Research Report, May 2022

Navigating China's politics for thematic real estate investment

Executive summary

China remains a highly centralized political regime in which President Xi Jinping has supreme authority, unlimited presidential terms and tight control over all socio-economic activity. A solid grasp of domestic politics is essential to successfully navigate real estate investment in the country, in the long term.

At the recent China Two Sessions 2022 meetings[1], the country's most important annual meeting, policymakers calibrated priorities to stabilize growth in the face of geopolitical uncertainty and renewed restrictions to curb the spread of COVID-19. Fiscal and monetary policy will be eased in the short term while some structural reforms will continue apace to cement growth momentum in the long run.

The Two Sessions, in line with the 14th five-year plan (2021-2025), doubled down on three macro themes: infrastructure investment, technological self-sufficiency and new urbanization.

These themes are expected to help reinforce long-term structural trends and policy tailwinds that benefit certain real estate sectors, despite market uncertainty and disruptions in the short term:

- Modern logistics warehouses, especially cold-chain logistics warehouses
- Data centers and business parks
- Residential private rental sector

1 The China Two Sessions meetings is the annual back-to-back assemblies of two of China's top policy bodies: the National People's Congress and the Chinese People's Political Consultative Conference. The China Two Sessions 2022 were held from 4-11 March 2022.

Image by Karin Herzog from Pixabay.com

Policy aims to **stabilize growth in 2022**

The Two Sessions are critical in providing a strategic roadmap for China's economic development and general policy direction, particularly amid heightened economic and geopolitical uncertainty and resurgent COVID-19 outbreaks.

Most importantly, the GDP growth target for 2022 has been set at 'around 5.5%' (Figure 1), the lowest in the past three decades. This growth deceleration is unsurprising as the Chinese economy has matured, with the real GDP growth rate moderating from 10.6% in 2010 to 6.0% in 2019.

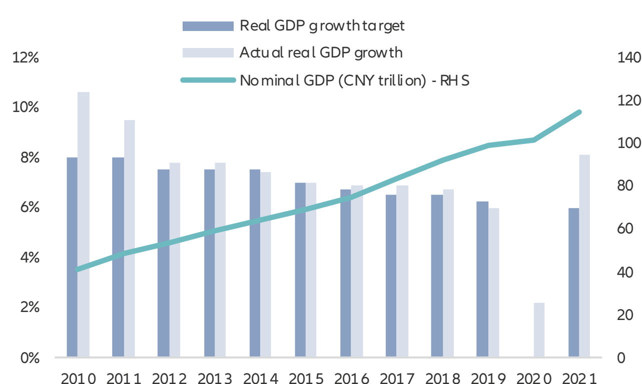
It is worthwhile noting that 1% growth in 2022, or CNY 1.14 trillion, would be equivalent to a 2% rise in 2012 when nominal GDP was just CNY 53.9 trillion (Figure 2). As a result, the 5.5% growth target for 2022 equates to approximately 10.1% in 2012, indicating significant economic progress.

Figure 1. **China's 2022 Two Sessions Economic Targets**

Major aspects	2022 target	2021 target	2021 actual
GDP growth	Around 5.5%	Above 6%	8.1%
CPI inflation	Around 3.0%	Around 3.0%	0.9%
Official fiscal deficit (% of GDP)	2.8%	3.2%	3.8%
Estimated total fiscal deficit (% of GDP)	6.4%	n.a.	5.2%
Urban job creation (m)	Above 11.0	Above 11.9	12.69
Survey-based urban jobless rate	Around 5.5%	Around 5.5%	5.1%
Total social financing (% change)	In line with normal GDP growth	In line with normal GDP growth	10.3%

Source: Oxford Economics; China State Council, 2022 Government Work Report from China's 2022 Two Sessions, March 2022; Allianz Real Estate.

Figure 2. **China's real GDP growth rate and nominal GDP***



Source: Oxford Economics; Chinese government agencies; Allianz Real Estate.
* No GDP growth target for 2020.

Image by Brownie Hsu from Pixabay.com

Policy easing to support real estate

Image by jcx516 from Pixabay.com

The 2022 Government Work Report (GWR), which resulted in targeted fiscal and monetary easing measures, was the most important policy document of the Two Sessions.

Infrastructure investments will most likely rise in tandem with the expanding quota of 2021's unused and this year's new local government special bonds.[2] Monetary stance should further loosen to support the healthy development of pillar industries including manufacturing and real estate.[3]

2 The 2022 official fiscal deficit is targeted at 2.8% of GDP, lower than the 2021 target of 3.8%. However, the official target masks expansionary fiscal measures by the Chinese government. Oxford Economics estimates the aggregated fiscal deficit for 2022, including carryover, surplus funds, cash deficit and government funds deficit, at 6.4% of GDP, reflecting a further fiscal easing.

