PROPERTY INSIGHTS

Kuala Lumpur | Quarter 2, 2018

Short term pain for long term gain; post-election euphoria

Market Overview

- Malaysia's GDP growth moderated to 5.4 per cent in Q1 2018. Improved labour market conditions and lower inflation have contributed to stronger consumer confidence. Policy uncertainties are likely to prevail in the short term, amid the unprecedented victory of Pakatan Harapan in the 14th General Election on 9 May 2018 after 61 years of rule under Barisan Nasional.
- Average monthly rents remained unchanged at RM5.98 per square foot (psf), with average capital value of RM875 psf.
- Occupancy of malls in Kuala Lumpur (KL) remained stable at 86.0 per cent quarter-on-quarter (q-o-q) in Q2 2018.
- Prices for high-end condominiums increased marginally by 4.4 per cent q-o-q to RM784 psf with rents declining by 6.3 per cent q-o-q to RM2.77 psf per month.

The Economy

Key Highlights in Q2

- Malaysia's economy expanded by 5.4 per cent year-on-year (y-o-y) in Q1 2018 (Q4 2017: 5.9 per cent y-o-y).
- Unemployment rate decreased marginally to 3.3 per cent in Q1 2018.
- Headline inflation, measured by the annual change in Consumer Price Index (CPI), trended lower at 1.8 per cent in Q1 2018 (Q4 2017: 3.5 per cent).
- Consumer Sentiment Index (CSI) rose higher to 91.0 in Q1 2018 from 82.6 in Q4 2017.
- In Q2, the Ringgit depreciated by 3.0 per cent, to RM3.98 per US dollar.

Market Commentary

Malaysia's GDP recorded a growth of 5.4 per cent y-o-y in Q1 2018, compared to the 5.9 per cent in Q4 2017 (Figure 1). On a q-o-q seasonally adjusted basis, the economy expanded by 1.4 per cent.

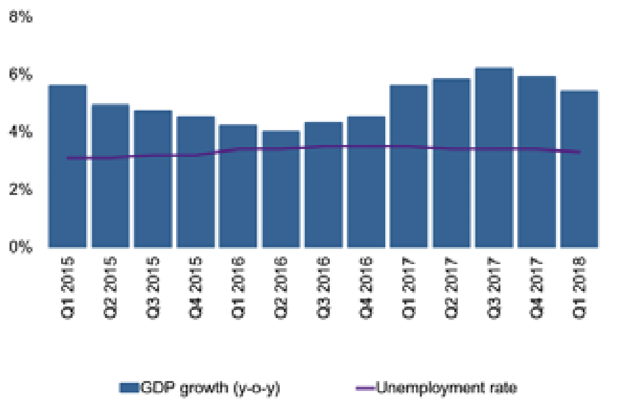
Domestic demand continued to grow, albeit at a slower pace of 4.1 per cent compared to 6.2 per cent in Q4 2017. This was due to the moderate growth in private sector spending and a marginal decline in public expenditure.

On the supply side, growth was driven by the services sector which rose 6.5 per cent y-o-y, followed by the manufacturing (5.3 per cent), construction (4.9 per cent), agriculture (2.8 per cent) and mining (0.1 per cent) sectors.

Headline inflation trended lower at 1.8 per cent. This can be attributed mainly to the lower inflation recorded in the transport sector, as the stronger Ringgit offsets the impact of higher global oil prices in Q1. According to Bank Negara Malaysia (BNM), headline inflation for 2018 is projected at 2.0 to 3.0 per cent, depending on global oil prices.

Figure 1

Malaysia GDP growth and unemployment

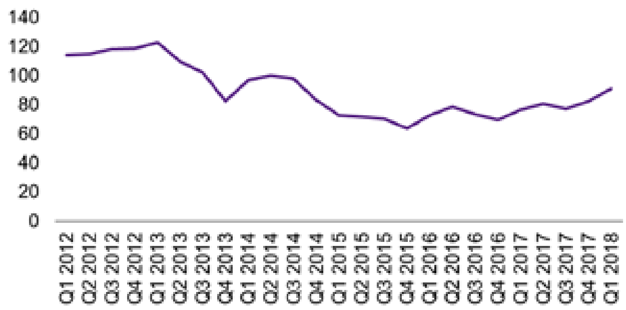


Source: Bank Negara Malaysia, Department of Statistics Malaysia, NTL Research

Given the sustained domestic demand, short-term uncertainties are unlikely to derail the long-term growth prospects.

Figure 2

Consumer Sentiments Index



Source: Malaysian Institute of Economic Research, NTL Research

There was a slight improvement in the labour market in Q1 2018, as net employment gain outweighed the expansion of labour force, resulting in lower unemployment rate of 3.3 per cent from 3.4 per cent in Q4 2017.

