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Economic Research Department

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Economic QuickView

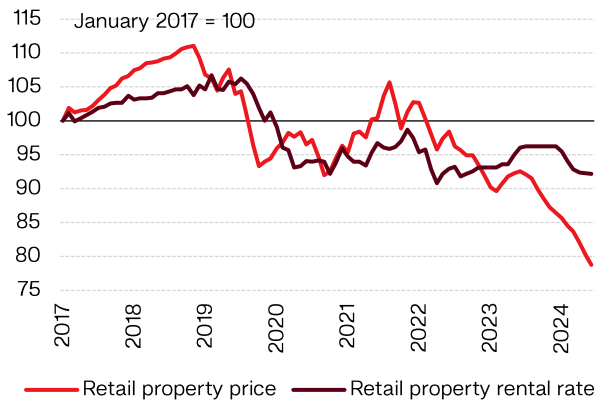
Hong Kong Retail Properties: A modest silver lining for retail property sector

- Hong Kong's retail premises have experienced a bumpy recovery amidst various challenges; however, the most challenging period is likely behind us.
- The reasons for a slow recovery included a structural shift in Mainland visitors' consumption patterns, a slow return of non-Chinese visitors, a rapid surge in outbound travel by Hong Kong residents and elevated interest rates.
- Landlords' swift adaptation, healthy demand-supply dynamics, supportive policies and a steady economic outlook support a stable outlook for Hong Kong's retail properties.

Hong Kong's retail property sector has experienced a bumpy recovery. In the post-pandemic recovery, Hong Kong's retail properties faced renewed challenges, following a brief rebound in 1H 2023. The official rental rate and price indices for private retail properties once rose by 3.2% and 0.6% in 1H 2023, respectively. The price index then went down by 6.7% in 2H 2023, with another 8.8% decline in 1H 2024, resulting in a total decrease of 14.9% from 1H 2023 to 1H 2024. Meanwhile, the rental rate index remained relatively stable, staying flat in 2H 2023 and falling by 4.2% in 1H 2024. By June 2024, both price and rental rate indices were significantly lower than their pre-pandemic levels in December 2019, showing shortfalls of 16.6% and 8.9%, respectively.

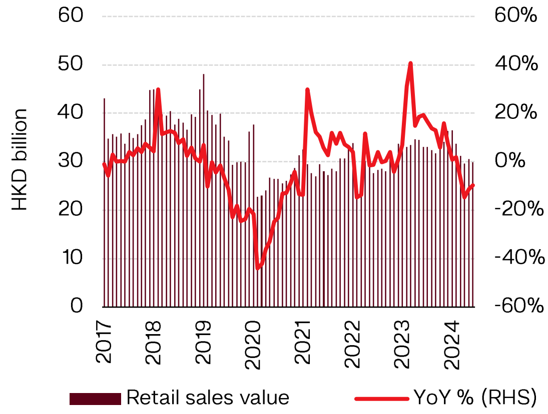
Hong Kong's retail property market is heavily influenced by retail sales performance and financial conditions, both of which have undergone notable changes. In terms of retail sales, there has been a structural shift in tourists' consumption patterns. Local residents are also spending more abroad through outbound travel and online purchases. This shift placed downward pressure on Hong Kong's retail sales in 1H 2024, after the reopening boost in 2023 faded. Additionally, high interest rates have dampened business and investor sentiment, affecting both the expansion plans of retail businesses and investments in retail properties, leading to low transactions on retail premises. The key trends affecting retail premises' performance are elaborated on in more detail below:

Retail property price and rental rate index



Source: Bloomberg

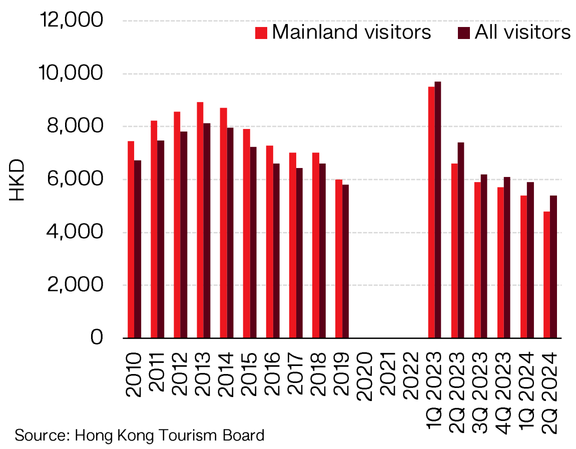
Retail sales value



Source: Bloomberg

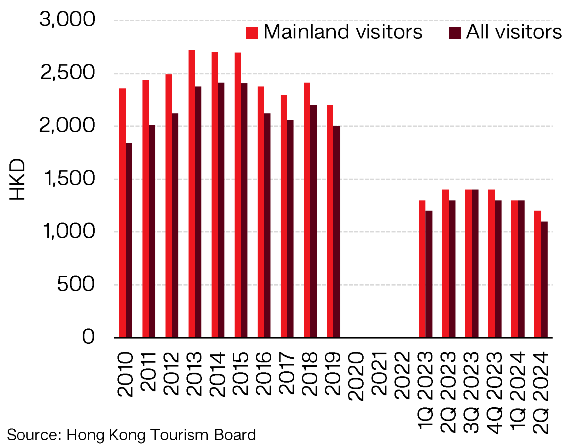
1) **Chinese Mainland visitors' consumption patterns have shown a structural shift.** While the number of Chinese Mainland visitor arrivals has recovered, their impact on retail sales has diminished as visitors' per-capita spending has softened gradually. This can be attributed to growing competition from other tourism destinations and an increase in quality supply within the Chinese Mainland. For instance, the rise of duty-free shopping zones in Hainan provides Mainland luxury shoppers with an attractive alternative. Besides, more foreign brands and retailers have established a presence in the Chinese Mainland. Together with more frequent travel to Hong Kong by Mainland visitors, these developments have diverted some Mainland visitors' spending away. Meanwhile, Mainland visitors are now opting for cultural and leisure experiences over shopping, a trend observed not only in Hong Kong but also in other Asian travel destinations. Hence, Hong Kong's retail sales recovery has been uneven. Tourist-driven outlets like department stores and jewellery & watch shops have lagged significantly, while supermarket, fuel and food sales have held up relatively well. Consequently, the rentals of high-end luxury malls fared worse than those of general retail premises. For instance, the average retail rental rate at Harbour City, one of Hong Kong's largest luxury malls, was down by 26% in 1H 2024 from its peak in 2018, notably underperforming the market average decline of 12%.

Spending per capita for overnight visitors



Source: Hong Kong Tourism Board

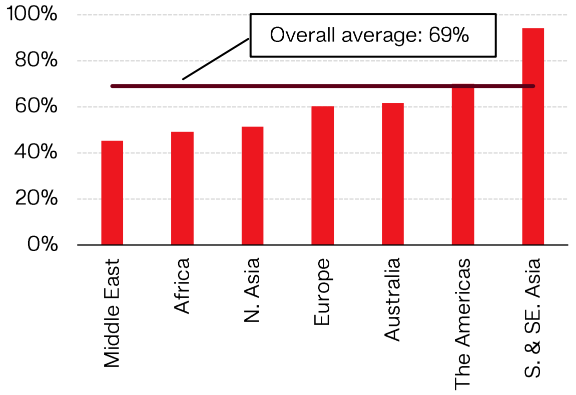
Spending per capita for same-day visitors



Source: Hong Kong Tourism Board

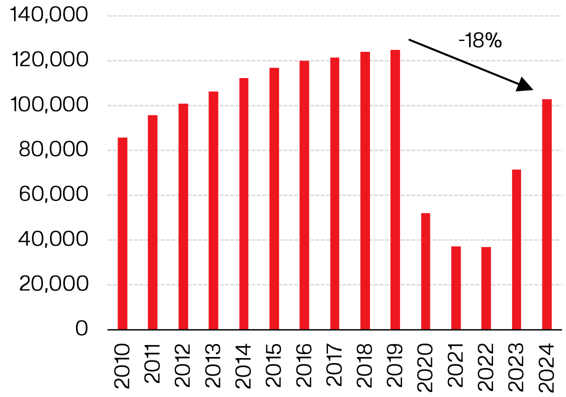
2) **The recovery of non-Chinese visitors is incomplete.** The recovery of non-Chinese visitor arrivals to Hong Kong has remained incomplete, with varying paces among the key source markets. In 1H 2024, Hong Kong's visitor arrivals from South and Southeast Asia were above 90% of their respective levels in 1H 2018, whereas those from the Americas, Europe and North Asia only recouped about 50-70%. This can be attributed to a delayed restoration of flight capacity. In the first 7 months of 2024, the number of aircraft landing in Hong Kong was still around 18% lower than that in the same period of 2019. Besides, the prevalence of video conferencing technology, a strong Hong Kong dollar (HKD), and soft business and financial market activities were also viewed as key reasons behind a lukewarm rebound in travel demand by non-Chinese visitors. This also affected the pace of retail sales recovery, with lower spending per-capita for visitors.