3 For example, more cuts in interest rates and banks' reserve requirement ratio; credit growth should be in line with nominal GDP growth.

Although the GWR prioritized growth stability in the short term, structural reforms remain vital to long-term growth momentum. The transition to renewable energy, for example, is still a key long-term goal.[4] Despite no target for energy consumption per unit of GDP this year amid concerns about energy security, China is promoting an ESG campaign to attain peak emissions by 2030 and carbon neutrality by 2060.

The government's efforts to step up industrial upgrading, new urbanization and common prosperity will continue in 2022 since China has increasingly turned inward to pursue high-quality domestic growth.

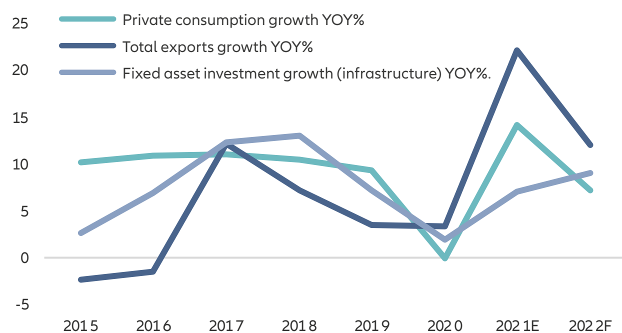
4 The 2022 Government Work Report mentioned the average concentration of fine particulate matter in big cities dropped by 9.1% while the capacity of renewable energy power generation exceeded 1 billion kilowatts.

Major macro themes to **fuel real estate demand**

The Two Sessions reaffirmed three macro themes of high policy priority and economic significance, in line with the 14th five-year plan: infrastructure investment, technological self-sufficiency and new urbanization. These themes are expected to help drive demand for certain real estate sectors.

Infrastructure investment will take center stage in 2022 as consumption and export growth are likely to soften (Figure 3), At the Central Committee for Financial and Economic Affairs meeting on 26 April, President Xi Jinping announced another infrastructural push to boost growth.[5] The GWR highlights some key areas including city-cluster intercity and commuter rail, logistics hubs and cold-chain logistics, and new infrastructure including 5G and data centers.

Figure 3. **Growth drivers rotate to infrastructure investment**



Source: Oxford Economics; Allianz Real Estate.

The GWR also includes a three-year action plan to boost the country's digital economy and innovation as part of a re-emphasis on technological self-sufficiency.[6] As China is aiming for greater digitalization, the focus has shifted to 'stuck neck' technologies in which China excessively relies on other nations, such as high-end semiconductors.

5 Cheng, E., 'China's Xi announces another infrastructure push to boost growth as Covid drags on', www.cnbc.com, 27 April 2022 (https://www.cnbc.com/2022/04/27/chinas-xi-calls-for-another-infrastructure-push-as-covid-drags-on.html).

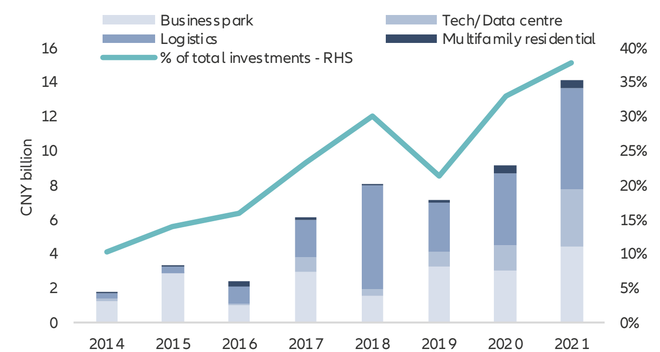
6 The three-year action plan aims to reform the science and technology management system, encourage local governments to enhance technology investment and deduct taxes for R&D spending.

Last but not least, China is accelerating its new urbanization push, with the Two Sessions insisting that "houses are for living, not for speculation". As part of the campaign, the Chinese government is advocating rental housing to tame skyrocketing housing costs.[7]

These macro themes are poised to bolster the investment case for modern logistics warehouses, particularly cold-chain logistics warehouses, data centers and business parks, and private rental sector. Meanwhile, increased ESG awareness will potentially strengthen the appeal of real estate sectors with high ESG credentials (i.e., green buildings with high levels of local or international green certification) in China.