The lower inflation and stable labour market have contributed to the rise in consumer confidence, as evidence by the growth in the CSI (Figure 2).

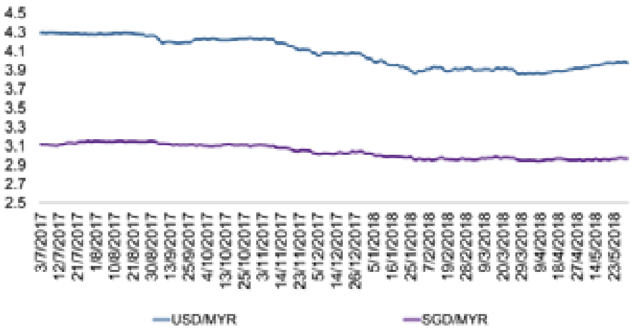
Between 30 March and 31 May 2018, the Ringgit depreciated against the US dollar by 3.0 per cent (Figure 3). While the higher crude oil prices and sustained economy provide upside potential for the Ringgit, its future growth will also be dependent on the economic policies of the newly-elected Pakatan Harapan Government.

Outlook

For 2018, BNM forecasts the GDP to grow by 5.5 to 6.0 per cent. Economic outlook remains positive, despite concerns on policy uncertainties posed by the election results and cutbacks on mega infrastructure projects, announced as well as under review.

Figure 3

Malaysian Ringgit Exchange Rate



Source: Bank Negara Malaysia, NTL Research

Residential

Key Highlights in Q2

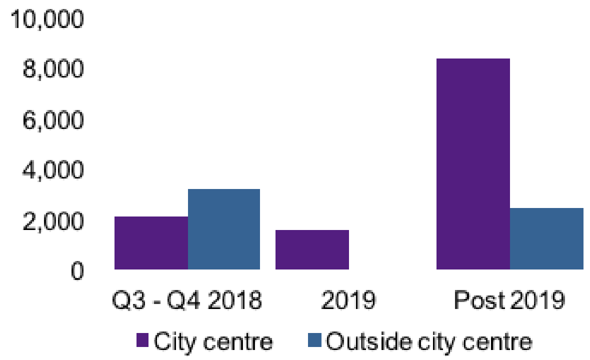
- Two developments were completed in Q2 2018, bringing a substantial new supply of 1,168 condominium units into the market. The two developments are The Fennel in Sentul East (916 units) and Dorsett Residences in Bukit Bintang (252 units).
- Some 5,260 high-end residential units are expected to complete in H2 2018, of which 40 per cent will be in the city centre (Figure 4).
- The price of high-end condominiums increased by 4.4 per cent q-o-q to RM784 psf (Figure 5).
- On the other hand, rent eased by 6.3 per cent q-o-q to RM2.77 psf in a competitive market lacking tenant demand.

Market Commentary

In its election manifesto, the new Pakatan Harapan Government has pledged to address critical issues pertaining to the local property market. Among its promises is to build one million affordable homes in the first two terms as a Government. The Government has also pledged to introduce a special housing loan scheme to encourage youths to buy their first home. These initiatives will likely increase number of transactions and encourage more affordable housing projects by both public and private sectors.

Figure 4

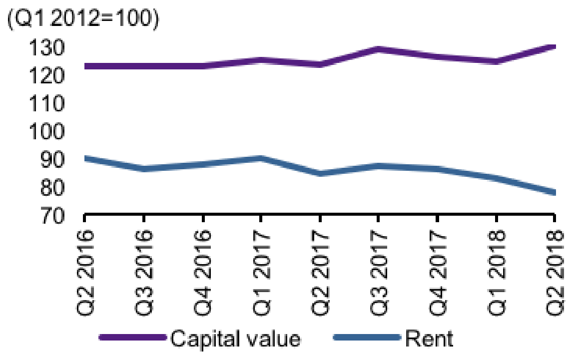
Future supply of high-end condominiums in Kuala Lumpur



Source: NTL Research

Figure 5

Rental and price indices of high-end condominiums in Kuala Lumpur



Source: NTL Research

The zero rating of the GST made effective on 1 June 2018 will lower prices in the medium term and is expected to boost buyers' confidence and overall market sentiment. The GST implementation required developers to consider the GST on input costs, resulting in an increase on overall development cost that was passed on to the buyers.

In the latest release by the National Property Information Centre (NAPIC), as of Q1 2018, the cumulative unsold completed residential units (including serviced apartments and SOHOs) has increased significantly by 55.7 per cent y-o-y, to 34,532 units worth RM22.26bn as compared to 22,175 units worth RM13.27bn in 2017. Overall, across all price segments of units launched, a third remain unsold, of which properties priced between RM500,000 and RM1.0m had the largest share of launched units.