Non-Chinese visitors arrivals in 1H 2024 (as % of 1H 2018)



Source: Census and Statistics Department

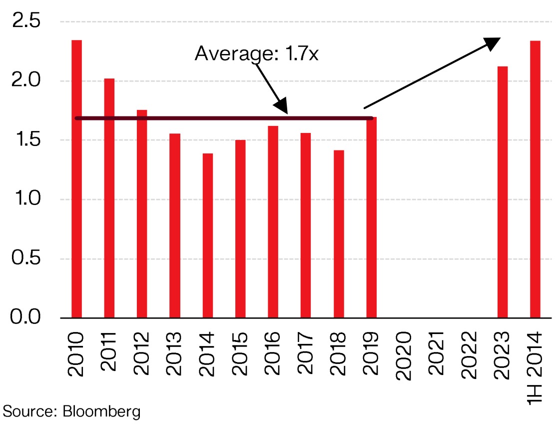
Number of aircrafts landing Hong Kong in the first 7 months



Source: Hong Kong Airport Authority

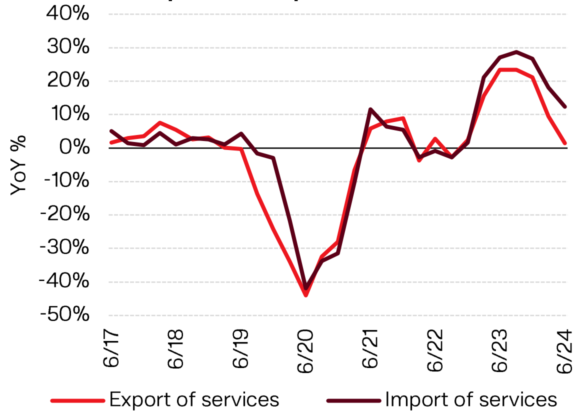
3) **Stronger connectivity with the Greater Bay Area (GBA) has led to a rapid surge in outbound travel by Hong Kong residents.** Another major factor affecting Hong Kong's retail premises has been the surge in residents' spending outside of Hong Kong. While part of this reflects the pent-up demand for travel, stronger connectivity with the GBA appears to be a critical driver and has further strengthened its uptrend. In recent years, various facilitation measures have been implemented to make it easier for Hong Kong residents to travel to the GBA, such as the commencement of passenger services at the Heung Yuen Wai Control Point in February 2023, the northbound travel for Hong Kong vehicles in June 2023, and enhanced support for e-wallet and mobile network services. Residents' outbound trips in 1H 2024 exceeded their pre-pandemic levels in 1H 2019, while visitor arrivals have yet to fully recover. Furthermore, the ratio of residents' outbound trips to visitors' arrivals grew to 2.3x in 1H 2024, far exceeding its 10-year average of 1.7x in 2010-2019. A stronger HKD exchange rate, due to its peg to the US dollar (USD), has also made spending abroad more attractive. Therefore, the growth of Hong Kong's exports of services has lagged behind that of imports during the post-pandemic recovery.