Despite the pandemic, investments into these sectors markedly surged by 28.3% year-on-year in 2020 and 54.3% in 2021 (Figure 4). This reflects shifting investor interest and ongoing portfolio reweighting towards real estate sectors leveraging on secular demand drivers and policy tailwinds.

Figure 4. **Rising investments in new economy real estate**



Source: RCA; Allianz Real Estate.

7 Policy supports include land supply, tax incentives and financial assistance.

Cold-chain logistics warehouses in the spotlight

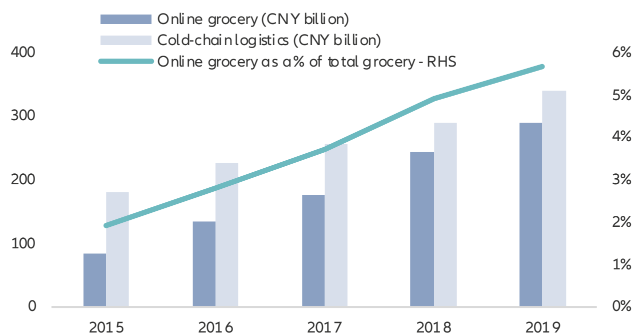
Modern logistics warehouses have thrived in China on the back of booming e-commerce and new infrastructure. The COVID-19 pandemic has reinforced these underlying trends alongside creating additional demand for logistics warehouses. Businesses have switched from a 'just in time' to a 'just in case' operating model, while consumers forced to stay indoors have increased their online activity.

Cold-chain logistics warehouses, which enable the proliferation of online grocery and cold-chain logistics to safely store and transport perishable items such as fresh food and pharmaceutical products, have become particularly sought after.

From 2015 to 2019, online grocery shopping rose at a 36.7% compound annual growth rate (CAGR) to reach CNY 289 billion, accounting for 5.7% of total grocery sales in China (Figure 5). Market penetration is projected to nearly double its 2019 level to 10.6% by 2023. Accordingly, the cold-chain logistics market is expected to grow at an 8.5% CAGR between 2018 and 2025, reaching CNY 522 billion.[8]

8 Brodie, S., 'Looking beyond COVID-19: Cold storage logistics is heating up in China', Cushman & Wakefield, May 2020.

Figure 5. **Online groceries and cold-chain logistics market**



Source: Cushman & Wakefield; Allianz Real Estate.

The availability of cold-chain logistics warehouses is limited to only 6.6 million sqm, accounting for 2.1% of China's total logistics warehouse stock as of 2019. What's more, China's cold storage warehouse space per urban capita is just 0.13 cubic meters, considerably lagging global and regional leaders, such as the Netherlands (0.96), the U.S. (0.49), Japan (0.32) and Australia (0.28).[9] This supply-demand imbalance, underpinned by secular demand drivers, could offer significant opportunities for market growth in the long run.

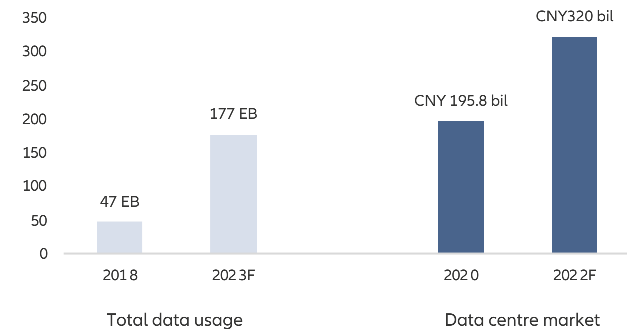
9 CBRE, *Asia Pacific Cold Storage: An Investor's Guide*, 2019.

Data centers and business parks to benefit from digitalization

Policy initiatives to expedite technological self-sufficiency, such as 'New Infrastructure' and 'Made-in-China 2025' are expected to elevate the prominence of the digital economy. The 14th five-year digital economy plan envisions that China's digital economy will account for 10% of total GDP by 2025, up from 7.8% in 2020.

COVID-19 lockdowns have led to a structural rise in online activity (e.g., cloud computing and online services such as shopping, education, healthcare and entertainment) which has buoyed data consumption and created new data center demand. Online data usage is predicted to more than triple from 2018 levels.[10] Consequently, the data center market is forecast to expand at a 27% CAGR between 2020 and 2022, from CNY 195.8 billion to CNY 320 billion (Figure 6).

Figure 6. **China's data usage and data centre market size**



Source: BCG; lit research; Minsheng Securities; Kezhi Consulting; MIIT; CICC; Allianz Real Estate.

