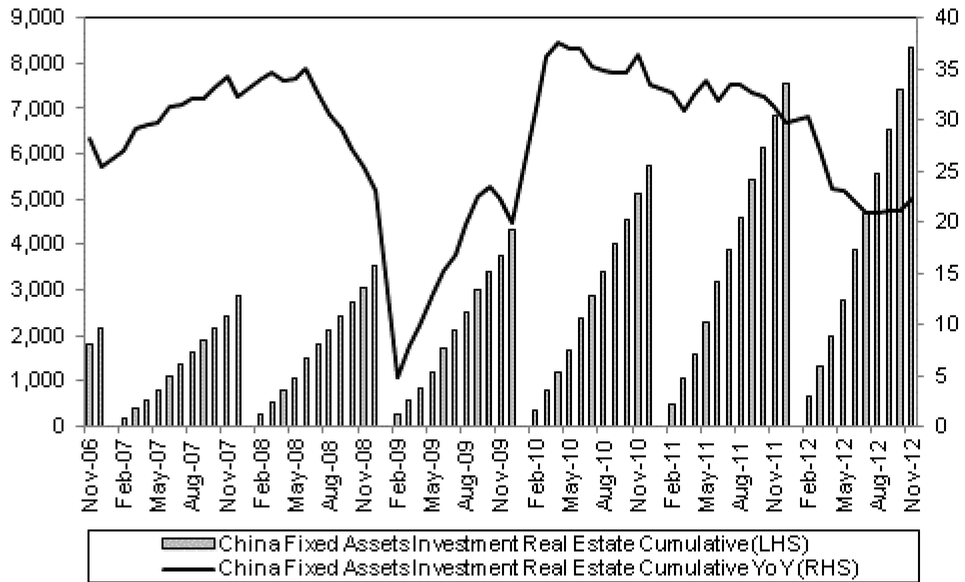
Source: China National Statistics, Bloomberg

The total FAI data above goes as far as August 2012. Yet, sub-sector data from the Chinese authorities going to November 2012 suggest that total FAI in Q412 was higher, and our expectation is that it will keep rising into 2013. The real estate sector (which according to our estimates makes up around 70% of the total construction sector industry value) is going to be the driver of growth in 2013.

Real estate fixed asset investments have shown a clear rebound since the second half of 2012. Latest price data coming out of China suggest a revival in the real estate market. People's Daily Online reported industry figures in mid-January 2013 which showed that new house sales in major cities across China nearly doubled in the first days of January compared to the same period over 2012. Real estate equities in Hong Kong and Shanghai, such as **Poly Real Estate**, **Guanghui Energy** and **Central China Real Estate**, have also surged showing a revived market confidence that the draconian government clampdown on the property market has eased up. Though the market is below the levels it was previous to the slowdown, it is showing healthy momentum.

Signs Of A Rebound

China Real Estate Fixed Asset Investment

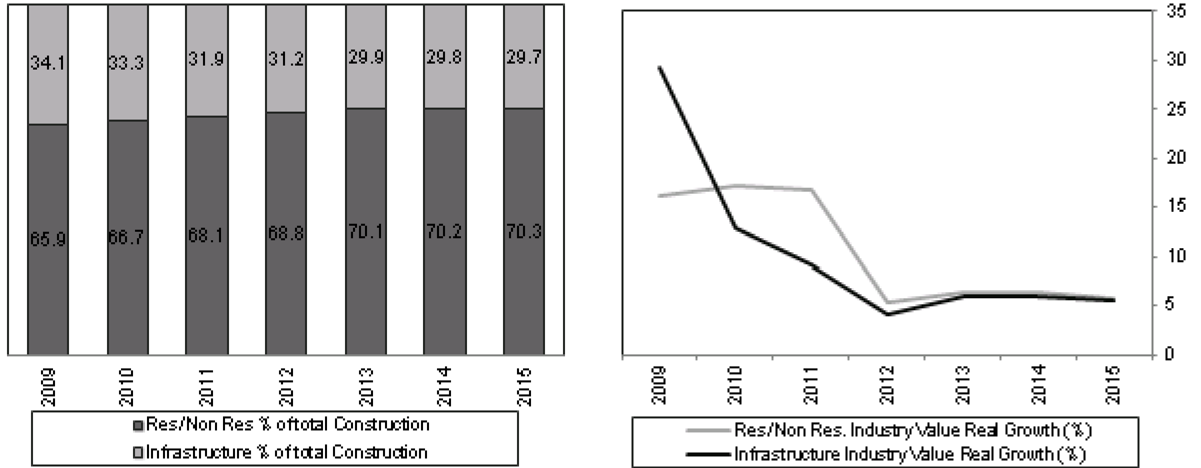


Source: China National Statistics, Bloomberg

We have taken the market signals onboard and have intervened to change our forecasts for 2013 infrastructure and residential and non-residential growth, and contribution in the total construction sector. Whereas previously we were pricing in a strong rebound for infrastructure (primarily on the back of the stimulus plans by the government), the data from FAI in railways (*see graph further down*) in combination with the data coming out of the real estate segment prompted a downgrade of infrastructure industry value real growth to 6.3%, from a previous forecast of 12.8%, and an upgrade in residential and non-residential industry value real growth to 6.4%, from 3.4%.

Residential And Non-Residential Growth Powers Ahead

Residential/Non-Residential And Infrastructure Industry Value Forecasts

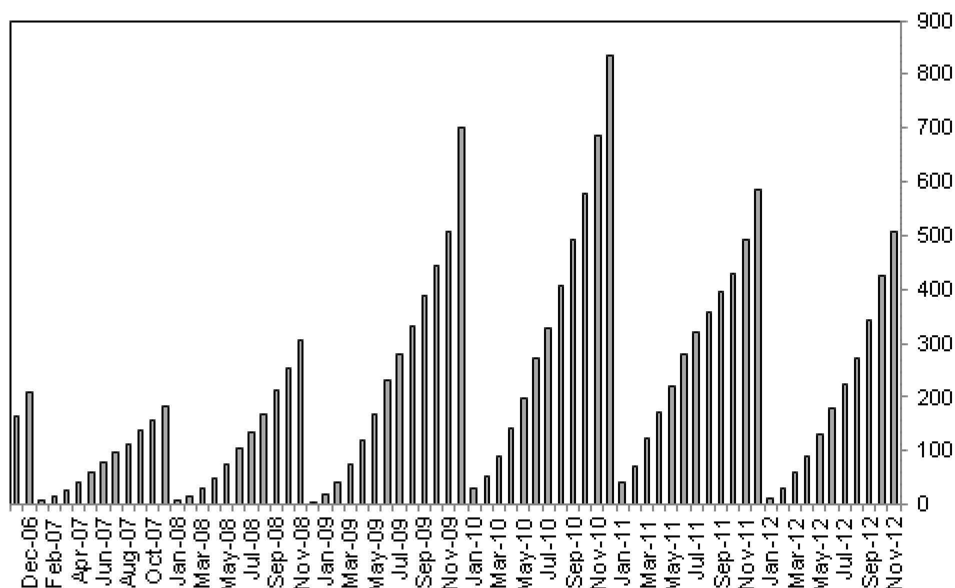


2012=BMI estimate, 2013-2015= BMI forecast

One of the biggest signals we have had validating our view on China's infrastructure is the decline in fixed asset investments in railways. According to data by the national statistics going up to November 2012 (*see graph below*), the sum of fixed asset investments has been falling for two consecutive years. We were estimating minimal real growth in railways construction industry value, but according to the FAI data, growth was in fact negative for 2011, falling by 30%. Over 2012 the decline in value continued, relative to the year before - though following the announcement of the immediate spending on railways in September 2012, by November 2012 the cumulative value of FAI in railways was 3.2% higher y-o-y.

2012 Stimulus Gets Going In Q412

Railways Fixed Asset Investments In China, Cumulative, CNYbn



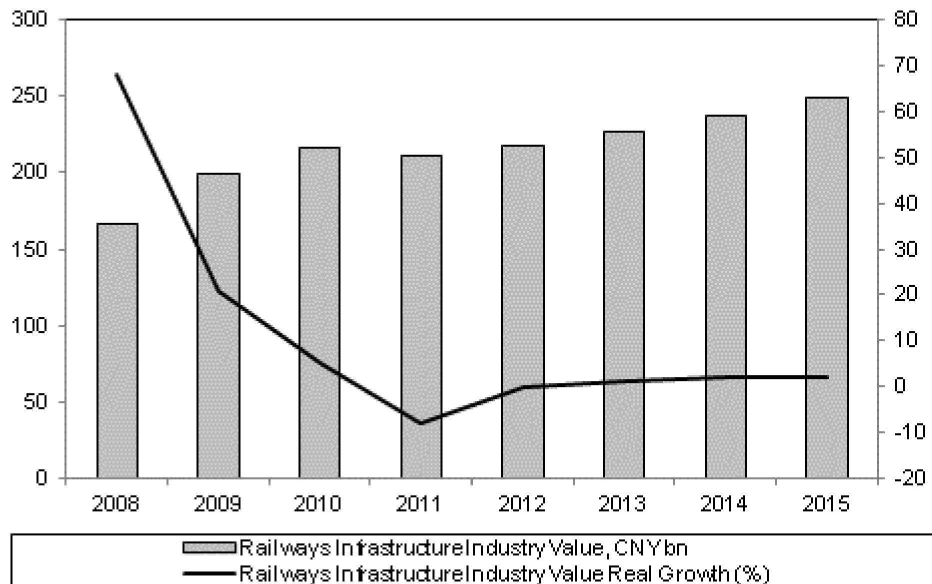
Source: China National Statistics, Bloomberg

Assuming similar patterns for December 2012, we estimate flat growth in railways construction industry value real growth for 2012. For 2013, we believe that the government's plans will continue to filter through, and will therefore create momentum in the sector. As a result of the downward growth revisions to our historical estimates for the segment, our forecasted growth has also moderated, and we now see railways infrastructure industry value reaching CNY226bn in 2013, equivalent to real growth of 1.4% y-o-y.

Subways are especially pertinent. Over the past six months this year, the National Development and Reform Council (NDRC) has approved the building or expansion of metro lines in 23 Chinese cities. In November 2012, the NDRC sanctioned infrastructure projects worth CNY75bn (US$12bn) for the country, adding further fuel to the stimulus.