Ratio of HK residents' outbound travel to visitors arrival to HK



Source: Bloomberg

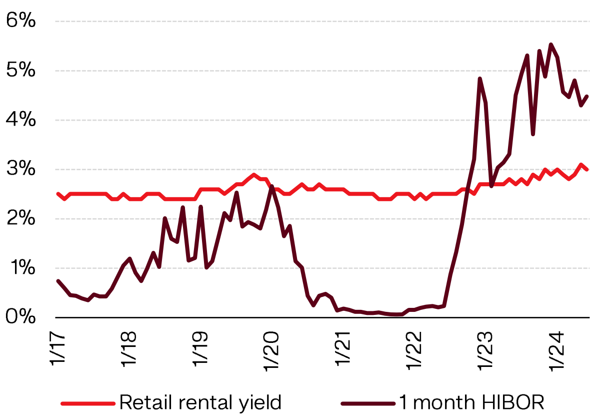
Growth in export and import of services



Sources: Bloomberg

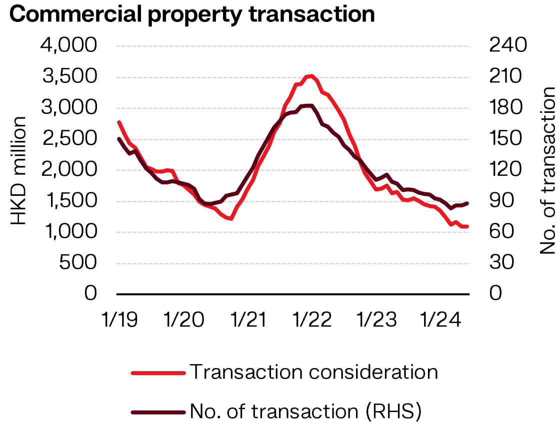
4) **Investment sentiment has been dampened by monetary tightening.** The commercial real estate sector globally has been under pressure due to aggressive monetary tightening, and Hong Kong is no exception, with HKD interest rates rising in tandem with USD interest rates. Higher borrowing costs have increased the burden on investors and businesses. Particularly, higher interest rates have resulted in a negative carry on holding retail properties (where market yields are lower than one month HIBOR rates). These factors have reduced investment demand for retail properties, leading to sluggish market activity despite the ongoing recovery in the broader economy.

1 month HIBOR vs retail rental yield



Source: Bloomberg

Commercial property transaction



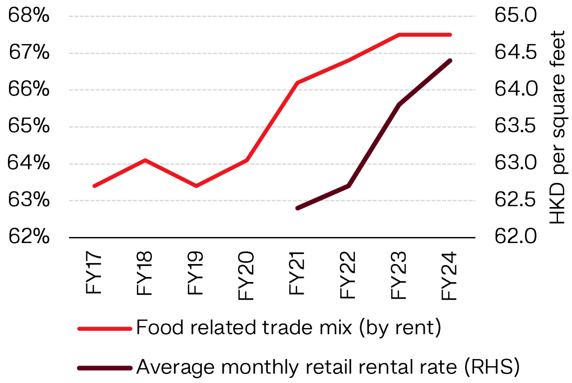
Note: Figures are adjusted as 12-month moving average
Source: Rating and Valuation Department

Despite the near term challenges mentioned above, the outlook for retail premises is set to stabilise gradually, thanks to Hong Kong's proven ability to adapt across different business cycles:

1) **Landlords are swiftly adapting to the evolving retail landscape.** Recognising shifts in consumer behaviour, landlords have adjusted their tenant mix to better meet the challenges facing the retail sector. Link REIT, the biggest community mall owner in Hong Kong, is a notable example of adapting its trade mix by focusing on the food and beverage businesses.

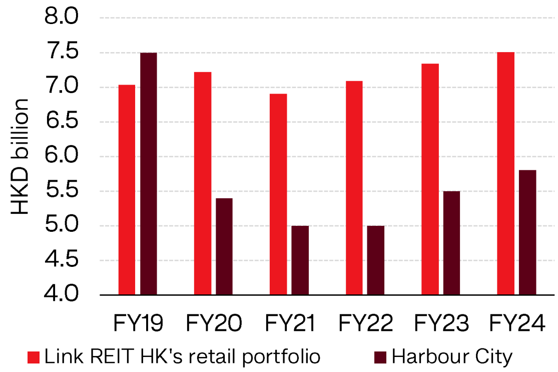
Since the financial year (FY) 2020, the food-related trade mix (i.e. food and beverage, supermarkets and foodstuffs, markets/cooked food stalls) for Link REIT has been steadily increasing to around 68% of its retail portfolio in Hong Kong, leading to an uptrend in its average retail rental rate even during the pandemic period. Furthermore, Link REIT's Hong Kong retail rental revenue has surpassed its pre-pandemic levels in FY2019 and continues to grow steadily, while high-end luxury malls like Harbour City have lagged. This showcases a successful adaptation to focus on local demand and changing consumption patterns.

