INTERPRETING CHINA'S 14TH FIVE-YEAR PLAN

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China's Five-Year Plan (FYP) is a medium- and long-term master plan for national economic and social development, focusing on central policy areas such as national infrastructure, the structure of the economy, and distribution of economic growth and social wellbeing.

The outlines of the 14th FYP, covering the period 2021 – 2025, (with an extended planning horizon to year 2035) was agreed at the Fifth Session of the 19th Central Plenary Session held in October 2020, with the release of *Recommendations of the Central Committee of the Communist Party of China on Formulating the 14th Five-Year Plan for National Economic and Social Development* together with *Long-Term Goals for 2035*.

Together, these communiques review the success of the targets set five years ago and present a blueprint for China's development in the coming five years and, this time, through to the next 15 years.

The 14th FYP is particularly significant, coming in the aftermath of the COVID-19 pandemic and as the world wrestles with unprecedented uncertainties. China's economy itself faces major challenges and, as the world's second-largest economy, China's planning decisions have the potential for global impact. We can draw three top-level observations from the new FYP:

- **The first to be issued since China has achieved recognition of economic middle-income country status**
- **Confirms overall planning goals of economic modernization and achieving "medium-developed" country status and a doubling of per-capita income by 2035**
- **Sets out the framework of development target indictors for the coming five-year period as the foundation towards the 2035 goals**

The structure of the 14th FYP emphasizes healthy and sustainable economic growth, leadership in technology, environmental protection and the green economy, and social stability and wellbeing. Within these areas, goals in technological innovation, new urbanization and "dual circulation" economic development, together with a reiteration of the principle that "homes are for living in, not for speculation," are all expected to bring positive impacts to China's future real estate markets.