Weak market sentiments coupled with several factors including stringent financing policies, supply-demand mismatch and locational factors, have attributed to the increase of unsold units.

The new ruling Government is expected to bring more changes that could benefit the overall housing market.

Outlook

Meanwhile, it is still too early to assess the impact of the new Government change toward the overall housing market in Malaysia. Market players are interested to witness how the new Government will realise its pre-election promises. Issues that are critical to the property market such as affordable housing and multi-billion-ringgit infrastructure projects have been featured remarkably in the Government's manifesto.

The industry is expecting a positive outlook provided that the economy can be managed well. The Government's decision to scrap the Kuala Lumpur-Singapore high-speed rail (HSR) and the Mass Rapid Transit 3 (MRT3) projects has been praised as one of the best actions to save country from unsustainable debt, although this will impact on property projects served by the proposed lines. With the new Government, more policies relating to housing will likely to be reviewed and this will bring uncertainties to the market in the short term.

Retail

Key Highlights in Q2

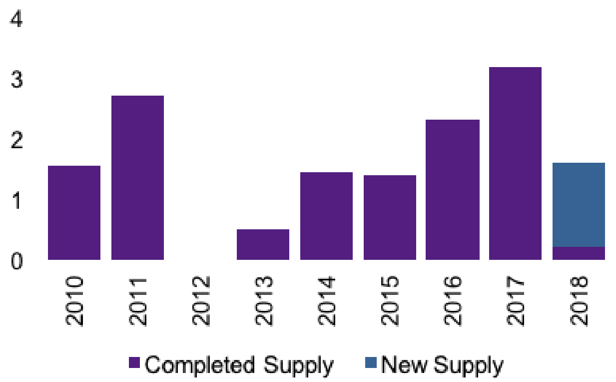
- Retail sales recorded a modest growth of 2.6 per cent for Q1 2018.
- Total retail stock in KL rose to 31.1m sq ft with the opening of Shoppes at the Four Season Place in May. Meanwhile, stock outside KL remained at 31m sq ft (Figure 6).
- Retail mall occupancy in KL lingered at 86.0 per cent.

Market Commentary

The CSI surged by 8.4 points to 91 during Q1 2018, backed by stronger than expected GDP growth. Despite staying below the 100 points threshold, the Index in Q1 2018 was the highest since late 2014. The CSI improved in the last three consecutive quarters, signifying a revival of optimism.

Figure 6

Retail new supply (NLA) in Kuala Lumpur, sq ft (million)



Source: NTL Research

Retail sales in Q1 2018 recorded a lower-than-expected growth of 2.6 per cent. Growth declined by more than half of the forecast of 5.4 per cent. With spending to remain cautious during the quarter, the festive Lunar New Year season failed to lift retail sales.

The change in Government is expected to improve consumers' confidence in the economy and in turn lead to higher expenditures. As part of its election manifesto, the new Government has zero-rated Goods and Services Tax (GST) for an interim period of three months, from June to August, en-route to abolish the widely detested levy.

The plan to abolish the GST is expected to positively impact the retail industry. Sales and Services Tax (SST) is being reintroduced and will likely to take effect in September with unforeseen effects.

Zero-rated GST coupled with the biggest festive season of Hari Raya are stepping stones for improved retail sales.

Table 1

Selected upcoming retail malls in Klang Valley

Name of development	Est area (NLA, sq ft)	Location	Est year of completion
Empire City Damansara	2,500,000	Selangor	2018
Tropicana Gardens Mall	1,000,000	Selangor	2018
Central Plaza @ i-City	1,000,000	Selangor	2018

Source: NTL Research

On new completions, the city centre welcomed the opening of Four Seasons Place, located at the heart of Kuala Lumpur. The 65-storey tower comprises hotel, residence, and retail. The retail podium, Shoppes at the Four Seasons Place, comprises 200,000 sq ft of retail space is largely occupied by Robinsons; a department store with presence in both Malaysia and Singapore.

Outlook

Looking ahead, retail sales for Q2 2018 is expected to expand by 6.3 per cent, in anticipation for the festive Eid season. Sales for Q3 and Q4 2018 are expected to grow by 6.8 and 3.5 per cent respectively. Overall, for 2018, a growth of 5.3 per cent is anticipated.

