Global Real Estate Conference: Insights

State of the Global Economy

Presenters:
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Hans Volkert Volckens (HVV):

Well, Andrew, thank you very much for your insights and your welcoming remarks, kicking off this wonderful conference today and now let's turn to four great specialists that will share their view on the global economy with us, which is so decisive to understand the real estate dynamics. And with us today are Richard Barkham, global chief economist of CBRE, Yael Selfin, our KPMG U.K. chief economist, Constance Hunter, chief economist from KPMG U.S. and Kevin Kang, KPMG China. Thank you so much for patching in and sharing your views on the global economy, its development and the potential influences on our real estate markets.

I would ask Richard to share his views on the state of the global economy and thank you very much, Richard, for being with us. It's a pleasure having you.

Richard Barkham (RB):

So, thank you, Hans, and okay, let me just kick off with a brief overview of the global economy as we see it, and a little comment on real estate. I think we're set for 24 months of really strong growth, pushed, generated really by really strong fiscal response, particularly in America and also extremely loose monetary policy around the world.

But the key really is beginning to get control of COVID-19. And it is far from under control I would have to say, but it looks like we're on track for the Americas actually to reach herd immunity by around July. The United Kingdom may get to herd immunity by around August. Europe is a little behind. And it will get to herd immunity at the end of the year. But the developed economies are looking at herd immunity. And by that, I mean 70 percent vaccinated.

So, there is a sense that we are able to open up the economy and all of that fiscal stimulus and monetary stimulus is really going to act on the pent-up demand that preexists to create, as I say 24 months of extremely strong growth. We might see growth in the United States at about seven percent this year. I think Europe is going to lag. It's taken a little bit longer to roll out the vaccine. But in some ways, that's quite good for the global economy because we've got the U.S. leading the world with China in 2021. But then, I think thereafter, in 2022, Europe will take over as the key growth driver. And that gives us a nicely balanced global expansion over the next 24 months.

Of course, all of this fiscal expansion, all of this monetary expansion and the monetary policy settings are still super loose by any standards, has given rise to a fear of inflation. And indeed, we saw U.S. inflation figures trending up yesterday to 2.5 percent. I think the consensus of the economics community and certainly it's our view is that is, that's really not an issue. There's still just too much spare capacity in the world economy right now with, with what we call in economics output gaps, prevailing in most of the global economy for the next two or three years. So I don't think folks should be too worried about inflation.

It may be that a little bit of inflation pressure builds up in the United States because its expanse will be more robust, and we will see the U.S. trade deficit certainly ballooning and we'll see probably downward pressure on the U.S. dollar. And a little bit of inflation, as I say, over the next 24 months in the United States, but certainly inflation isn't really an issue going forward. Still too much spare capacity.

I would say that other risks are just as important as inflation. And as the virus recedes, what we're beginning to see is a return to geopolitical risks. And I think the buildup of Russian troops in Ukraine and perhaps a little bit of tension between China and Taiwan and China and the United States are a little bit of a sense that Russia and China are testing the Biden Administration, testing how robust Joe Biden will be. And so, we don't think that's a major issue. It'll be resolved, it'll ease. But, it creates a risk of an accidental flashpoint for sure. So I think that's an important risk going forward, but certainly there is a sense that economic momentum is developing pretty strongly.

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Just turning very briefly to give a CBRE overview of real estate, the four sectors, industrial and logistics over the course of COVID does not seem to have broken step. We have robust rental pressure and robust investor demand. In the multifamily or the apartment sector, has been a period of weakness, particularly in the United States. But we see new, the 2021 letting season has picked up, even in big cities, like New York and Boston. There is a sense in which the apartment market is reviving.

The office market is I think further advanced in APAC, most advanced in APAC, and most lagging in the United States. We're not back to the office yet, with around 20, 25 percent occupancy. And so rental pressure across the office sector is weakest in the United States. And it's coming back in APAC, apart from some markets which are oversupplied. And it's reasonable balanced in Europe.