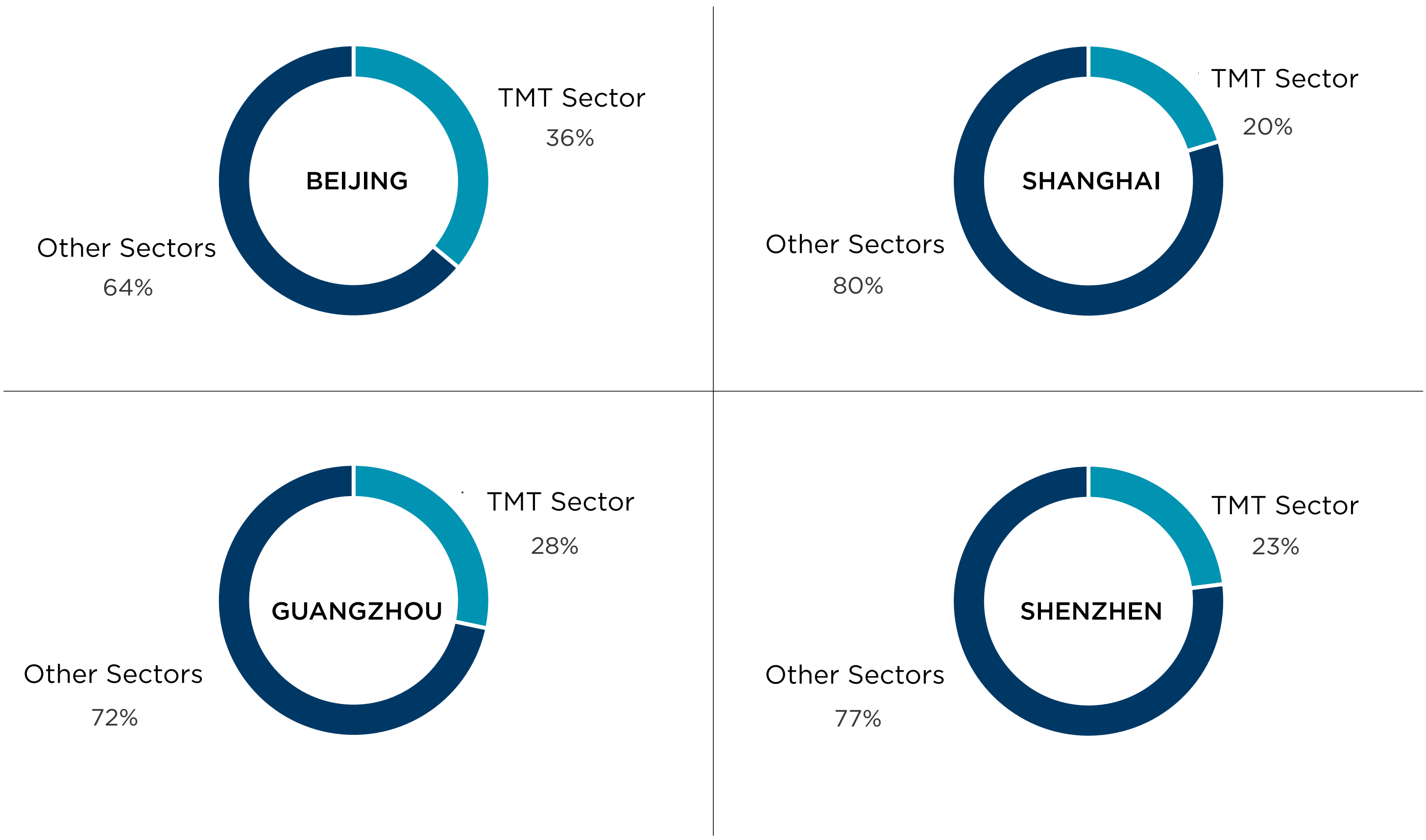
KEYWORDS: Technology and Innovation

A strong focus on technology and innovation will generate sustained future demand in the office market

The 14th FYP places more emphasis on technology and innovation than at any previous time, placing the sector front and center in China's future industrial policy. The FYP calls for "science and technology self-reliance" as a key strategic support for national development in the next five to fifteen years. Achieving "major breakthroughs in key core technologies" is a constituent of the long-term goals for 2035, with the digital economy set to play the leading role in the economy's development in the coming decade.

The prioritization of technological innovation and the digital economy is expected to provide a sustained boost to China's office property market. Cushman & Wakefield Research shows that, in the past five years, TMT sector firms have accounted for 36% of total office leasing deals in Beijing. Of the other first-tier cities, the figure is 28% in Guangzhou, 23% in Shenzhen, and 20% in Shanghai, highlighting the key role of technology industries in supporting and growing China's office real estate market (Figure 1).

Figure 1:
TMT sector office leasing deal activity as a percentage of total office leasing deals activity (FY 2016 - Q3 2020)



Source: Cushman & Wakefield Research.

We can also take positives from the impact of previous specific policy support measures. In 2015, the "Made in China 2025" directive was a cornerstone of the previous FYP. The push to grow China's overall innovation capabilities was coupled with the establishment of a technology innovation center in Beijing. The Zhongguancun technology hub district has since enjoyed a surge in demand, with vacancy remaining below 5% and overall average rents rising from RMB304.4 per sq m in Q1 2016 to RMB401.8 per sq m in Q1 2020. The 32% jump has far outstripped other business districts in Beijing (Figure 2).

In the coming five years we can expect the implementation of the 14th FYP to be accompanied by supportive local policy measures in the fields of research and innovation, helping to attract further players in emerging areas such as Industrial Internet, biotechnology, semiconductors and new energy vehicles.

Figure 2:
Rental trends: Overall Beijing Grade A office and Zhongguancun technology hub (RMB per sq m per month)

Source: Cushman & Wakefield Research.

KEYWORDS:
Dual Circulation Economic Development

Expanding domestic consumption will help drive the retail, e-commerce and logistics real estate markets

The 14th FYP maintains clear reference to the "dual circulation" economic development principle first introduced by President Xi Jinping, and we can expect the doctrine to guide the direction of China's economic planning in the coming five years. Of the two "circulation" components, the strongest focus is on the "domestic" cycle – creating jobs, raising income levels in both urban and rural populations, and continuing to boost domestic consumption. The "international" cycle, relating to economic growth derived from engagement in foreign trade and investment, plays a complimentary role.