Office

Key Highlights in Q2

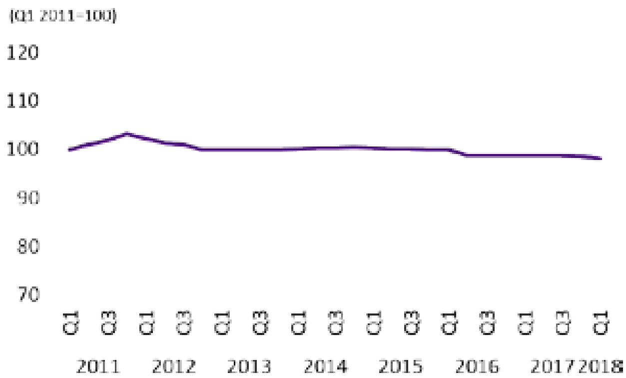
- There were no new completions in Q2 as the bulk of new completions for 2018 are expected in H2 2018.
- Capital value and average monthly rental rates remained at RM875 psf and RM5.98 psf respectively (Figure 7).
- Average occupancy rates remained flat at 80.0 per cent with no major upside in demand as businesses continue to be cautious with emerging external risks such as a trade war (Figure 8).

Market Commentary

In the run up to the 14th GE, less activities were recorded with an unchanged average occupancy rate of 80.0 per cent. Despite having no completions in the quarter, approximately 4m sq ft Net Lettable Area (NLA) of office space is expected to be completed in H2 2018, including Etiqa Bangsar (380,000 sq ft NLA), Equatorial Plaza (460,000 sq ft NLA) and The Exchange 106 (2.6m sq ft NLA) (Figure 9).

Figure 7

Prime rental indices – Kuala Lumpur



Source: NTL Research

In Q2, the average monthly rent for prime office remained unchanged at RM5.98 psf while the average monthly rent for secondary space eased further to RM4.14 psf from RM4.20 psf in the previous quarter. Capital value was stable at RM875 psf, while the yield maintained at 6.25 per cent.

Businesses are generally adopting a wait-and-see attitude on the back of policy uncertainties.

Since the GE on 9 May, the new Pakatan Harapan Government has been reviewing all mega projects, with the possibility that some of the major planned office developments in KL, especially those linked to GLCs, will be affected given public debt level concerns. The controversial TRX project, KL new international financial hub, will continue.

The opening of Alibaba's first regional Southeast Asia office in KL at Bangsar South could help jumpstart the emerging e-commerce sector in Malaysia in conjunction with the Digital Free Trade Zone (DFTZ) which is also involved in KLIA.

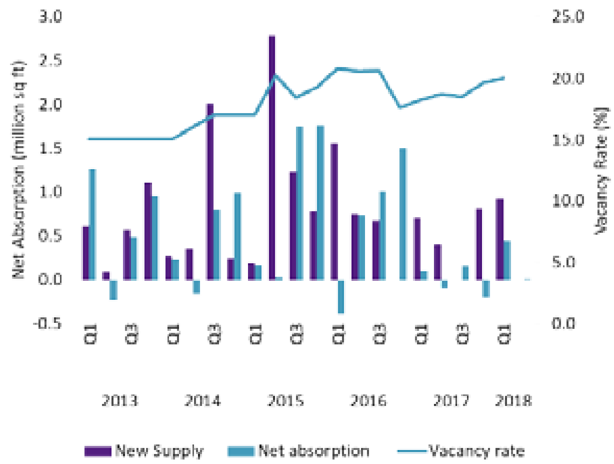
Outlook

The office market in KL is expected to remain challenging in H2 2018 as there are currently no major catalysts to boost demand in the short-term to meet the new supply of close to 4m sq ft NLA of office space by end 2018. Concerns on policy uncertainties are likely to hold investors in the short-term.

Notwithstanding, rising oil price is leading to more activities and projects in the office market. Hopefully, this can be translated to newer spaces in due course, after the recent spate of consolidation. Confidence in the new Government to boost economic growth and attract foreign direct investments are likely to produce a positive outlook in the medium term.

Figure 8

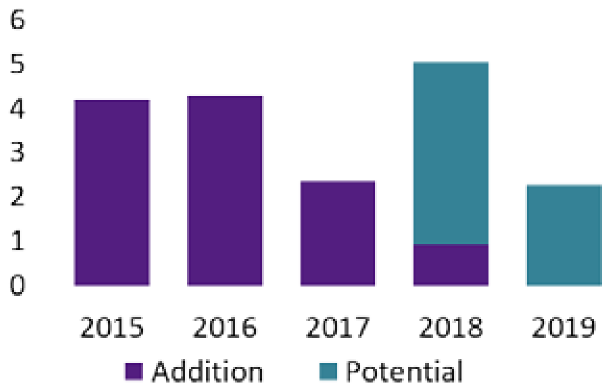
Office net absorption, sq ft (million)



Source: NTL Research

Figure 9

Future pipeline supply, sq ft (million)



Source: NTL Research

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