Railways Regaining Some Steam

Railways Infrastructure Industry Value Forecasts



2012=BMI estimate, 2013-2015 = BMI forecast. Source: BMI

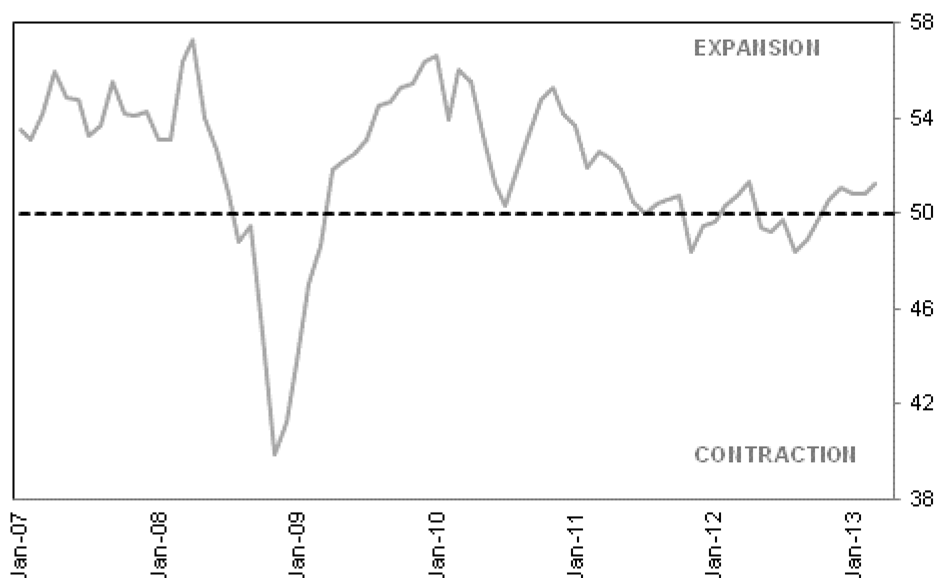
Macroeconomic Forecasts

BMI View: *We are starting to see signs of a broader realisation on the part of Beijing that the previous government's state investment-led policies were inherently unsustainable and have provoked risk of a systemic crisis. Should the new leadership reduce support for loss-making state-dominated industries, this would mean a much weaker H213 and 2014 for China's economy than the consensus currently expects. Extensive structural reform, while unlikely, could trigger a near-term growth collapse but lead to a major improvement in the country's long-term prospects.*

For several months now **BMI** has been calling for a bounce in China's real economy (*see 'Growth: Upside Risks Amid Structural Downturn', November 12 2012*). As we saw it, Beijing's renewed efforts to ignite both credit markets and infrastructure spending would lead to a tangible - if inherently unsustainable - rekindling in economic activity. Latest purchasing managers' index (PMI) data would suggest that this growth upturn is now well under way. If we strip out the Chinese New Year-distorted months of January and February, the simple average of China's official and unofficial PMI headline readings are at their highest level since May 2011, with new orders leading the charge.

Bounce Under Way

China - Average Of Official & HSBC PMI



**Adjusted for CNY Effect. Source: BMI, China Federation of Logistics and Purchasing, HSBC/Markit*

The encouraging PMI data beg the question as to why we are sticking to our relatively downbeat real GDP growth forecast of 7.5% for 2013, which would not only imply a further deceleration from 2012's 7.7% print, but also sits some way off consensus projections of 8.1%. We could point to the fact that China's PMI is only just back above water (ie, the 50 expansion-contraction threshold) despite Beijing's renewed expansionary efforts last year. Measured against the credit-induced PMI surge of 2009, the recent uptick has been trivial, underlining our long-held concern about the diminishing returns of stimulus.

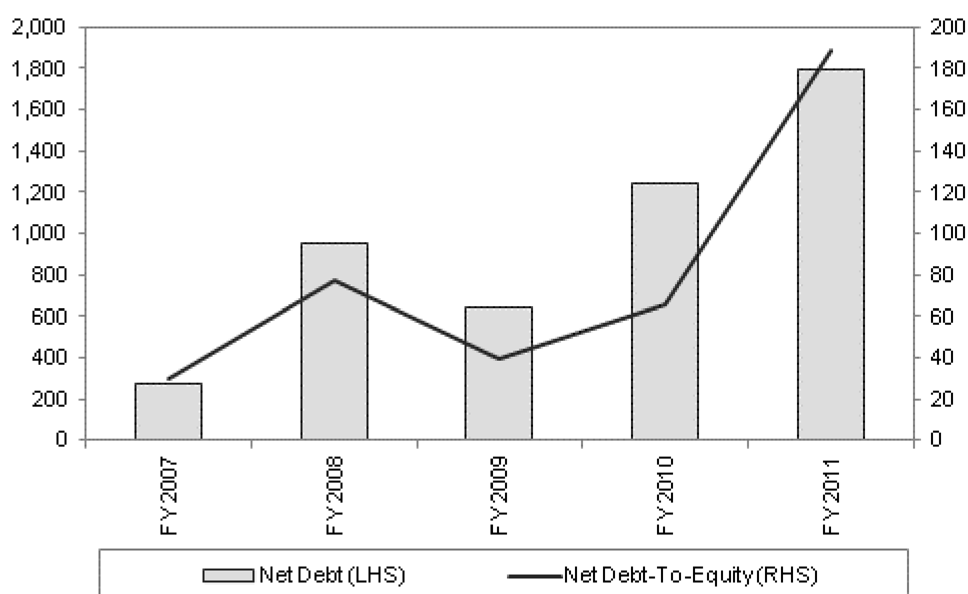
However, there is potentially an even more important story at work and, as has been our approach in recent times, we take our macro cues from the dynamics under way at an industry level. Three developments, in particular, have caught our attention.

Farewell Ministry Of Railways: The government announced in mid-March that the state behemoth Ministry of Railways (MoR) would be split into two smaller entities: the China Railway Corporation (CRC) and the State Railway Administration (*see ' Benefits Of Rail Ministry Break-Up Not Immediate', March 22 2013 in our infrastructure service*). We have been tracking the MoR's fall from grace

since first warning of an impending collapse in China's high-speed rail sector in early 2011. The ministry had more in common with a state-owned enterprise (SOE) than a government agency, and had been racking up debt for many years to fuel unprofitable railway development. The MoR's poor balance sheet health and alleged widespread practice of corruption are well known. **The fact that the new leadership of President Xi Jinping and Premier Li Keqiang allowed the politically powerful railway ministry to be cut down to size is a positive signal, in our view**.

Lights Go Out

Suntech - Net Debt, US$mn & Net Debt To Equity, % (RHS)

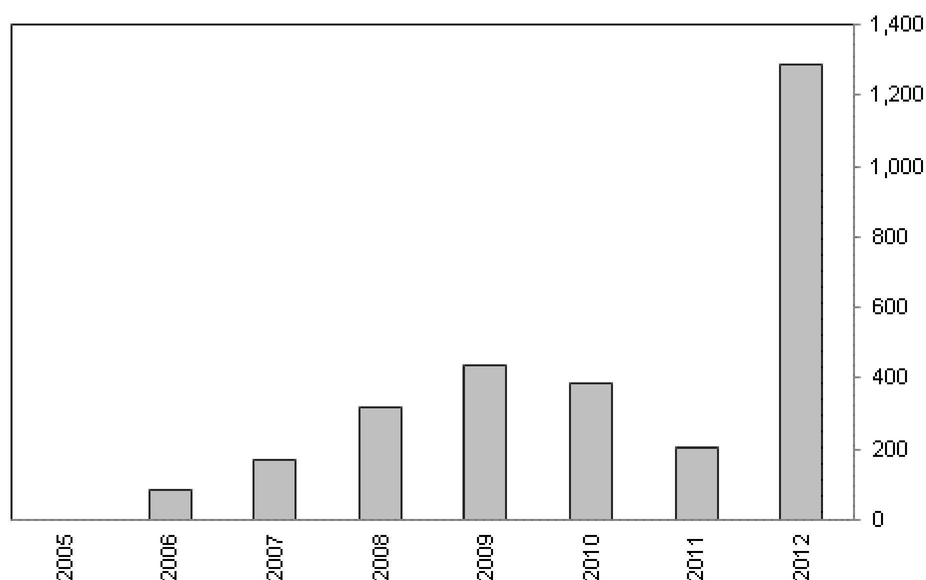


Source: BMI, Bloomberg

(Finally) A Corporate Default: On March 21, Chinese solar panel maker **Suntech Power Holdings** announced that it would be filing for insolvency following the default of US$541mn in outstanding bonds. Suntech's demise traces a similar pattern to that of the MoR - an unsustainable mix of overcapacity, high leverage, collapsing margins, and persistent losses (*see ' Suntech's Fall From Grace: Broader Implications', March 26*). Again, it is not Suntech's failings that are particularly surprising to us, but rather that the company was allowed to fail. **Suntech was, to our knowledge, the first corporate bond default in Chinese history - and a default of the world's largest solar manufacturer**.

Surge In Securitisation

China - Trust Loans, CNYbn



Source: BMI, PBoC

WMP Regulations Tightened: We have written extensively about non-traditional lending inside and outside of China's banking system, and the associated risks posed to the country's financial and economic stability. For example, trust loans financed by 'wealth management products' (securitised retail products) have proliferated in recent quarters outside the realms of regulatory oversight. On March 27, the authorities finally responded, with the China Banking Regulatory Commission announcing that WMPs must henceforth be clearly linked to specific assets, each product must be audited individually, banks must disclose who such securities are being issued to, and that no more than 35% of a bank's total issued WMPs should be invested in debt or used to make loans. **That Beijing has announced such explicit measures to curtail non-core lending is significant given how important such channels have been in driving China's recent credit resurgence (and, by extension, economic rebound)**.

What Does This All Mean?

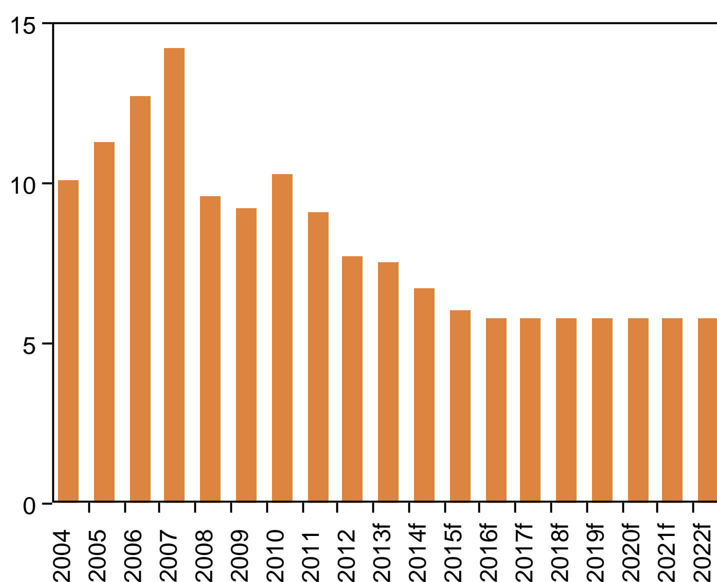
From our perspective, the above developments are not merely a coincidence. They form part of a broader realisation on the part of Beijing that the previous government's state investment-led policies were inherently unsustainable and have provoked risks of a systemic crisis should the property bubble unwind,

local governments face a credit crunch, or the wheels fall off the shadow banking system. Pre-empting Chinese policymakers has been a thorny task historically, but the official rhetoric of late has been notable for its matter-of-factness. As an example, Premier Li explicitly stressed the need to 'break up' existing state monopolies in his National People's Congress address, and recent actions suggest that the incoming administration is genuine in its intentions.

If the decision to strip down the MoR and allow the Suntech default means that the government will no longer throw good money after bad, this has massive implications for the Chinese economy's cyclical and structural trajectory, such has been the importance of state-led investment as the primary engine of economic growth. Starting with 2013, **the developments outlined above provide us with comfort that China's current rebound will prove fleeting and that a growth relapse is on the cards in H213.** Our baseline scenario sees economic growth falling back towards 7.0% in the coming quarters, contrary to the mainstream view of a V-shaped recovery.