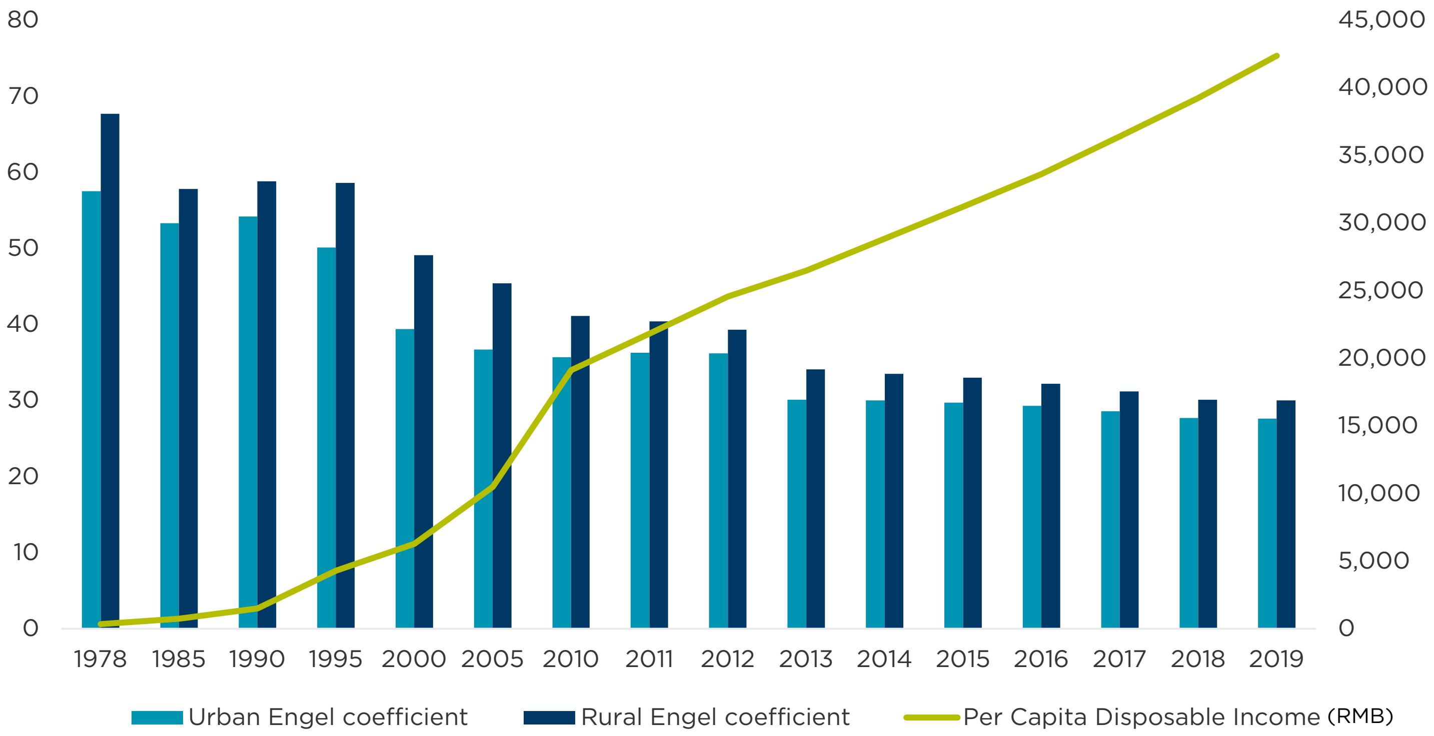
After years of sustained effort, China's economy has now turned the corner in its journey from an export-oriented model to an economy driven by domestic demand.

China's dependence on foreign trade for GDP growth has dropped from 64.25% at its peak in 2006 to 31.8% in 2019, while the contribution of domestic demand to economic growth has continued to move in the other direction. Domestic demand contributed 89% to total economic growth in 2019, of which, consumption expenditure accounted for 57.8%. Per capita GDP also exceeded US$10,000 for the first time in 2019.

These metrics indicate that China is now entering a post-industrial societal era, whereby services industries dominate economic activity. Overall disposable incomes and consumption patterns can be expected to continue on an upwards trend.

Using the Engel coefficient as a measure of the living standards of a country, China moved into the "wealthy" category in 2019, according to the structure recognized by the United nations, with its Engel coefficient dropping to 28.2%, according to the National Bureau of Statistics (Figure 3). To put this into context, non-food consumption in China has risen from 42.5% in the early stages of reform and opening up, to more than 72% in 2019. The change reflects China's economic development, rising income levels and growing disposable income in areas such as beauty and healthcare, lifestyle, tourism, education and luxury items.