And then retail, of course. Retail is the reciprocal of industrial and logistics in the sense that it's not only had to face the pandemic but the structural shift towards e-commerce. And so, the retail sector remains in a period of restructuring. Cap rates are rising, and rental pressure is generally weak, although let's note that there will be, when we fully open our economies, I'm expecting physical retail to outperform based on people's desire to get out and do things. So we are expecting a bounce back, but the structural shifts within retail are still in play certainly.

But overall, it surprised us that values have been recently stable. Cap rates, as I say, trending up a little bit in retail, but generally stable for other investment classes. In fact, probably an industrial logistics, some cap rate compression. But in any case, that would be my summary of where are, robust growth for the next 24 months. Cap rates recently stable in real estate, but rental pressure on balance weak, with quite a lot of structural shifts that preexisted COVID, but also are accelerated by COVID playing out in the real estate sector. Thank you, back to you.

HVV:

Thank you so much, Richard, for this very different shaded and very international view on real estate, economy and further development. It's rather optimistic and I think we all really love hearing some optimistic tones in our way of working. And let's stay in the U.S. for a moment, and I would like to ask Constance, what is your view on the crisis, on the development of the crisis and how states react to that, and what is the impact on real estate and the different asset classes from your point of view?

Constance Hunter (CH):

Sure, thank you, Hans, and thank you, Richard for that great introduction. So, in the U.S. I think there's three things to really think about. Of course, the first is the virus and I do think we're going to reach probably 70 percent herd immunity by the summer.

There's some question marks though. One is that 70 percent herd immunity works with the less virulent strains of the virus. With more virulent strains, with a higher R0, we need greater herd immunity, more like 85, 90 percent. And then the second question mark is how long do the vaccines last. And so right now, the medical community seems to have landed on about six months, which means we're all going to have to go through this vaccination exercise again, and we're going to have to do it periodically until we determine that the vaccines last for longer.

So, this new information is certainly giving me a bit of pause with regard to my growth outlook, although it is very positive. And I guess this gets to the second question which is what happens to the central business district. And as Richard rightly pointed out, people are moving back into big cities. The Cleveland Fed did a fabulous bit of research which showed the exodus from many cities was not what drove the next decline in occupancy.

In fact, it was that a lot of college students decided not to move into the big cities when their terms ended last summer and instead waited, because we know that college educated people can for the most part work from home. And so, if they were hired by firms, they didn't have to move into the cities or the central business district where those firms were located. And with the reopening of the economy, we expect that to change. And of course, that will impact all sorts of things. It'll impact hotels, it'll impact retail. It will impact obviously office and apartments. And then of course, the low interest rates do keep the yields very attractive on these properties.

And so this brings us to our second question, or third question rather. This brings us to our third question, what will happen with interest rates? And here we have the juxtaposition of two things, one is sort of inflation expectations, and again, I'm with Richard. I think many of these higher prices are one of the biggest contributors, for example in the recent CPI print was energy. And that is a year over year phenomenon. We've seen a rise in energy prices compared to where they were. We don't expect to go, for example, to $90 a barrel on oil. So that rise, we will have a bit of base effect for the next several months, but then that will dissipate.

The other reason of course that prices are rising is because goods consumption is up while there remains supply bottleneck. And we expect that to continue really well into the fourth quarter of this year, but when we get to 2022, we're looking at an inflation rate of maybe 2.1, 2.3 percent, which is well within the Fed's range that they want to see, and really plays catch up of the last several years, where we've been well below a two percent inflation rate.

Then of course, the second thing impacting interest rates will be what happens with potential growth. So, with all of this impact on the economy, both the shock of the pandemic forcing technological advancements and technological diffusion, as well as the high savings really being put to work in investment and then eventually spending in the economy, we think that there is a large probability that we see higher productivity in the decade ahead. And that would raise our potential GDP. If we went from a 1.5 percent productivity rate, for example, to a two or 2.5 percent productivity rate, that raises potential GDP, which then would raise the outlook for long term rates.

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And so, we're looking out very closely to see if that hypothesis will pan out. But that means that we would have an interest rate regime that's more on the order of the pre-global financial crisis than the post-global financial crisis. And getting that right is going to be really important for the real estate market.