No V-Shaped Recovery

China - Real GDP Growth, %



Source: BMI, NBS

Additionally, such measures could be setting the stage for near-term interest rate hikes. We are presently calling for the People's Bank of China to stay on hold in H113, before delivering a rate *cut* in the

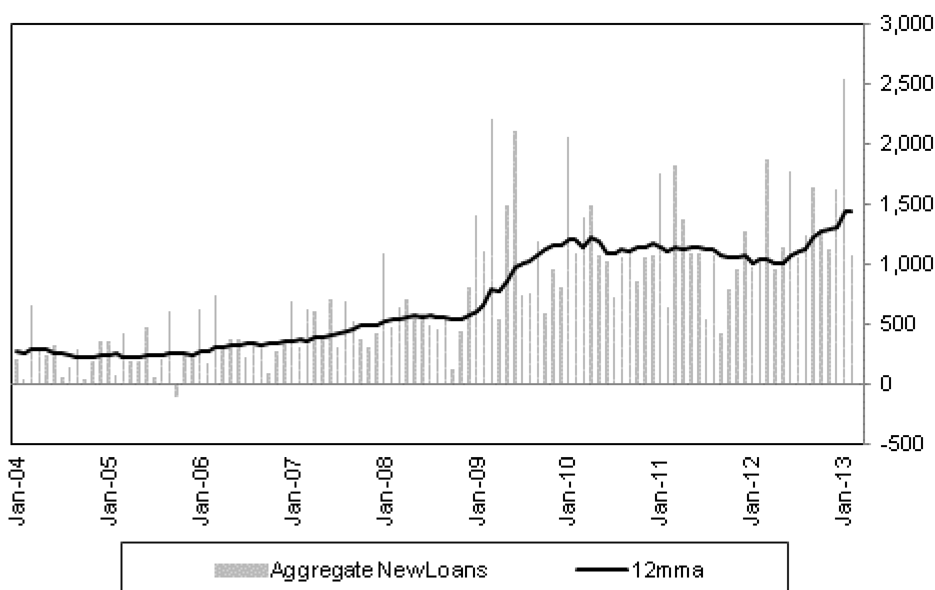
second half of the year as it grapples with a weakening economy. However, with inflation back on the rise (consumer price inflation hit a 10-month high of 3.2% year-on-year in February), the authorities may be tempted to tighten monetary policy in the near term.

The Alternative Scenario: Growth Collapses, Crisis Averted?

We continue to hold reservations as to whether the new leadership has the appetite and ability to push through much-needed structural reform. This includes: extensive privatisation of SOEs (whose total assets stood at CNY85.4trn, or 183% of nominal GDP, in 2011); exchange rate, capital account and interest rate liberalisation; reform to the *hukou* household registration system; and resource pricing reform, to name a few. Firstly, wholesale reform will require Beijing to take on the vested interests of local governments and politicians, whose performance is inextricably tied to land sales, property markets, and flagship infrastructure projects. Secondly, we have yet to see a reining in of credit excesses. On a 12-month moving average basis, net new total social financing (TSF, a measure of aggregate credit supply) came in at an all-time high of CNY1.45trn in February. If the current pace were sustained, new credit issuance would equate to a whopping 30.5% of GDP in 2013.

Credit Still Flowing Freely

China - New Total Social Financing, CNYbn



Source: BMI, PBoC

However, if we assume that the current leadership enacts sweeping reform initiatives, this would have game-changing implications for the economy. We actually attempted to answer this question all the way back in 2009 (*see 'Three Scenarios For Growth', October 7 2009*). At that time, we wrote:

'...the authorities could step in to cool credit growth in the near term. This would undoubtedly, in our view, lead to reversal in recent asset price inflation, and would see investment spending (and to a lesser extent private consumption) fall sharply...'

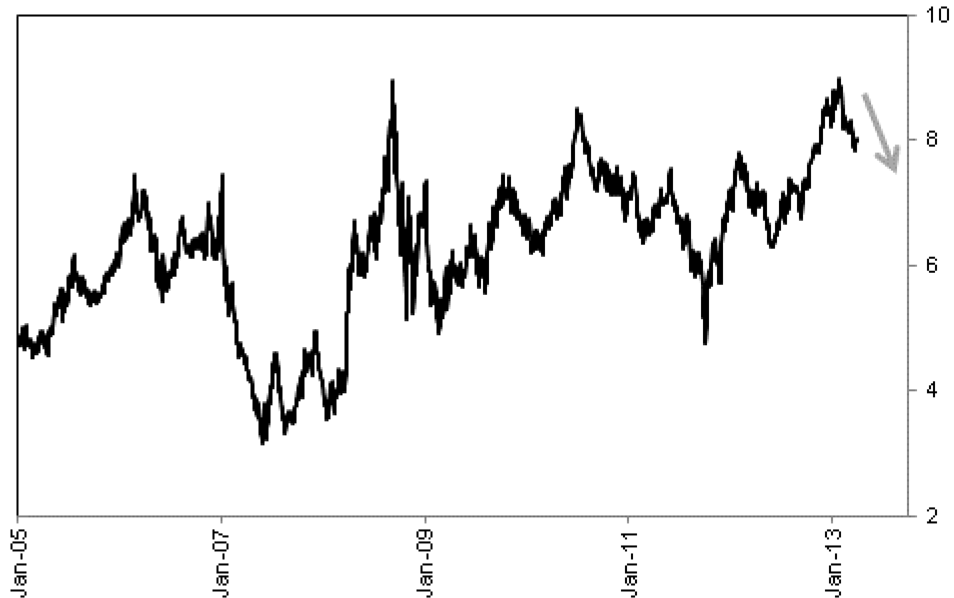
The above sentence still holds true. **Concerted efforts to apply the brakes on credit growth, allow loss-making SOEs to fail, and enact structural reform would almost certainly trigger an economic growth collapse in China**. To illustrate this point, if we assume no real growth in gross investment - and make the crude assumption that private and public consumption remain unaffected - headline real GDP growth would fall to around 5.0%. The reality would most likely be more severe as China's banks would be on the hook for major credit write-downs, and deflation in asset prices would hit consumer spending. However, such a scenario would warrant an upgrade to China's long-term growth prospects (we currently see long-term growth trending at around 5.8%), as the realisation and liquidation of poor investment would allow capital to be reallocated to more productive areas of the economy.

Market Implications: Staying Underweight Financials

From a China asset allocation perspective, **we maintain our view that financials will underperform the market in 2013, which we are expressing via a 'Shanghai Industrials Over Hang Seng Financials' stance in our regional asset class strategy**. For some, the H-Financials valuations may appear relatively attractive, with the trailing price-to-earnings (P/E) ratio currently sitting at just 8.1x. However, we would point to the 'attractive' single-digit P/E ratios enjoyed by both US and UK banks in 2007, on the eve of major housing market corrections, which exposed major asset-liability mismatches and led to a collapse in sector earnings.

Look Out Below

China - Ratio Of H-Financials Over Shanghai Industrials



Source: BMI, Bloomberg

On a more positive note, diminishing SOE influence could create a more level playing field, not least in terms of credit allocation (at least over the medium term) and **we continue to target consumer goods/ service-orientated firms with sizable market share, healthy balance sheets and (ideally) overseas aspirations**. Despite closing out our bullish view on Chinese drug distributor **Sinopharm** on January 31 (locking in respectable gains of 30.9%), the HK-listed equity remains a good long-term play. Other sectors to watch include telecoms services, insurance and online retail.

Table: China Economic Activity

	2009	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Nominal GDP, CNYbn 1	34,632	40,293	46,547	51,469	56,905	62,485	68,068	73,973	80,407
Nominal GDP, US$bn 1	5,069	5,953	7,200	8,159	9,178	9,958	10,719	11,469	12,276
Real GDP growth, % change y-o-y 1	9.2	10.3	9.1	7.7	7.5	6.7	6.0	5.8	5.8
GDP per capita, US$ 1	3,798	4,438	5,343	6,028	6,752	7,296	7,826	8,345	8,907
Population, mn 2	1,335	1,341	1,348	1,354	1,359	1,365	1,370	1,374	1,378
Industrial production index, % y-o-y, ave 1	11.1	14.4	10.8	7.8	8.2	8.5	8.0	8.0	8.0
Unemployment, % of labour force, eop 3	4.3	4.1	4.4	4.9	5.0	5.0	5.0	5.0	5.0

Notes: e BMI estimates. f BMI forecasts. Sources: 1 National Bureau of Statistics, BMI; 2 World Bank/UN/BMI; 3 National Bureau of Statistics.

Industry Risk Reward Ratings

Asia - Risk/Reward Ratings

The Real Estate Risk/Reward Ratings provide a regional country-by-country comparison of the risks and rewards for the real estate market. The ratings evaluate the industry's current size and growth potential, and take into account various issues that could affect the industry's development, such as the size and forecasted development of the construction sector, commercial bank lending, financial infrastructure, per capita GDP, urbanisation, real estate prices, and lending rates. The score also covers country and industry specific factors which may inhibit or encourage future development in the Real Estate sector, such as political and economic stability.

Table: Asia Pacific Real Estate Risk/Reward Ratings

	Real estate market	Country structure	Returns	Market risks	Country risk	Risks	Real estate rating	Rank
China	80.0	48.4	*68.9*	86.7	50.0	*73.8*	71.4	1
India	87.5	37.2	69.9	86.7	38.4	69.8	69.8	2
Australia	65.0	91.6	74.3	60.0	75.0	65.3	69.8	3
South Korea	55.0	71.3	60.7	83.3	69.6	78.5	69.6	4
Hong Kong	52.5	91.7	66.2	66.7	74.5	69.4	67.8	5
Malaysia	55.0	59.5	56.6	83.3	60.1	75.2	65.9	6
Taiwan	60.0	67.0	62.4	73.3	59.2	68.4	65.4	7
Singapore	52.5	97.6	68.3	50.0	81.9	61.2	64.7	8
Indonesia	82.5	35.3	66.0	76.7	37.9	63.1	64.6	9
Pakistan	67.5	29.3	54.1	86.7	42.6	71.2	62.7	10
Japan	57.5	77.9	64.6	53.3	73.3	60.3	62.5	11
Philippines	65.0	44.1	57.7	73.3	51.0	65.5	61.6	12
Thailand	45.0	36.7	42.1	86.7	39.4	70.1	56.1	13
Vietnam	65.0	16.7	48.1	73.3	29.6	58.0	53.0	14

Scores out of 100, with 100 the best. Source: BMI

China - Risk/Reward Ratings

China's Risk/Reward Ratings

China leads the pack in our Real Estate and Construction Risk/Reward Ratings (RRRs), with India, Australia and South Korea not far behind. Persistent structural weaknesses, such as a lack of competitiveness in the market, high levels of corruption (which leads to issues with the transparency of the tendering process) and an economic slowdown have prevented any improvement in the country's rating over the past 12 months.