Figure 3:
Trend of Engel Coefficient in China's urban and rural areas



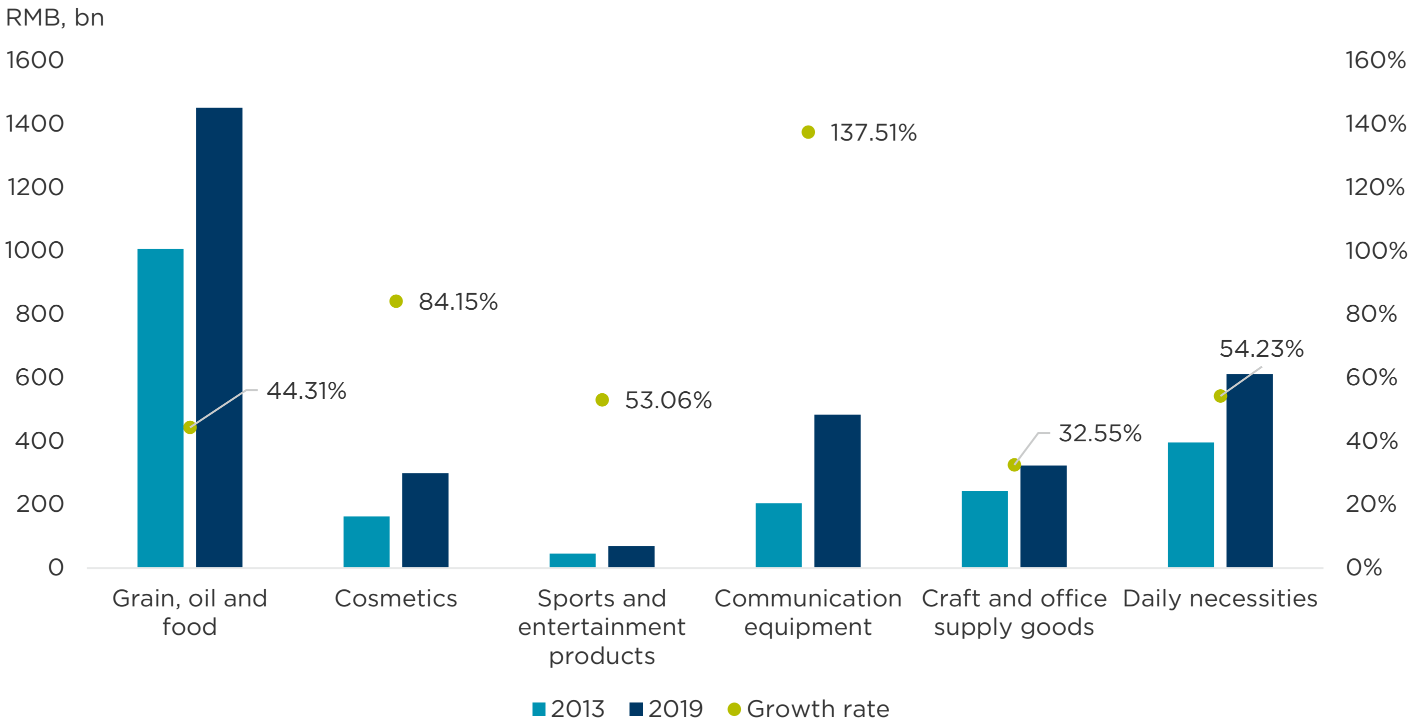
Source: National Bureau of Statistics

National Bureau of Statistics data show that consumer spending on cosmetics products in China rose more than 137% in the period from 2013 to 2019. Sales of communications electronics rose 84% in the same period, with spending on daily necessities up 54.% (Figure 4).

Overseas travel by Chinese citizens has also exploded. Outbound travelers recorded 162 million trips in 2019, up more than 28 times since the year 2000, according to the Ministry of Culture and Tourism.

Growth in incomes and the desire to enjoy overseas travel have driven a surge in luxury goods consumption at home and abroad by Chinese nationals, reaching RMB770 billion in 2018, according to McKinsey, accounting for one-third of total global luxury goods consumption. Forecasts show this figure rising to RMB1.2 trillion by 2025, taking a staggering 65% share of worldwide luxury goods spending.

Figure 4:
Retail sales and growth rates of goods categories



Source: National Bureau of Statistics

The significance extended to "domestic cycle" economic growth in the 14th FYP, and consequent proactive measures to boost domestic demand and support consumer spending, bode well for the retail sector ahead. Although hit extremely hard by the COVID-19 pandemic in 2020, the effective containment of the coronavirus domestically has allowed shoppers to return to stores and for the sector to commence recovery. Post-pandemic, consumption in some areas has rebounded sharply, led in part by the "revenge shopping" phenomenon. High-end restaurants and luxury goods have taken the lead in the recovery, although many shopping malls in major markets have seen vacancy rates rise in the aftermath of the pandemic.

