Research & Strategy

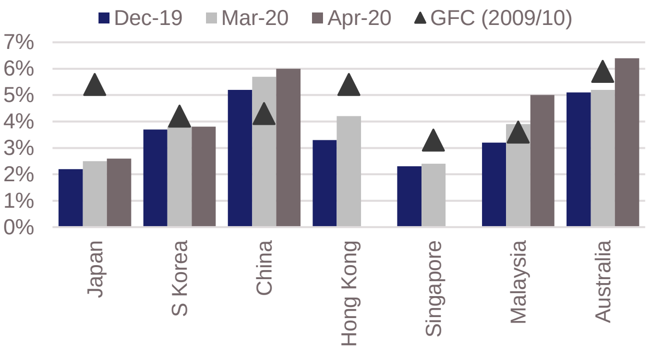
Second wave of COVID-19 unlikely to derail economic recovery

- The cost of a global lockdown has been significant, fuelling significant job losses and a sharp decline in economic output. While significant amount of fiscal stimulus and monetary policies have been introduced, global governments are under pressure to reopen the economy despite the high level of threat that a second wave of infections can pose.
- **In the event of a second wave, we do not expect global economies to go into full lockdowns again, which would derail the ongoing economic recovery. The impact from a second wave, provided it is mild in terms of pressure on healthcare systems and fatalities, is unlikely to have the same impact on the global economy and investment markets as seen a few months ago**.
- Instead, a more targeted approach such as the implementation of partial lockdowns is more likely following governments' reduced fiscal positions and 'lockdown fatigue' that may not be as effective. Lessons learned from the first wave should help mitigate any risks from the second wave with lots of testing, tracking and quarantining.
- As the global economic recovery gains traction, investors should look beyond the short-term economic disruptions by looking at market fundmentals that drive occupation demand and pricing whilst positioning their portfolios for the future. Secular trends that are able to ride out the current pandemic crisis will continue to support solid investment growth. A sustained low interest rate environment is also expected to bolster allocations to alternative assets.
- **For investors with capital to deploy, the resumption of economic activity and recovery phase points to a window of opportunity ahead as capital values re-adjust. Hence it is important to have ready capital for deployment as the period ahead represents one of the best times to invest into quality real estate.**
- **As Asia Pacific flattens out the infection curve, the region is set to lead the global economic recovery ahead of other regions. Over the next five years, the Asia-Pacific region is set to account for a greater share of global growth, which should support expectations of occupancy, rents, and returns.**

Economic recovery to face headwinds

- After a tumultuous H1 2020 since the outbreak of the coronavirus, most economies have exited out of lockdowns. Significant amounts and multiple rounds of fiscal stimulus measures and loose monetary policies, mostly targeted to minimise job losses, were introduced although unemployment figures continue to climb across most markets (figure 1).

Figure 1: Unemployment rate across key AP markets

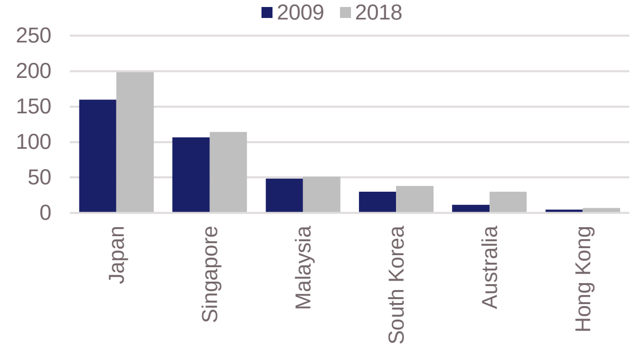


*Hong Kong and Singapore do not report monthly unemployment rates
Source: Trading Economics

- As the economy opens up to a new normal, there are concerns of a second wave emergence that may unwind the economic recovery underway. In June 2020, Beijing saw over 100 new infections emerge after two months of no cases. The latest resurgence, linked to a wholesale food market, has attracted much attention as the potential for a rebound in coronavirus cases is the biggest risk to the economic recovery in China.
- While Beijing's numbers are not huge, it can escalate exponentially given its larger population size of 21.5 million, twice of Wuhan's. However, China has enough experience with this to get testing rolled out quickly, avoiding a full lockdown and instead opting to implement partial lockdown in certain 'high risk' districts in Beijing. **A second wave of coronavirus outbreak across the region — if any — will likely be more manageable as policymakers have learnt to handle such a situation, unlike the first wave where every country was struggling to contain the contagion.**
- Despite the resurgence in cases, Asia — excluding Japan — is expected to recover quicker than other regions due to effective institutional response in economies such as China, Taiwan, Korea, and Hong Kong, where COVID-19 has gotten under control earlier. Consensus Economics expects 2020 Asia Pacific GDP growth to contract -1.2% before rebounding 6.1% in 2021.