Rewards

Industry Rewards

China's score has historically been high in this category, on account of the market's large size and strong growth. It is this combination of factors that work to give China a high score in the Industry Rewards category (80.0), which in turn boosts its overall score in the Asia Pacific RRRs, well above the regional average of 63.6.

Country Rewards

The labour market in China is overregulated, thus making the labour force quite inflexible. Low labour costs also reflect the low quality of labour, which increasingly puts the country's domestic construction and real estate sector at a disadvantage, as requirements for more complex projects place higher demands on the skills of the labour force. The state-owned banks that dominate the financial market in China have been willing to extend loans to state-owned enterprises for projects, especially since the infrastructure stimulus programme was implemented. China scores 48.4, below the regional average of 57.4 for this indicator.

Risks

Industry Risks

Although China's construction sector has been dominated by a few state-run enterprises, the country is trying to move towards a more competitive regime. China is also looking at attracting higher levels of foreign investment. The country has made reasonable efforts towards this in the face of US criticism of being unable to reduce market entry barriers and reform its existing intellectual property (IP) regime. The

north-east and western China rejuvenation programmes could provide major opportunities for foreign investment, although we maintain cautiously optimistic in terms of the extent of opportunities for foreign investors in the country, as significant obstacles remain. China scores 73.8 for this indicator.

Country Risks

In-depth analysis of seven indicators rank China's economic structure as just above average. Though the financial system has been immune to the external financial shocks, the economy as a whole has not been immune to the contraction in trade and the decline of exports. Policies are expected to be largely stable in the long run, with no major surprises in store. However, without reform, China's legal system appears disappointing. The country is also known to be plagued by high levels of corruption. China scores 50 for this indicator.

Market Overview

Is The Sector Suffering In Face Of The 'Stimulus That Never Was'

The hopes of many analysts were lifted in late 2012, as a raft of projects were fast-tracked up the agenda, and local governments, such as that of Changsha, were reported to be preparing vast spending plans. Chongqing and Tianjin both announced spending plans of CNY1.5trn, while relatively underdeveloped province Guizhou outlined plans to invest CNY3trn on its tourism base.

Based on our concern about local government debt and overcapacity, we refrained from factoring in a significant proportion of the projects being touted. In the case of Changsha's 'US$130bn' infrastructure programme, it appears that the sum merely reflected the funding wishes of the city's governor, and that the vast majority of projects will not enter the pipeline. This partially reflects the increasingly tight project financing environment - we still question the ability of firms to finance new projects in an environment where state banks are encountering problems boosting credit issuance, and governments and firms are focusing more on shoring up their bottom line than investing in new assets.

Reflecting the increasing urgency of a government looking to avoid falling below the 7% level of GDP growth, a significant number of projects, totalling an estimated CNY2trn, have been fast-tracked so that construction can begin in the coming months, according to China's planning agency, the National Development and Reform Commission. Guangdong alone has released over 177 new infrastructure projects worth around CNY1trn.

We were treating all these announcements with caution in the beginning. However, the real estate fixed asset investments have shown a clear rebound since the second half of 2012. Latest price data coming out of China suggest a revival in the real estate market. People's Daily Online reported industry figures in mid-January 2013 which showed that new house sales in major cities across China nearly doubled in the first days of January compared with the same period over 2012. Real estate equities in Hong Kong and Shanghai, such as **Poly Real Estate**, **Guanghui Energy** and **Central China Real Estate**, have also surged showing a revived market confidence that the draconian government clampdown on the property market has eased up. Though the market is below the levels it was previous to the slowdown, it is showing healthy momentum.

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2013: Spend Or Slump

We have now priced in the upside risks we previously identified for China's residential construction sector. Significantly, it is our view that China's leadership transition will be positive for the sector as short term fiscal loosening would have a stimulating effect - as it appears to be having. We believe that Xi Jinping will carry on the policies of Hu Jintao's regime, which include the short-term intensification of construction. Furthermore, we are confident that current vice premier Li Keqiang (who will succeed premier Wen Jiabao) will continue and perhaps intensify the building of affordable social housing.

In August 2012, the vice-premier addressed a neighbourhood committee on the importance of fairness in housing allocation, highlighting his commitment to the governments scheme to build 36mn new units between 2010-2015 - a policy that has gained momentum in recent months and is the cornerstone of our upwardly revised sub-sector forecast. According to the Chairman of China's largest cement manufacturer, **Anhui Conch**, a further 7mn new units are slated to enter the construction phase over 2013.

Li, who has built his reputation on championing the housing rights of disenfranchised workers, will likely look to renovate shanty towns and run-down urban fringes. We believe that the type of housing being constructed will alter over the long run from nominally affordable builds sponsored by local government (which are often sold off to private speculators at a premium), to the construction of more peripheral regeneration projects overseen and sponsored by the central government. Reflecting what we believe may reflect a new long-term policy direction; a joint initiative has seen the Ministry of Finance, Ministry of Housing and Urban-Rural Redevelopment commit to investing US$5bn in subsidies to allow poor rural homeowners to renovate their housing.

A number of factors support this view; the centre is becoming increasingly critical of local officials and, in the face of increasing local debt which is being financed by Beijing, is trying to curb both rampant cronyism and high levels of speculation in the market. At the same time, the central government are looking to increase housing stock for the millions of citizens - including many of the middle class - who are priced out of the market, perhaps the most vital issue of discontent amongst Chinese and one to which the new generation of leaders will look to consolidate their legitimacy.

Spending on infrastructure is the most critical constituent of China's GDP; yet, over the long term, sticking to previous spending trends in the face of weakening demand - investing in unused roads, factories, speculative assets and, in some cases, ghost towns - will likely inflate structural imbalances in the long run. This is especially true in the face of a downturn in macroeconomic activity - especially in the export sector. However, housing for those at the lower end of the income strata remains one potential (albeit lower value) growth market that remains open to the government and, as manufacturing continues to underperform and the rural-urban migration of workers slows, we believe that investment in the area (both rural capital works and urban regeneration) will incrementally increase to quell nascent discontent and bolster GDP.

Shanghai

According to Forbes, 2012 saw a 28% decline in commercial and residential investment. Shanghai's economic growth is easing, although retail sales remain resilient. Price curbing measures are also ongoing in the city, implying that this downward slide could continue for the coming months.

Shanghai's strong GDP growth over recent years has been in large part a result of strong retail sales growth in the city. This could lead to increased retail development as new retailers to the country vie for a competitive position in the market - at the same time that retail centres vie for more upscale tenants in order to attract foot traffic. However, the office market is suffering from tighter vacancy rates and slow leasing, as **Jones Lang LaSalle** (JLL) has recorded in its Q1 property review that there has been no new office supply. Industrial demand remains strong in the west of Shanghai, although this is primarily a result of demand continuing to outpace limited supply and may therefore present only a short-term boost.

Beijing

Beijing is one of the top five cities for overseas investors, according to Cushman & Wakefield's 'Winning in Growth Cities' report. However, the effect of property price curbs in place by the government is not just limited to residential space in Beijing. Sales of residential and commercial property in the city saw an overall decline in 2011, highlighting the problems that top quality developments may face in 2013. Commercial sales declined by 13.9%, and pressure is expected to increase in 2013 to keep prices down.

Wuhan

Wuhan is experiencing a huge urbanisation drive owing to city planners. New roads, road widening and subway improvements (in which it is hoped 215km will be added by 2017) are under way. In the last year, fashion and hospitality brands have also opened premises in the city. For example, **Marks & Spencer** (M&S) is in the process of opening a store in the city, choosing this location over Beijing or Guangzhou,

where the company also has no presence. It is hoped that other commercial entities will follow suit, as Wuhan's international profile increases. However, it still has a way to go to match the interest in China's first-tier cities.

To secure loans and fund the planned infrastructure projects, **Wuhan Urban Construction & Development Co** (which was set up to finance the city's improvements) must rely on land sales. There is a glut of housing in the city and cooling measures have not yet had sufficient effect on rocketing prices. So it may be a few years before Wuhan is able to complete its infrastructure improvements and truly compete with other major cities.

Shenzhen

The Chinese edition of Forbes Magazine has rated Shenzhen as the most innovative city on China's mainland for the second year running. The survey calculates innovation capacity by each city's new patent applications and spending ratio on technology. Accolades such as this could boost high-tech interest in Shenzhen, which could increase demand for industrial real estate, in particular.

However, following the general trend in China of declining revenue from land sales, Shenzhen experienced one of the largest declines and lowest overall revenue in the country in 2011. Total revenue reached CNY18.4bn (US$2.91bn), more than CNY100bn less than Shanghai, and a decline of 22% y-o-y.

According to Reuters, reports emerged in February that authorities are looking to develop Qianhai, in Shenzhen province, into a financial centre. Shenzhen's stock exchange maintains the area's financial reputation, but if these plans go ahead there could be an influx of office and financial development throughout the area.

Office

Rents And Yields

Our most recent round of in-country interviews was conducted in December 2012. It is unsurprising, given China's size that the picture for rents varies wildly from city to city. It also follows that Beijing and Shanghai - as China's established commercial powerhouses - command much higher rents in comparison with Wuhan and Shenzhen, the other two cities for which we gather data.

The movement in office rents between H111 and H212 has been up and down in all four cities, with Shanghai and Beijing on the up as the commercial powerhouses continue to attract investment, whereas

Wuhan and Shenzhen suffered contraction in light of the 2012 wobble in China's growth story. Shanghai's minimum rents took a dive going into 2011, reaching CNY60 per square metre (m^2) a month from CNY300. They recovered in the second half of the year, and according to our in country sources have rebounded by year-end 2012. Although the picture still shows that early 2012 was not a strong period for investment in Shanghai, it shows that the second half of the year saw a rebalancing in rental rates, however due to the oscillating nature of Chinese rents over the past 24 months, on top of a more precarious economic backdrop, this is likely to persist.

In Beijing there appears to have been no corresponding decline in office rents in H211 and H212 which have born impressive growth over the period, emphasising the reports that the city's office market is still strong. For the most part levels remained stable at minimum levels (though a small minimum increase implies that overall quality may have slightly improved during this time). In the second half of 2011 and again in 2012 our estimates show a dramatic increase in maximum level rents. It is also of note that up to 50% of available office space lay vacant in Q112, according to our sources. While this has not yet affected the growth in rents, a dearth of supply at a time when demand is ebbing could prove a downside risk. Predictably though, rates in the city centre are considerably higher than those in outer locations.

Wuhan's office market is considerably more subdued than the other three cities, although overall contraction in rates over the 24-month period does imply that the previous degree of resilience is waning, and flags caution. Shenzhen fared little better as although rates remain significantly higher than those of Wuhan, overarching contraction was still present.