Mall operators have taken the opportunity to adjust and upgrade tenant mixes to better meet trends in demand among millennials (generally the most active shopper demographic) and in the coming FYP period we can also expect to see accelerated progress in O2O, omnichannel marketing, and New Retail formats.

The pandemic also gave further impetus to the growth of e-commerce. Online retail sales of consumer goods rose to a 29% share of total retail sales by September 2020. The roll-out of 5G networks and continual expansion of e-commerce applications and platforms will only further push this figure upwards, with a knock-on effect in supply chains and, specifically, the logistics real estate sector.

Asia's largest warehouse developer, GLP, reports that leased area taken by e-commerce customers accounted for 40% of their total global leased area by the first half of 2020, compared to 20% - 25% just five years ago.

In China, we can confidently expect the growth of e-commerce to rise within the coming FYP period, with subsequent implications for rising demand in the logistics market and investor interest in logistics real estate.

KEYWORDS:
New Urbanization

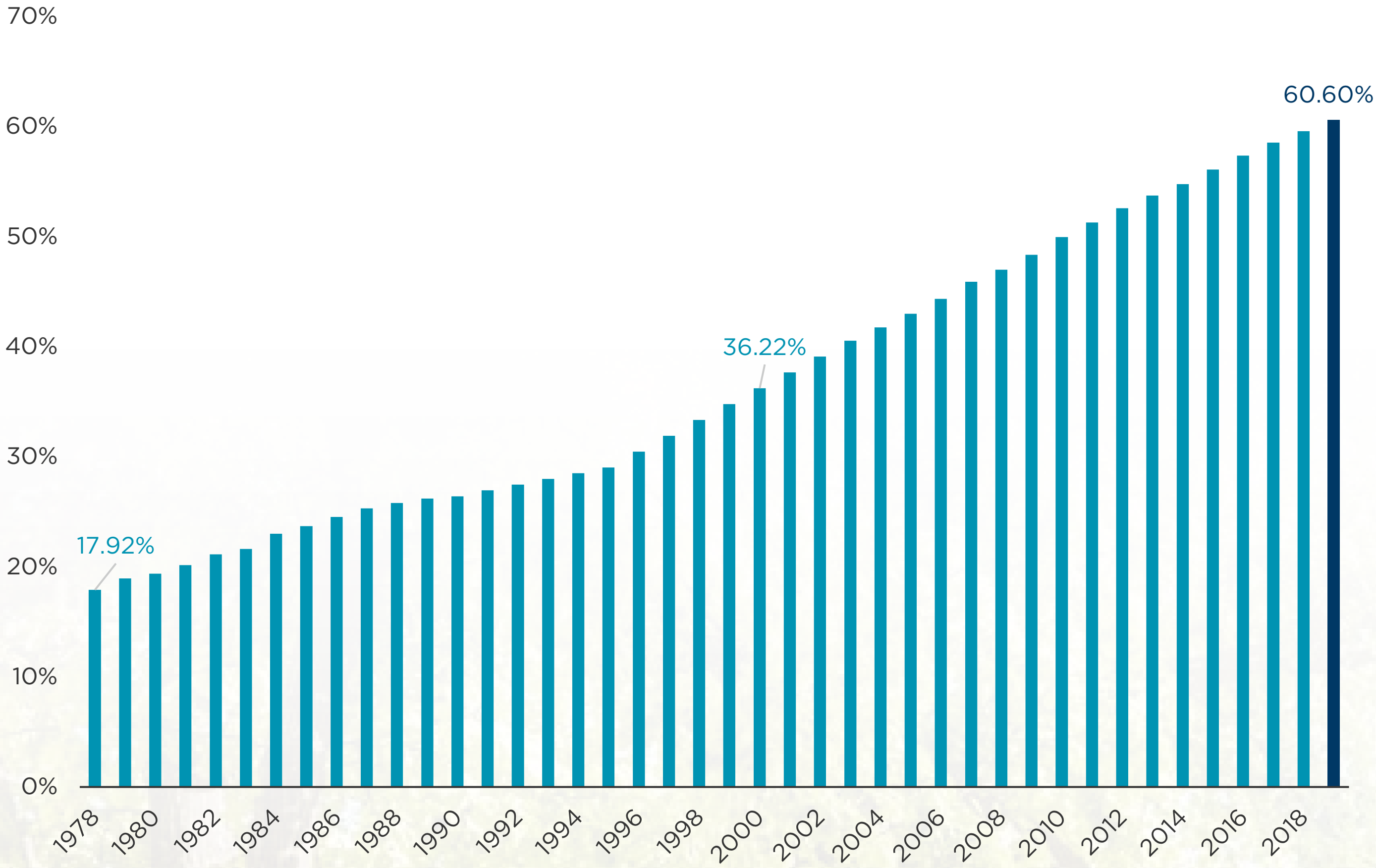
Urbanization will remain an important driver of economic stability and long-term development