- Nevertheless, an uneven recovery is still to be expected in the coming months, as gradual opening up of economies boosts domestic activities but an uncertain global outlook will continue to cloud prospects for export demand.
- The surge in public debt, thanks to multiple rounds of fiscal stimulus packages to mitigate sharp economic losses has also left public balance sheets in a weaker position. **As public debt continues to mount, governments are under pressure to reopen economies as soon as possible (figure 2).** Weaker sovereign balance sheets would have an impact on infrastructure spending that would inherently affect real estate capital values.

Figure 2: Public debt-to-GDP ratios (%) for key AP markets

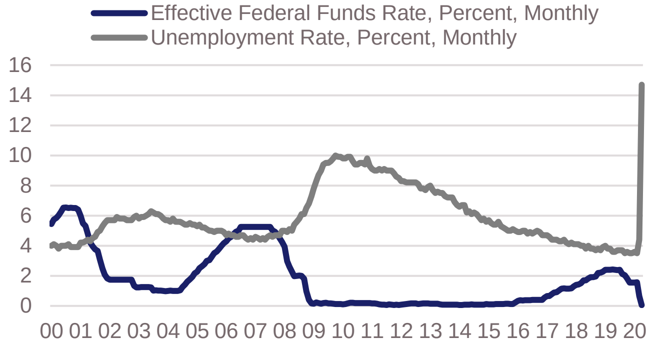


Source: IMF

Looking past short-term disruptions

- **As the global economic recovery gains traction, investors should look beyond the short-term economic disruptions by looking at market fundmentals that drive occupation demand and pricing whilst positioning their portfolios for the future.**
- Secular trends such as urbanization and rising middle class that are able to ride out the current pandemic crisis will continue to support solid investment growth.
- **It is likely that the lower-for-longer interest rate environment becomes a protracted one in view of the pandemic, which caused a sharp spike in unemployment not seen since the GFC, both globally and also in the U.S.**
- A look at the early 2000 crisis showed that it took four years before the U.S. Federal Reserve (Fed) raised interest rates after unemployment eased from 6.2% in 2003 to 4.4% in 2007. Similarly, it took about eight years before the Fed raised interest rates as the unemployment rate eased from 9.9% in 2009 to 4.9% in 2015 (figure 8).

Figure 8: U.S. Federal Reserve Fund Rate vs U.S. unemployment rate (%)



Source: Federal Reserve Bank of St Louis

- **With the current U.S. unemployment rate at 13.3% in May 2020, our view is that interest rates would remain at current levels or even lower for at least four years.** It would take much longer for the unemployment rate to gradually ease to the 5-5.5% level, at which history suggest this as the turning point for interest rates.
- **A sustained low interest rate environment is also expected to bolster allocations to alternative assets in an environment of low bond yields and volatile equity markets. Coupled with the trickling of fiscal handouts to the rest of the economy, real asset prices are expected to see some inflationary effects in the medium term.**

Important to have capital for deployment to seize upcoming opportunities

- While most economies are expected to face recessionary risks and there will be shocks to property income that will eventually lead sellers to realise losses, this decline has not happened yet. As long as the credit market does not end up like in the Global Financial Crisis, where credit was unavailable at any price, owners can delay potential losses. Thus, the probability of significant discounts in most commercial sectors is low as buying opportunities emerge in line with a resumption in economic activity.
- **The resumption of economic activity and recovery phase points to a window of opportunity ahead as capital values re-adjust. Hence it is important to have ready capital for deployment as the period ahead represents one of the best times to invest into quality real estate.**
- **Past cycles have shown that each market dislocation has historically been followed by prolonged recoveries in both rents and values, with the size and speed of that rebound determined by local demand-supply fundamentals.**
- **As Asia Pacific flattens out the infection curve, the region is poised to lead the global recovery ahead of other regions. Over the next five years, the Asia-Pacific region is set to account for a greater share of global growth, which should support expectations of occupancy, rents, and returns.**

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