Table: Historic Rents - 2011-2012 (CNY per m2/month)

	Rental Cost - 2011 (Jan-Jun)		Rental Cost - 2011 (Jul-Dec)		Rental Cost - 2012 (Jan-Jun)		Rental Cost - 2012 (Jul-Dec)	
	Min	Max	Min	Max	Min	Max	Min	Max
Shanghai	60.00	300.00	67.20	450.00	150.00	390.00	120.00	485.00
Beijing	130.00	300.00	130.00	650.00	135.00	500.00	142.50	705.00
Wuhan	20.00	150.00	25.00	150.00	40.00	95.00	42.50	127.50
Shenzhen	105.00	350.00	85.00	300.00	85.00	300.00	92.50	297.50

Source: BMI

Table: Net Yield, 2011-2012 (%)

	2011 (Jan-Jun)	2011 (Jul-Dec)	2012 (Jan-Jun)	2012 (Jul-Dec)
Shanghai	5-6%	3-8%	2-8%	3-8%
Beijing	6-10%	6-10%	3-10%	3-10
Wuhan	5-6%	5-6%	7-9%	7-9%
Shenzhen	6-7%	5-7%	4-7%	4-7%

Source: BMI

Table: Terms Of Rental Contract/ Leases - H212

	Lease terms (in years)	Rent free months (if any)
Shanghai	2-6	1-3
Beijing	1-2	1-3
Wuhan	1-5	1
Shenzhen	1-5	1-4

Source: BMI

Retail

Property consultant **DTZ** has reported that the retail trend in China has been for foreign investors to buy property instead of renting it. Soaring rents and competition for prime locations have contributed to this situation. Companies such as **Tesco** and **Inter Ikea Center Group** (co-owned by Swedish giant **Ikea**) have announced plans to build their own shopping centres in China. However, it is uncertain what this will do to rental levels in the long term as these companies are then likely to rent out their own retail space to other tenants.

Retail demand remained buoyant at the end of 2012, according to **Jones Lang LaSalle** (JLL). Many mid- and high-end retailers (such as Gucci, Gap and Dior) have opened new stores in China, implying that demand in this sector has not yet been affected by the slowdown currently occurring in the office market.

There is a suspected glut of retail property occurring in China at present, as a number of shopping malls are being built across the country. **CapitaMalls Asia**'s agreement with **Suzhou Industrial Park Jinji Lake Urban Development Co** to develop Suzhou's largest shopping mall is one such example. It has been

suggested that this is the result of the desire to increase China's retail space per capita, but some sources would argue that demand is not high enough to sustain so many projects, which may cause vacancy rates to rise.

Conversely, Hang Lung is continuing with its plans to complete at least one shopping mall in China every year until 2015. The plan seems to be succeeding in spite of the supply glut, as the continued growth in the middle class is helping to keep the competitive retail sector lucrative.

Hong Kong developer **Hang Lung Properties** has opened a new mall, Forum 66, in the capital of the north eastern province of Liaoning, China, reports China Daily. Forum 66 will offer 93,600m2 and is already fully leased to high end retailers. In addition to the shopping complex there will be serviced apartments, office towers and a hotel.

Chinese developer Dalian Wanda Group has opened 18 shopping malls and 12 five-star hotels in China over 2012, according to China Daily. The firm plans to continue its expansion over the coming years, with 20 new malls and 15 new hotels planned per year from 2014. However, the country's economic slowdown is expected to reduce spending and numbers of visitors to malls from 2012 onwards.

Retail seems to have been the most resilient commercial sub-sector over the last few months, despite the oversupply that remains in some areas. But it seems as if second-tier cities formed a major part of 2011/12's solid investment figures, with transactions outside first-tier locations accounting for more than half of the CNY26.5bn recorded, according to JLL. Emerging markets within the country are likely areas to watch as slowdowns continue in major centres such as Beijing and Shanghai.

Rents And Yields

Overall in the 24 months between H111 and H212, Shanghai and Beijing have seen promising overall growth in retail rents, while the picture is less optimistic in Wuhan and Shenzhen. Minimum rents in Shanghai dipped in early 2011 to CNY200/m2 a month. They rallied and surpassed even H210 levels at the end of the year, reaching an estimated CNY300/m2 a month, and this rate has been maintained over the months with H212 closing at CNY304/m2 a month. Maximum rents increased steadily throughout the period, ending 2011 at an estimated CNY800/m2 a month. The reported explosive first six months of 2012 which saw top end rents rise to CNY1,500 has tempered by the end of the year to reach CNY1,175. The indication is that when minimum levels dipped there was more competition for Grade A space, which levelled out with steady demand by the end of 2012. Nevertheless, minimum rents are highest in Shanghai than any of the other cities for which we gather data.

In Beijing, retail rates remained consistent throughout 2011. This resilience has seen the sector reportedly flourish over the course of 2012, with gradual growth in both minimum and maximum rents. There is an indicated stability in the market that should enable it to weather a potential glut of new supply in 2012/13. Maximum levels in particular, peaking at an estimated CNY1,170/m2 a month in H112, second highest only to Shanghai of all four cities, which may also explain their lack of growth overall.

The situation in Wuhan over the past 24 months has been considerably more subdued. From an already low base, retail rents have declined at all levels in 2011 and 2012, and despite maximums rallying in H111, 2012 figures closer reflect the performance in the second half of 2011, the consistency of these results indicate that the market has now settled at this lower level. It appears demand in the past year has been much more focused on centres such as Beijing and Shanghai, where a dearth of new projects has appeared. However, this picture may also suggest that Wuhan (and Shenzhen) is suffering from a glut of supply, causing a lowering of rates in order to entice renters and remain competitive. After reaching CNY300 in early 2011, it is clear that the increase was unsustainable at the time, heightening the difference between the retail outlook for Wuhan compared with China's major cities.

In Shenzhen, minimum rents actually have been declining steadily but have now settled, implying that the supply and demand dynamic has reached an equilibrium. Owners of lower grade premises are likely to be lowering rents in a bid to entice higher demand. The city also saw a lot of movement in maximum levels, which climbed from CNY360/m2 a month in H111 to peak at CNY500 in early 2012: top end rents in the city have yet to settle.

Table: Historic Rents - 2011-2012 (CNY per m2/month)

	Rental Cost - 2011 (Jan-Jun)		Rental Cost - 2011 (Jul-Dec)		Rental Cost - 2012 (Jan-Jun)		Rental Cost - 2012 (Jul-Dec)	
	Min	Max	Min	Max	Min	Max	Min	Max
Shanghai	200.00	600.00	300.00	800.00	300.00	1500.00	304.50	1175.00
Beijing	180.00	900.00	180.00	900.00	300.00	1170.00	310.00	1000.00
Wuhan	100.00	300.00	80.00	250.00	110.00	255.00	102.50	252.50
Shenzhen	110.00	360.00	105.00	305.00	100.00	500.00	105.00	412.50

Source: BMI

Table: Net Yield, 2011-2012 (%)

	2011 (Jan-Jun)	2011 (Jul-Dec)	2012 (Jan-Jun)	2012 (Jul-Dec)
Shanghai	3 - 5%	3 - 6%	2 - 8%	3 - 7%
Beijing	6 - 8%	6 - 8%	3 - 7%	3 - 7%
Wuhan	6 - 7%	6 - 7%	7 - 8%	7 - 8%
Shenzhen	6 - 7%	6 - 7%	2 - 5%	3 - 5%

Source: BMI

Table: Terms of Rental Contract/ Leases - H212

	Lease terms (in years)	Rent free months (if any)
Shanghai	2 - 6	1 - 6
Beijing	1 - 3	1 - 3
Wuhan	1 - 10	1
Shenzhen	1 - 3	1 - 3

Source: BMI

China - Retail Sales Indicators

Table: China Retail Sales Indicators, 2010-2017

	2010	2011	2012e	2013f	2014f	2015f	2016f	2017f
Retail sales, CNYbn	15,889	17,943	20,502	23,113	26,150	29,460	33,032	37,001
- US$bn, fixed 2009 foreign exchange rate	2,326	2,627	3,001	3,383	3,828	4,313	4,835	5,416
- US$bn, forecast foreign exchange rates	2,347.2	2,775.7	3,250.3	3,686.4	4,102.0	4,567.6	5,043.1	5,606.3
Retail sales as % GDP	39.4	38.5	39.8	40.6	41.8	43.3	44.7	46.0
Retail sales per capita, CNY	11,845	13,315	15,147	17,003	19,160	21,508	24,036	26,845
- US$	1,733	1,949	2,217	2,489	2,804	3,148	3,518	3,929
Total retail sales growth, CNY	26.8	12.9	14.3	12.7	13.1	12.7	12.1	12.0
Per capita retail sales growth, CNY	26.2	12.4	13.8	12.3	12.7	12.3	11.8	11.7
Private final consumption, CNYbn	14,025	16,224	17,995	19,979	22,285	24,787	27,493	30,494
- real growth % y-o-y	15.8	15.7	10.9	11.0	11.5	11.2	10.9	10.9
- US$bn	2,072	2,510	2,853	3,186	3,496	3,843	4,197	4,620

f = BMI forecast. Source: China Ministry of Commerce, BMI

Industrial

Supply And Demand

Industrial demand throughout China retains potential for growth, as manufacturing and logistics companies have increasingly looked to emerging markets in recent years in order to maintain growth. However, there has recently been a decline in manufacturing activity in the country that is having a knock-on effect on GDP growth. This could cause a temporary slip in demand for property in the industrial sub-sector. It may even be that these two factors cancel each other out, resulting in a continuing stability in the industrial market.

However, industrial demand in Shanghai seems to remain strong at present. This is so much the case that the west of the city (a popular location for logistics companies) currently has no vacant space, according to reports. Manufacturers are spreading outside the west and the city centre for their distribution centres, which could help Shanghai to remain resilient in the wake of any manufacturing downturn.

US property services firm Jones Lang LaSalle has reported that the logistics sector is growing rapidly in China as the country expands its global trade relations, according to Globe St. The firm has claimed that the situation brings many investment opportunities for US logistics professionals, including the fact that there is a shortage of quality warehouse properties. This shortage has occurred due to a traditional focus on facilities for manufacturing and professional services, rather than storage and distribution.

Rents And Yields

Industrial rents are traditionally much lower than their counterparts in the office or retail sub-sectors, and according to our latest data collection covering the full year 2012, the sector has been the worst performer in terms of the year-on-year (y-o-y) rental market. Bringing an end to the sustained growth experienced between H210 and H211, 2012 has seen rates fall - and in some cases quite dramatically - across the board. This is indicative of the slowdown in manufacturing activity which we previously highlighted as a downside risk to market performance. Shenzhen has noted the most contraction, although it retains its spot as the most desirable location for industrial space, while Shanghai was the only city to posit marginal growth.