China's urbanization rate surpassed the 60% milestone in 2019 to reach 60.6%, a rise of 24 percentage points since the year 2000 (Figure 5). In the past decade, an average of 17.86 million people have moved from rural areas into cities every year. The 14th FYP does point to an adjustment in strategy, with a lower rate of continuing urbanization to prevail, possibly to give pause for thought following the experience of the COVID-19 pandemic.

However, there is still considerable room for growth to achieve the eventual target of a stable urbanization rate of 70%. A likely scenario could still see 16 million people moving to cities every year.

Under this premise, city renewal and the planned implementation of inter-provincial urban agglomerations and city clusters will be a key development trend. Infrastructure networks such as transportation and communications will become more well-connected, while bigger labor markets and improvements in productivity and innovation will bring greater economic opportunities for core cities. These factors will be significant for real estate in China, stimulating further development of office, retail, logistics and residential markets across core cities.

Figure 5:
China's urbanization process



Source: National Bureau of Statistics

KEYWORDS:
Homes Are for Living in, Not for Speculation

The 14th FYP reiterates the guiding principle that homes are for living in and not for speculation, with policy orientated towards continuing to stabilize city-level housing markets and to support balanced development of the real economy. The mantra of "housing, not speculation" has been repeatedly emphasized at central government meetings since the 19th National Congress of 2017, and is considered as testament to the government's determination to eliminate dependence on the real estate market to stimulate economic growth.

Real estate has made an unquestionable contribution to China's economic development over the past two decades. However, it is also true that soaring home prices have drawn huge volumes of funds into the market, while consumers have been impacted by high prices and mortgage payments pressure. By insisting on the principle of "housing, not speculation" the central government is aiming both to suppress potential new property bubbles at the city level, and to free up consumer spending outside of housing costs.

We expect to see continuing government oversight of the market in the coming period. Specifically, supervision or control of real estate companies' financing and monetary stability will continue, with a recognition that the high-leverage, high-turnover and high-growth model of the past is no longer sustainable. Instead, firms will shift to less aggressive, more stable and higher-quality growth, with further stress-testing and risk mitigation measures in place. This environment is also likely to inhibit further growth prospects for small and medium-sized players, and lead to further consolidation within the industry.

Finally, as living standards continue on an upwards trend and consumer expectations rise, real estate firms will be obligated to respond to demands for higher quality in residential projects, improving both the product quality and their property management capabilities.

SUMMARY

The 14th Five-Year Plan sets out the vision for China's development in the next five years and through to 2035. It comes as China has reached economic middle-income country status and as the world faces a complex and uncertain future.

In industrial policy, the plan puts the strongest focus yet on technology and innovation, calling for self-reliance in science and technology in support of national development. This national policy level drive can be expected to generate a sustained boost in China's office property market.

The plan also formalizes the principle of "dual circulation" economic development and highlights the importance of "domestic cycle" economic growth towards long-term national development. Proactive measures to boost domestic demand and support consumer spending bode well for the retail sector ahead, with positives for the retail, e-commerce and logistics real estate markets.

Looking ahead, continued urbanization nationwide and the planned development of urban agglomerations and city clusters will continue, stimulating demand in office, retail, logistics and residential markets.

However, change in the real estate environment is also apparent. Adherence to the doctrine of "housing, not speculation" is designed to rein in residential real estate markets and help liberate consumer spending from the yoke of high housing loan payments. Real estate firms, meanwhile, are braced for an extended era of state oversight and financial regulatory scrutiny, thwarting business expansion potential for smaller firms and leading to further consolidation within the industry. As well, real estate firms must prepare to upgrade their residential product offerings and property management capabilities in response to rising consumer demands and expectations.

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