Link's REIT's trade mix for food related sector and Link REIT's average monthly retail rental rate



Rental rate was restated starting from FY21
Source: Link REIT

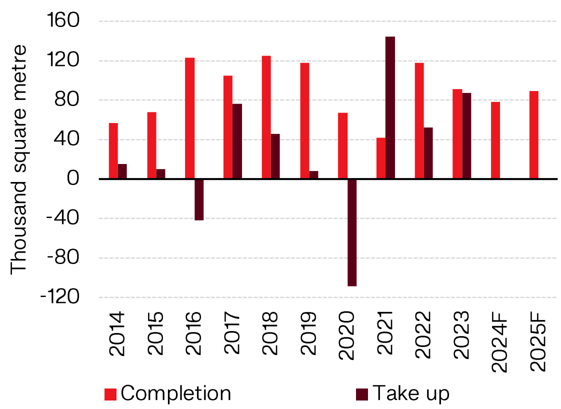
Retail rental income for Link REIT and Harbour City



Note: Anuualised figures used for Harbour City for FY24; Liink's financial year ends on 31 March
Source: Link REIT, Wharf REIC

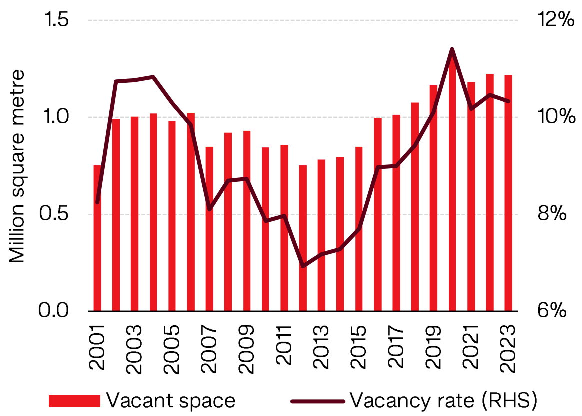
2) **Demand-supply dynamics for retail premises are becoming more balanced.** The supply of new private commercial properties (mainly retail premises) in 2024-25 is estimated to be an average of 84,000 square meters per annum, about 9% lower than its 10-year average. And, the take-up volume for private commercial properties (a net increase in occupied floor spaces) has been positive for three consecutive years since 2021. This trend indicates that demand-supply dynamics in the retail property sector are becoming more balanced.

Retail space demand-supply dynamics



Source: Rating and Valuation Department

Retail space vacancy trend



Source: Rating and Valuation Department

3) **An upcoming rate normalisation cycle is likely to improve market sentiment and boost investment.** As the US Federal Reserve is set to begin its rate cut cycle in September, the shift is likely to benefit Hong Kong's retail property market by lowering borrowing costs, reducing the negative carry on holding retail properties, fuelling new investments in business expansion, and encouraging stronger consumer spending due to improved economic conditions.

4) **The Central Government and Hong Kong SAR Government have pledged concerted efforts to unleash the economic potential of the GBA.** While Hong Kong's retail sector is experiencing outflows of consumption to other GBA cities, it can benefit from GBA's development into an international tourism hub. Given its highly developed transport network and strategic location, Hong Kong can offer overseas visitors multi-destination packages within the GBA. This could create a larger economic pie for Hong Kong and other GBA cities.

5) **A steady economic recovery in the near term, coupled with positive long-term prospects, is expected to generate new growth momentum for Hong Kong's retail property market.** Despite some unevenness in the economic recovery, Hong Kong's labour market remains resilient, with the recent unemployment rate staying low at around 3.0% and real wage growth showing a positive 1.5% YoY in Q1 2024. On balance, Hong Kong's economic growth is on track to reach the SAR Government target of 2.5-3.5% for 2024. In addition, the SAR Government is actively reinforcing Hong Kong's position as an international financial centre while also advancing its development into a global innovation and technology hub. On the business front, a steady recovery of flight connections, a pipeline of mega events and exhibitions to be held, and various talent & enterprise attraction policies are set to generate more high value-added businesses, jobs and visitors in the near future, which will benefit Hong Kong's retail sector. Furthermore, Hong Kong's role as a global gateway between the Chinese Mainland and the rest of the world has remained intact. Many international brands continue to view Hong Kong as a key location to showcase their offerings. For example, Hongkong Land and its luxury retail tenants have announced plans to invest USD 1 billion in LANDMARK, Hong Kong. Together, these drivers are anticipated to gradually generate new growth momentum for the retail property market moving forward.

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