Table: Historic Rents - 2011-2012 (CNY per m2/month)

	Rental Cost - 2011 (Jan-Jun)		Rental Cost - 2011 (Jul-Dec)		Rental Cost - 2012 (Jan-Jun)		Rental Cost - 2012 (Jul-Dec)	
	Min	Max	Min	Max	Min	Max	Min	Max
Shanghai	30.00	50.00	25.00	105.00	21.00	54.00	34.00	62.50
Beijing	30.00	110.34	30.00	110.00	24.00	90.00	31.50	92.50
Wuhan	10.00	25.00	7.00	18.00	13.00	31.00	9.25	22.50
Shenzhen	30.00	330.00	25.00	125.00	20.00	90.00	25.00	107.50

Source: BMI

Table: Net Yield, 2011-2012 (%)

	2011 (Jan-Jun)	2011 (Jul-Dec)	2012 (Jan-Jun)	2012 (Jul-Dec)
Shanghai	6 - 8%	6 - 7%	7 - 9%	3 - 8%
Beijing	6 - 8%	6 - 8%	2 - 5%	4 - 6%
Wuhan	6 - 7%	6 - 7%	1 - 10%	7 - 8%
Shenzhen	6 - 7%	6 - 7%	2 - 10%	7 - 9%

Source: BMI

Table: Terms of Rental Contract/ Leases - H212

	Lease terms (in years)	Rent free months (if any)
Shanghai	2 - 20	2 - 3
Beijing	1 - 3	1 - 3
Wuhan	1 - 10	2 - 3
Shenzhen	1 - 5	2 - 6

Source: BMI

Competitive Landscape

It is widely acknowledged that China's 'big four' developers are **China Merchants Property Development** (CMPD), **Gemdale Corporation**, **China Vanke** and **Poly Real Estate Group**. As a result of this status, these four firms enjoy solid national reputations. However, even these four companies are likely to experience heightened competition or decreases in revenue as a result of the austerity the government has enforced in the residential sector. Overall, the four companies are better placed to weather a subdued 2013, as evidenced by recent reports that CMPD has bought four plots of land in different areas of the country for residential and commercial developments.

Government measures have affected more than just the big four developers, however. Reports are highlighting that smaller developers lack the liquidity to weather the slowdown in the property market. Two such companies - **Hangzhou Glory Real Estate Co** and **Guangdeye Property Development** - filed for bankruptcy in 2012. In addition, **China Construction Bank** has instructed 38 of its branches not to provide property development loans to small companies, presumably as they are riskier ventures in times of constraint. This bodes ill for any increase in competition among China's major developers.

Declines in price and sales levels in major cities, such as Shanghai and Beijing, have led to 70% of Shanghai- or Shenzhen-listed developers expecting a decline in earnings. In the three months to March 31 2012, only six of 33 property companies predicted an increase in their estimates. This is a reflection of the subdued nature of the market as a whole, despite small bright spots on the horizon.

The country saw much of its real estate investment switch focus to commercial property, where regulations are looser, towards the end of 2011. A number of developers known primarily for their residential interests were reported as looking into the commercial market: **Shimao Property**, **China Resources Land** and Poly Real Estate are a few examples.

A number of the larger developers (with greater access to funding) are swooping in as prices continue to decline. In mid-April 2012, it was reported that Beijing-based commercial property developer **SOHO China** had purchased its 11th plot of Shanghai real estate since August 2009. It acquired the Tianshan Road Project in one of the city's business districts for CNY14bn. According to China Daily, dropping real estate prices (a reflection of the property glut in many major cities) are posing some opportunities for stronger developers, as well as the downside risks involved.

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Prior to this transaction, SOHO China bought a 24-floor office building in the Pudong New Area of Shanghai for US$294mn, according to East Day. The 60,500m2 building is nearly complete and was the ninth project in the city that the company sealed since its first acquisition. According to a company statement, the building will be renamed SOHO Century Avenue.

The booming hospitality segment is also an area that could help to buoy real estate interest in China. In October 2011, for example, **InterContinental Hotels Group** signed a contract for its new China hotel brand, set to launch in 2013. It will be tailored to Chinese consumer tastes and the company aims to open venues in a number of tier-two and -three cities, as well as in Shanghai and Beijing. The brand eventually hopes to expand worldwide to cater to the increasing number of Chinese travellers abroad. This will boost domestic tourism as well as overseas interest in the country.

In another international move, **Goodman Group**, an Australian-listed industrial property giant, announced plans to boost its investment in China from US$250mn to US$2.5bn over the next five years, in the hope of benefiting from the country's expected boom in domestic consumption. The company claims there is a lot of room in China's underdeveloped logistics business. An accompanying shortage of warehouse space may also result in a dearth of new projects from other developers to improve facilities.

It seems that, amid the slowdown, foreign investors are looking to take advantage of the country's low prices and eased competition. French insurer **AXA**'s real estate arm is planning investment of US$2.6bn in major cities, while German company **SEB Asset Management** is keen on residential and office investment of up to US$400mn in the west of the country. It may be that China's major players cannot retain their domestic monopoly in light of these developments. At present a number of Chinese companies are keeping prime property off the market in the hope that the government will ease property restrictions. While this holds potential in the long term, the short-term market is therefore available for multinational investors to move in.

Some domestic commercial deals are also still going ahead, as urbanisation continues and second-tier cities begin to stand out. Real estate services provider **Century 21 China Real Estate** has agreed a franchise deal with **Nanjing Guangsha Real Estate**. According to Market Watch, the deal will see the property developer operate a new arm of Century 21 in Nanjing, the capital of Jiangsu province.

Company Profile

China Merchants Group/China Merchants Property Development

Strengths

- China Merchants Property Development (CMPD) enjoys a good reputation as one of the 'big four' developers.
- Massive land bank, in mainland China and Hong Kong.
- Diversified, geographically and by sector, which should ensure steady revenue even in times of downturn.
- Access to global capital through the broader China Merchants Group which, structurally, is similar to the largest Hong Kong-based conglomerates.

Weaknesses

- Residential and commercial markets have slowed as a result of government cooling measures.
- Less clearly a beneficiary of urbanisation than other majors.

Opportunities

- Membership of China Merchants Group means that development of real estate and infrastructure can be more easily coordinated.
- Rising number of wealthy and middle class buyers in China.
- A number of smaller developers are suffering from liquidity issues, potentially providing opportunities for larger players.

Threats

- A sharp and sustained rise in the prices of building materials would adversely affect the company.
- Banks' tighter lending measures may cause funding problems across the board.

Company Overview

China Merchants Property Development Company (CMPD) is a 50.86% Shenzhen-listed subsidiary, and is **China Merchants Group**'s flagship property company. It is involved with development and investment in leading real estate from offices to

residential properties in Beijing, Shanghai and Shenzhen, among others. **China Merchants Shekou Industrial Zone Co** and **China Merchants Zhangzhou Development Zone Co** (72%) are responsible for those respective areas.

Iconic office buildings in which CMPD has been involved include China Merchants Tower in Shanghai, China Merchants Centre in Beijing and the Beijing International Finance Tower.

Financial Data

In its annual report for 2011, CMPD reported total sales revenue of CNY15.1bn; a 9.6% year-on-year (y-o-y) increase. The company expects competition in the sector to remain high as a result of the government's austerity measures in residential property, and the revenue growth recorded will stand CMPD in good stead to weather the storm. The final figure was shy of CMPD's estimates for transaction value of CNY20mn. However, amid a national slowdown, net income increased by almost 30% y-o-y to reach CNY2.6bn.

Company Details

- China Merchants Property Development
- Shenzhen Nanhai Gallery, 3rd floor
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- Fax: 0755-26691037
- www.cmpd.cn

Gemdale Corporation

Strengths

- One of the 'big four' property developers.
- Massive property portfolio, with good diversity across major and second tier cities.
- Clearly developing a strong brand.
- During the year ended December 31, 2011, the company distributed approximately 2.336mn m2 of commercial and residential buildings

Weaknesses

- Exposed to the official moves to cool the residential property markets of Shanghai and other particularly large cities.
- Q311 net profit fell more than 98% y-o-y, implying that decreasing home sales hit the company hard.

Opportunities

- Gemdale has achieved success in boosting sales through price cuts with its project in Dachang.
- Regional expansion strategy, with reach into 16 Chinese cities.
- Strong pipeline of projects.
- Employment of strategies to improve sales whenever figures are down.

Threats

- Gemdale is vulnerable to a sustained surge in the price of building materials.
- While indications suggest a recovery is beginning, conditions remain tight for Chinese real estate.
- Vulnerable to government measures tightening the residential sector.
- Increase in taxes.

Company Overview

One of the Big Four developers, alongside **China Vanke**, **China Merchants** and **Poly Real Estate**, **Gemdale** entered the real estate industry in 1993, and was listed on the

Shanghai Stock Exchange in 2001. Its main focus has been Beijing, Shanghai and Shenzhen, but recent regional expansion has also given it a presence in another 13 cities, including Wuhan, Xian and Shenyang. Across the entire country, it has 61 projects and a land bank of around 15mn m2.

Completed projects include Shenzhen Gemdale Golden Bay Garden, Shenzhen Gemdale Honey Hill, Shenzhen Gemdale Mellon Town, Beijing Gemdale Green Town, Beijing Gemdale International Garden, Shanghai Gemdale Vision Trip, Shanghai Gemdale Green County, Wuhan Gemdale Green Town and Xian Gemdale Imperial Garden.

Gemdale has been one of the major companies to decrease home prices in a bid to increase sales. This proved successful in one of its developments in Dachang, where a decrease in price of CNY4,000 per square metre from August 2012 helped the company to sell 86 units in a seven-day period in early October.

For January/February of 2013, the company outlined plans for the commencement of new projects in the territory of Dongguan Koyama, Nanjing city itself, Nanjing Ming Wyatt, Xiaoshan Tin Yat, Shaoxing city itself, Yangzhou Arts Habitat, Changzhou skyline, Beijing Langyue Changsha 3000 House.

Financial Data

- January to December 2012, the company received contracts for an estimated 2.874mn square meters of development, a y-o-y increase of 28.5%
- Total contract amounts rose by 10.4% to CNY34.15bn.

Company Details

- Gemdale Corporation
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  Futian District

  Shenzhen

  China
- Tel: 86 (755) 8203 9999
- Fax: 86 (755) 8384 4555
- www.gemdale.com

Real estate subsidiaries in various cities and provinces:

Beijing

Floor 10 Block CHeqiao Building A 8Guanghua RoadChaoyang DistrictBeijing

Tel: 86 (10) 658 1665 5116

Fax: 86 (10) 658 17676

Shanghai

No. 12 Alley 201Fuxing RoadShanghai

Tel : 86 (21) 6433 8488

Fax: 86 (21) 6433 8201

Wuhan

Floor 13 Block CHubei Publishing Culture Town268 Chuxiong AvenueHongshan DistrictWuhan

Tel: 86 (27) 8712 9388

Poly Real Estate Group

Strengths

- A huge land owner, developer and trader.
- One of the 'big four' property developers.
- Broad diversification of interests across China, with a strong presence in and around Guangzhou, but also across a wide variety of second- and third-tier cities. Poly is also involved with projects in Beijing and Shanghai.
- State-owned as part of the China Poly Group.
- The China real estate research group has awarded the company as 'the leading brand of the Chinese central real estate enterprises' for four consecutive years.

Weaknesses

- It is not clear that the company can match its peers in terms of access to capital from global markets.
- Overly reliant on the fortunes of the Chinese market.

Opportunities

- Poly's status in the country should help it to retain sufficient sales to remain competitive.
- Strategic cooperation agreements, such as that with InterContinental hotel will help boost the company's international profile and prospects.

Threats

- Sustained cooling measures could result in a decrease in the company's sales and intensified competition in the sector.

Company Overview

Poly Real Estate Group is a diversified development company, with a focus on the design, development, construction and sale of residential and commercial properties. Within its range of property management services it also offers earthworks, interior design, air-conditioning and property management.