Weighed down by land scarcity, power shortages and stringent regulation, China's data center supply is relatively constrained. The country's four tier-1 cities (Shanghai, Beijing, Guangzhou and Shenzhen) were estimated to be short of 205,000 data center racks.[11] However, supply may gradually rise as market participants are tempted by the bright growth prospects of China's digital economy.

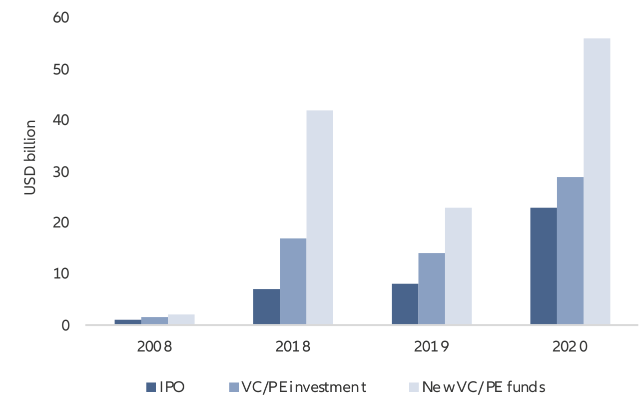
10 Boston Consulting Group, *China IDC market study*, July 2019.

11 DBS, *China Data Centre Sector*, December 2018.

Notably, as part of its digitalization plan, the Chinese government is increasingly focusing on high-value-added new economy sectors, such as technology, media and telecoms (TMT) and life sciences.[12]

Driven by the sheer weight of venture capital and strong growth trajectory (Figure 7), these sectors have kept expanding their footprints in business parks.[13] In Shanghai, for example, TMT and life sciences firms collectively accounted for 36% of leased business park space in 2021, up from 29% in 2018.[14]

Figure 7. **China life science investment activity**



Source: China Bio; Allianz Real Estate.

12 China is rebalancing its economic structure away from manufacturing towards a services-led growth model. As set out in the 14th five-year plan, new economy sectors in this context broadly refers to sectors capitalizing on modern services, advanced manufacturing and innovative technology and sciences such as healthcare, life sciences and TMT.

13 By 2021, the number of unicorn firms in China has increased substantially and ranked the country second globally, trailing only behind the U.S.

14 CBRE, *China's key business park survey 2021*, 2021.

Private rental sector to prosper on policy and market tailwinds

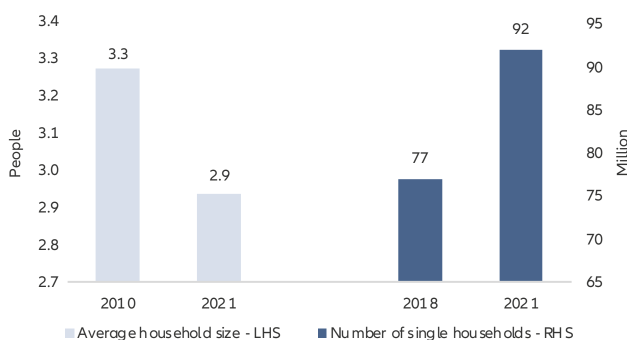
The residential private rental sector is expected to pick up more momentum as the GWR maintains an aggressive position to counter systematic financial risks in housing markets.

The government is advocating for-rent residential to speed up the new urbanization push. During the Two Sessions, the China Banking and Insurance Regulatory Commission and the People's Bank of China have pledged to provide financing and needed services to the long-term rental housing sector.

The sector benefits from a slew of socio-demographic trends including rising urban migrant mobility, shrinking household sizes, delayed marriage age, deteriorating affordability and rising home purchase requirements.

The national migrants-to-total-population ratio has nearly tripled from 9.6% in 2000 to 26.5% in 2020. Moreover, the average household size fell from 3.28 in 2010 to 2.94 in 2021 and is projected to decline even lower to 2.69 by 2030. Given rising living costs and a low fertility rate, the number of single-person households has risen by 19% from 77 million in 2018 to 92 million in 2021 (Figure 8).

Figure 8. **China's household composition**



Source: National bureau of statistics; Common population and family planning data 2002; Ministry of Civil Affairs of China; JLL; Allianz Real Estate.

Furthermore, the advent of infrastructure and logistics C-REIT markets has tremendous potential to institutionalize China's residential private rental sector by offering a secure and efficient exit path.[15] If for-rent residential C-REITs are launched, investors could be incentivized to make long-term investments into the sector and developers more eager to build.

Image by Myriam Cau from Pixabay.com

15 The first nine pilot C-REITs were listed on the Shanghai and Shenzhen stock exchanges in June 2021.

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