The company operates across the country in cities including Guangzhou, Beijing, Shanghai, Foshan, Shenyang, Changchun, Wuhan, Chongqing, Chengdu, Changsha,

Nanchang, Tianjin, Baotou, Hangzhou, and Yangjiang, all in China. According to the company website, over 18 cities are covered through 78 holding companies.

Major projects include Guangzhou Poly Garden, Poly Champagne Garden, Guangzhou Poly International Plaza, Guangzhou Poly Plaza, Poly Begonia Garden Poly Baiyun Villa and Beijing New Poly Plaza.

Company Details

- Poly Real Estate Group
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Shanghai Industrial Development

Strengths

- A major player in the Shanghai property development sector, with some interests in second-tier cities in other provinces.
- An element of Shanghai Industrial Investment (Holding) Co, a Hong Kong incorporated conglomerate owned by the Shanghai Municipality.
- Has posted five years of consecutive sales growth (2006-2011), with a total reported increment of 240%.

Weaknesses

- In spite of its links to the municipality government, it is still vulnerable to official measures to cool the Shanghai property market.
- Has a narrow range of revenue sources, conducting its business primarily inside China.
- Not all segments of the company are growing as steadily as the property sales department. In 2011, year-on-year sales fell for both the Property Management Services Division and the Services sector.

Opportunities

- Should benefit from further plans for urbanisation in China.
- Its expansion into second-tier cities is a positive factor.
- Further joint ventures with strategic investors.

Threats

- Protests in Shanghai against residential price cuts could be detrimental.

Company Overview

Shanghai Industrial Development is involved in the development, sale and management of real estate in Shanghai as well as Shandong and Henan provinces. It also undertakes domestic trading, industrial investment.

In September 2011, **Shanghai Industrial Holdings** announced that a number of its wholly owned subsidiaries would be converted into joint ventures with Tianjin-based equity investment funds. Introducing strategic investors for its subsidiaries could help

bolster the company against any potential downturn in the real estate market as a result of the government's ongoing cooling measures.

In July 2012, the company sold a property development subsidiary, **SI Properties Holdings**, to **Glorious Property** for CNY2bn.

Financial Data

For Q112, Shanghai Industrial recorded an increase in revenue of 6.6% year-on-year (y-o-y), to CNY812mn. Net profit reached CNY115mn, up 10.5% y-o-y. While modest, this increase (y-o-y and quarter-on-quarter) reflects ongoing activity for the company amid a slowdown.

For 2011 as a whole, revenue was up 8.3% y-o-y at CNY3bn. Net income increased by a much greater margin of 68.4% y-o-y, reaching CNY454.9mn.

Company Details

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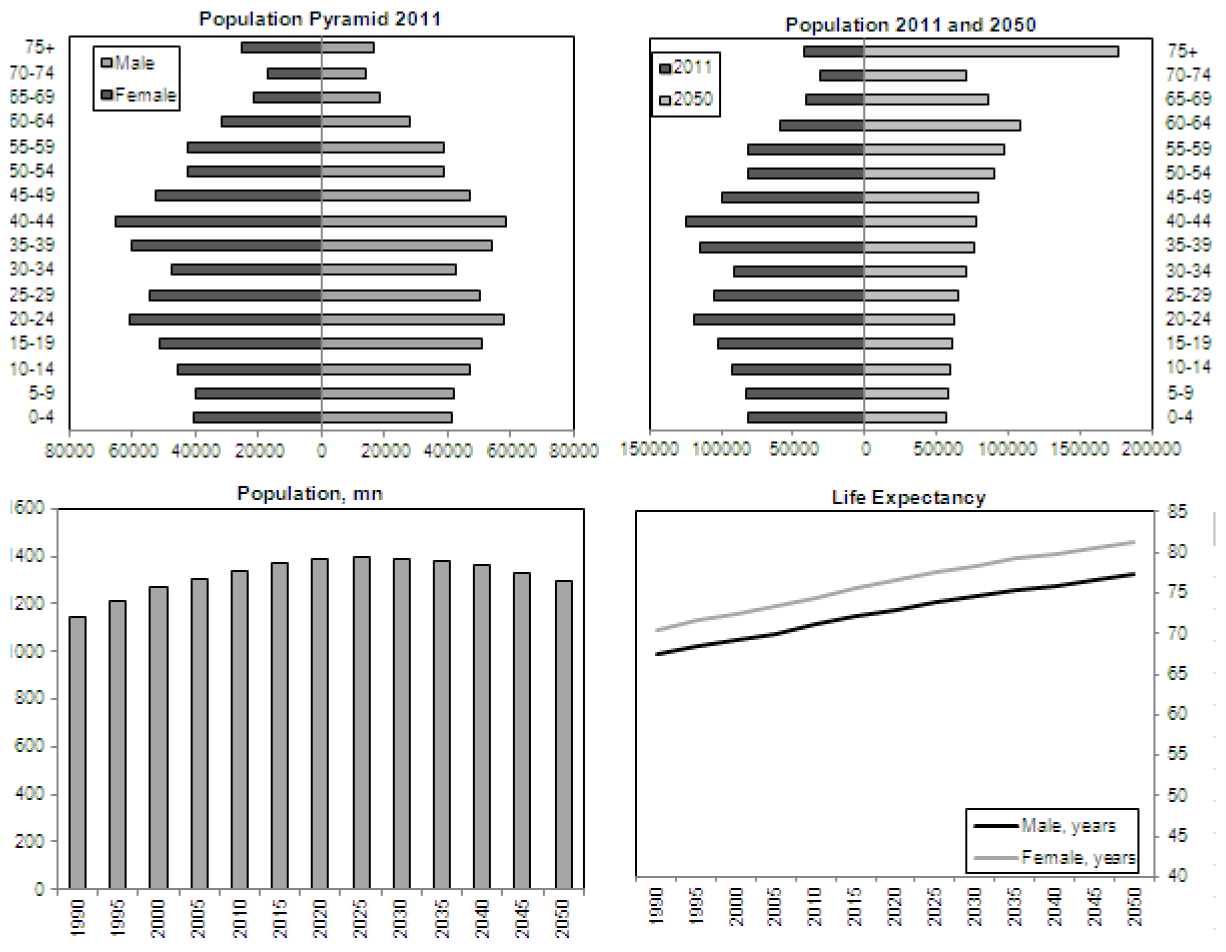
Demographic Forecast

Demographic analysis is a key pillar of **BMI**'s macroeconomic and industry forecasting model. Not only is the total population of a country a key variable in consumer demand, but an understanding of the demographic profile is key to understanding issues ranging from future population trends to productivity growth and government spending requirements.

The accompanying charts detail China's population pyramid for 2011, the change in the structure of the population between 2011 and 2050 and the total population between 1990 and 2050, as well as life expectancy. The tables show key datapoints from all of these charts, in addition to important metrics including the dependency ratio and the urban/rural split.



Source: World Bank, UN, BMI

Table: China's Population By Age Group, 1990-2020 ('000)

	1990	1995	2000	2005	2010	2012e	2015f	2020f
Total	1,145,195	1,213,987	1,269,117	1,307,593	1,341,335	1,353,601	1,369,743	1,387,792
0-4 years	122,707	106,754	96,127	84,494	81,596	81,672	78,809	72,677
5-9 years	103,264	121,619	106,035	95,549	84,050	81,209	80,771	78,387
10-14 years	94,891	102,865	121,248	105,741	95,313	90,050	83,375	80,513
15-19 years	123,279	94,524	102,512	120,767	105,348	100,091	94,622	83,064
20-24 years	126,521	122,520	93,962	101,684	119,963	116,376	104,547	94,100
25-29 years	98,781	125,547	121,633	92,956	100,759	109,676	119,005	103,714
30-34 years	85,809	97,934	124,566	120,436	92,060	91,000	99,905	117,993
35-39 years	88,064	84,961	97,051	123,321	119,321	107,823	91,356	99,095
40-44 years	63,605	86,953	83,961	95,861	121,976	124,921	118,358	90,539
45-49 years	49,145	62,456	85,502	82,563	94,424	105,416	120,520	116,934
50-54 years	45,577	47,813	60,894	83,457	80,755	82,876	92,736	118,424
55-59 years	41,692	43,641	45,919	58,604	80,619	80,882	78,321	90,179
60-64 years	33,812	38,821	40,794	43,072	55,307	64,610	76,574	74,684
65-69 years	25,923	30,068	34,662	36,589	38,998	42,117	50,691	70,509
70-74 years	19,903	21,366	24,885	28,810	30,845	31,293	33,466	43,912
75+ years	22,224	26,143	29,364	33,688	40,002	43,587	46,686	53,069

f = BMI forecast. Source: World Bank, UN, BMI

Table: China's Population By Age Group, 1990-2020 (% of total)

	1990	1995	2000	2005	2010	2012e	2015f	2020f
0-4 years	10.71	8.79	7.57	6.46	6.08	6.03	5.75	5.24
5-9 years	9.02	10.02	8.36	7.31	6.27	6.00	5.90	5.65
10-14 years	8.29	8.47	9.55	8.09	7.11	6.65	6.09	5.80
15-19 years	10.76	7.79	8.08	9.24	7.85	7.39	6.91	5.99
20-24 years	11.05	10.09	7.40	7.78	8.94	8.60	7.63	6.78
25-29 years	8.63	10.34	9.58	7.11	7.51	8.10	8.69	7.47
30-34 years	7.49	8.07	9.82	9.21	6.86	6.72	7.29	8.50
35-39 years	7.69	7.00	7.65	9.43	8.90	7.97	6.67	7.14
40-44 years	5.55	7.16	6.62	7.33	9.09	9.23	8.64	6.52
45-49 years	4.29	5.14	6.74	6.31	7.04	7.79	8.80	8.43
50-54 yyears	3.98	3.94	4.80	6.38	6.02	6.12	6.77	8.53
55-59 years	3.64	3.59	3.62	4.48	6.01	5.98	5.72	6.50
60-64 years	2.95	3.20	3.21	3.29	4.12	4.77	5.59	5.38
65-69 years	2.26	2.48	2.73	2.80	2.91	3.11	3.70	5.08
70-74 years	1.74	1.76	1.96	2.20	2.30	2.31	2.44	3.16
75+ years	1.94	2.15	2.31	2.58	2.98	3.22	3.41	3.82

f = BMI forecast. Source: World Bank, UN, BMI

Table: China's Key Population Ratios, 1990-2020

	1990	1995	2000	2005	2010	2012e	2015f	2020f
Dependent ratio, % of total working age [1]	51.4	50.8	48.1	41.7	38.2	37.6	37.5	40.4
Dependent population, total, '000 [2]	388,911	408,815	412,323	384,871	370,803	369,929	373,798	399,067
Active population, % of total [3]	66.0	66.3	67.5	70.6	72.4	72.7	72.7	71.2
Active population, total, '000 [4]	756,284	805,172	856,794	922,723	970,532	983,672	995,944	988,725
Youth population, % of total working age [5]	42.4	41.1	37.7	31.0	26.9	25.7	24.4	23.4
Youth population, total, '000 [6]	320,862	331,238	323,411	285,784	260,958	252,932	242,955	231,577
Pensionable population, % of total working age [7]	9.0	9.6	10.4	10.7	11.3	11.9	13.1	16.9
Pensionable population, '000 [8]	68,050	77,576	88,912	99,087	109,845	116,998	130,843	167,490

f = BMI forecast; 1 0>15 plus 65+, as % of total working age population; 2 0>15 plus 65+; 3 15-64, as % of total population; 4 15-64; 5 0>15, % of total working age population; 6 0>15; 7 65+, % of total working age population; 8 65+. Source: World Bank, UN, BMI

Table: China's Rural And Urban Population, 1990-2020

	1990	1995	2000	2005	2010	2012	2015	2020
Urban population, % of total	27.4	31.4	35.8	40.4	44.9	46.7	49.3	53.6
Rural population, % of total	72.6	68.6	64.2	59.6	55.1	53.3	50.7	46.4
Urban population, '000	311,040.7	378,324.5	452,026.9	526,702.9	602,259.5	631,590.1	675,283.1	743,856.3
Rural population, '000	824,144.3	826,530.5	810,618.1	777,017.1	739,075.7	722,010.6	694,459.5	643,935.3

Sources: World Bank, UN, BMI

Methodology

New Approach

This round of real estate reports incorporates a new approach. In each of the countries surveyed, we have made contact with local sources (typically major commercial real estate agents) and asked them 10 questions in relation to three sub-sectors - office, retail and industrial. We have combined the answers into the data tables and text that form part of the Real Estate Market Overview and the Industry Forecast Scenario.

In taking this 'grass-roots' approach, we believe we have ensured that we identify, in a timely fashion, key issues that will likely drive rents and yields over the short, medium and long term. We have developed a framework that facilitates comparisons between cities and sub-sectors in different countries. In developing our long-term forecasts, we have focused on net yields. Our view is that, as yields are driven by both rentals and capital values, the movements in yields provide a convenient short-hand for what is and is not expected to be happening in markets.

Our forecasts are based largely on qualitative judgements. Given that, in most of the countries that **BMI** surveys, the real estate protagonists are still dealing with the aftermath of the global financial crisis, it is questionable how valuable a quantitative approach would be. In part due to **BMI**'s own macroeconomic research and partly because of the insights gleaned from our in-country sources, we are normally able to comment in an informed way on the likely directions for rentals and capital values. Nevertheless, we recognise that we can and should refine the methodology and incorporate greater quantitative aspects over time as we accumulate more data on each of the various markets that we survey.

In mid-2012, our researchers conducted further interviews with the local sources in order to confirm details pertaining to rental levels and rental yields. In many cases, the new data has caused us to revise our forecasts for 2012-2017.

Overview

BMI's industry forecasts are generated using the best-practice techniques of time-series modelling and causal/econometric modelling. The precise form of model we use varies from industry to industry, in each case being determined, as per standard practice, by the prevailing features of the industry data being examined. **BMI** mainly uses OLS estimators and in order to avoid relying on subjective views and

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encourage the use of objective views, uses a 'general-to-specific' method. **BMI** mainly uses a linear model, but simple non-linear models, such as the log-linear model, are used when necessary. During periods of 'industry shock', for example a deep industry recession, dummy variables are used to determine the level of impact.

Effective forecasting depends on appropriately-selected regression models. **BMI** selects the best model according to various different criteria and tests, including, but not exclusive to:

- R^2 tests explanatory power; Adjusted R^2 takes degree of freedom into account;
- Testing the directional movement and magnitude of co-efficients;
- Hypothesis testing to ensure coefficients are significant (normally t-test and/or P-value);
- All results are assessed to alleviate issues related to auto-correlation and multi-co-linearity.

BMI uses the selected best model to perform forecasting.

It must be remembered that human intervention plays a necessary and desirable role in all of **BMI**'s forecasting. Experience, expertise and knowledge of industry data and trends ensures that analysts spot structural breaks, anomalous data, turning points and seasonal features where a purely mechanical forecasting process would not. Within the real estate industry, this intervention might include, but is not exclusive to, new investments across sectors, or projects getting cancelled; general investment climate and business environment changes; domestic or regional trends changing; macroeconomic indicators; and regulatory changes.

Example Of Construction Value Model:

$(\text{Construction Value})_t = \beta_0 + \beta_1*(\text{GDP})_t + \beta_2*(\text{Inflation})_t + \beta_3*(\text{Lending Rate})_t + \beta_4*(\text{Population})_t + \beta_5*(\text{Government Expenditure})_t + \beta_6*(\text{Construction Value})_{t-1} + \varepsilon_t$

Construction Industry

A number of principal criteria drive our forecasts for each construction and engineering variable:

Construction GDP And Infrastructure Spending Figures for construction GDP and infrastructure spending are based, where possible, on national accounts as published by the relevant central banks, as well as primary government/ministry sources and official data. Where these are unavailable, construction GDP forecasts are based on a range of variables, including:

- Stated infrastructure and development programmes;

- Likely increases owing to related urban or industrial sector developments;
- Political factors, such as an electorally motivated public works programmes.

Construction as a percentage of GDP is calculated using **BMI**'s macroeconomic and demographic forecasts.

Employment Within The Construction Industry These figures are forecast based on:

- The growth or otherwise of the construction industry;
- Company results and expansion plans.

Bank Lending

We assume that the growth rate for each of the three variables (assets, loans and deposits) varies over time. The growth rate in 2012 is deemed to be the actual growth rate achieved over the 12 months to the point in time for which the latest data is available. In practice, this is usually a date in late 2012. The growth rate in 2013 is assumed to be a weighted average - 80% of the actual rate achieved in the previous year and 20% of the long-term nominal rate of growth in GDP that **BMI** projects for the five years to the end of 2015. The growth rate in 2014 is assumed to be a weighted average where the respective ratios are 60% and 40%. In 2015, the ratios are reversed. In 2016, the ratios are 20% and 80%. In 2017, the three variables are assumed to increase at the annual rate of growth in nominal GDP over the five years. In effect, 2017 is the only year of the five where the actual growth of the variables achieved in 2011 has no impact on the projected growth rates.

Real Estate/Construction Business Environment Rating

BMI's Real Estate/Construction Business Environment Rating (RECBER) provides a globally comparative, numerically based assessment of the risk/return trade-off for the industry in each state covered by **BMI**'s real estate reports. In order to provide clients with a detailed assessment of this trade-off, the overall rating is made up of two distinct sub-ratings.

Limits Of Potential Returns

Evaluates the industry's current size and growth potential, and also assesses broader industry/state characteristics that may enable or inhibit the industry's development.

Risks To Realisation Of Returns

Evaluates issues within (a) the real estate sector, and (b) broader country risk vulnerabilities that increase uncertainty surrounding the stability of anticipated returns on investment into each state.

These ratings themselves comprise sub-ratings.

The 'limits' rating comprises:

- Real estate market. This evaluates industry growth/size dynamics.
- Country structure. This evaluates the broader economic/socio-demographic environment.

The 'risks' rating comprises:

- Real estate risks. This covers real estate-specific factors, including finance.
- Country risk. This evaluates the industry's broader country risk exposure.

Weighting

Given the number of indicators/datasets used, it would be inappropriate to give all sub-components equal weight. Consequently, the following weight has been adopted.

Table: Weighting Of Indicators

Component	Weighting
Limits of potential returns	50%, of which
Real estate market	65%
Country structure	35%
Risks to realisation of returns	50%, of which
Real estate risk	65%
Country risk	35%

Source: BMI

In all cases, scores are out of 100, with a higher score indicating greater potential returns (returns), or lower risks (risks).

Indicators

The following indicators have been used. Overall, the rating uses five subjectively measured indicators, and over 20 separate indicators/datasets.

Limits Of Potential Returns - Real Estate-Specific Factors

The ratings score for limits of potential returns considers four real estate-related factors, each of which is given equal weighting.

- Construction output, US$bn (previous year). Absolute size of construction sector used as proxy for size of real estate sector.
- Construction sector real growth, compound annual growth rate (CAGR) (previous year to three years hence). Indicates prospects for, and confidence in, the construction sector, and hence a proxy for prospects/confidence for real estate sector.
- Total commercial bank lending, US$bn (end previous year). Real estate projects are long term and capital intensive, with most finance obtained from commercial banks. Indicates funding availability.
- Commercial bank lending, CAGR (previous year to three years hence).This indicates prospects for the stability of finance and, implicitly, its cost. In times of crisis, this is likely to be the most volatile indicator.

Limits Of Potential Returns - Country Structure

The ratings score for limits of potential returns considers three other factors, each of which is given equal weighting.

- **BMI**'s Business Environment Rating for financial infrastructure. This captures the efficiency of the commercial banking sector - and other elements of the financial services industry - in making funding available to the real estate sector.
- Per capita GDP, US$. Higher per capita GDP correlates with the expansion of the middle classes, which are the key market for residential real estate, and the users of commercial and retail real estate properties.
- Urbanisation, % of total population living in urban areas. Urbanised states tend to be more conducive markets for real estate development, as they have deeper, more mature markets. That said, our scoring methodology views favourably less urban, or even predominantly rural, states that are characterised by persistently strong construction sector growth.

Risks To Realisation Of Returns - Real Estate-Specific Factors

The ratings score considers three factors that are directly relevant to the real estate sector. These are each given equal weighting. They are:

- Lending risks, ratio of the growth in nominal lending (ie by commercial banks to non-bank customers) to the nominal growth in GDP over a five-year period (last year to current year plus three). It is assumed that lending volumes and nominal GDP should, generally, grow at the same rate. If lending growth substantially exceeds nominal GDP expansion, this would suggest deterioration in risk standards by lending institutions. Conversely, if nominal GDP rises substantially faster than bank lending, then the cost of finance for real estate ventures is likely to rise (thereby affecting profitability).

- Financial institution confidence, change in the loan to deposit ratio over a five-year period (last year to current year plus three). This is used as a proxy for the stability of finance. Thus, a rapid decline in the ratio (ie a lending squeeze) is penalised. Conversely, we are more tolerant of a rise in lending, as in itself, this may be positive for the industry. High rates of lending growth are penalised as they could indicate an investment bubble unless the state's Country Risk Short-Term Economic Rating - a proxy for vulnerability to an economic shock - is very high.
- Real estate prices, % change y-o-y. There are a number of methodological challenges in identifying suitable proxies for real estate prices in each country. Nevertheless, where possible, we have identified a national index (usually for house prices) and assess annual growth. The rating is symmetrical, in that high growth (which indicates a bubble) is penalised, as is sharp price falls (which indicates that bubbles have been burst). Where no real estate price index is available, this indicator does not affect the overall score for this section.

Risks To Realisation Of Returns - Country Risk Factors

- **BMI**'s Long-Term Economic Rating. A measure of long-term economic stability.
- **BMI**'s Business Environment Legal Framework Rating. Denotes the strength of legal institutions in each state - security of investment can be a key risk in some emerging markets.

BMI's Business Environment Bureaucracy Rating. Denotes the ease of conducting business in the state.

Sources

Sources used in real estate reports include UN statistics, national accounts, housing and economy ministries, officially released company results and figures, trade bodies and associations and international and national news agencies.