HVV:

Thank you very much. And again, a very positive outlook. I mean a stable economy, low inflation, a robust way to do business in real estate actually and thank you so much Constance. Yes, let's take a look a Europe. And of course, things are slightly different, as Richard was pointing out. We are not the speediest. I mean U.K. is, but definitely continental Europe isn't with regard to vaccination of the people. But what is your view on the development of the economy in Europe and its impact on real estate? Is it similar to the U.S. or is it slightly different?

Yael Selfin (YS):

Thank you, Hans. What we've seen in Europe so for is the vaccine rollout to start with has lagged both the U.S. and the U.K. I mean by mid-April, we've just seen about 15 percent of people vaccinated at least first time. And that's about two months and a half behind the U.K. and about one month and a half behind the U.S. And we've also had some mixed experience in terms of the test and trace in Europe compared to both U.S. and the U.K. So as a result, we have seen a rise in death in the EU in recent weeks.

So, overall, we've also seen the rise in containment measures in Europe. So as a result of that, we have seen a rise in mortality in Europe and also the introduction of containment measures and that sort of means that we are expecting another contraction in the first quarter of this year for the Euro area on the back of contractions in the fourth quarter, so we're again in a recession compared to a potentially stronger contraction, slightly strong contracture in the U.K. because we had more restrictions in the first quarter still despite the fact that the vaccination rollout was faster. So overall, we could see growth in the Euro area of around four percent over the next four years compared to growth of around five-and-a-half percent in the U.K., which is partly on the back of a weaker performance earlier last year. So, it is relatively strong numbers.

Just looking at what it means from real estate overseas(?) is some very interesting questions. We've done some research looking at towns and cities in the U.K. and what we found is that post COVID is people go back to work, not all of them will return. And we expect between 27 percent to 11 percent of the commuter footfall to be lower across towns and cities in the U.K.

We're also expecting retail to suffer. On the back of retail, we see the High Street retail offering decline by between 40 percent and 10 percent across U.K. towns and cities, and really what we would expect to see is what we call cultural offering attracting footfall back to those centers, and that really was a strength of larger cities are. So in terms of vulnerability, interesting enough, it's the cities that tend to be less vulnerable and London being the one being less vulnerable than the smaller towns around it.

Now, just looking at Europe overall, it's very unsurprising that we saw a very sharp fall in the price of retail property just at the start of the recession with a fairly strong fall in office prices as well. But the recovery there was a bit stronger and continued rises in residential property prices, although in some countries that was less strong than others. And definitely, a preference especially in countries like the U.K., for properties that are outside the city centers, but within commuting distance, and prices of industrial assets are very, very hot across the majority of the U.K.

And just one thing to think about that I think is very interesting in Europe is where you have countries with one very large city that dominates, like U.K, and Paris, the Paris for example, in France, you tend to see less of a return to the office than countries like Germany, where you have a number of centers in terms of the number of cities. And when you look at the latest data on mobility from Google, you see the difference in terms of the fall in transit on the back of it.

So my guess would be if you look at especially in offices and residential, it will be countries like Germany that will be less impacted from the latest trend than countries like the U.K. and France.

HVV:

Thank you so much. Again, a very different shaded view and showing us that continental Europe has different economies and different habits of working in offices and dealing with real estate. Thank you so much, Yael. And I would like now to turn to the Far East. Kevin, please share your view. China, of course, as Richard was alluding to, is one of the big economic players in 2020 and '21, getting more powerful. And what is your view, what would you like to share with us with regards to economic development and real estate impact?

Kevin Kang (KK):

Thank you, Hans. Thank you for the invitation. Overall, I think China's economy continues to recover. So when we look back for 2020, China was the only major economy showing a positive growth last year. So China's economy grew 2.3 percent in 2020. We are expecting another 8.8 percent growth this year.

So when we look back our really two major drivers for China's economy for last year, so one is industrial production and another one is exports. So even though China was the country first hit by the pandemic, the government took very strict quarantine measures so those measures helped China control for the spread of the pandemic. So the production resumed very quickly. So meanwhile many advanced economies like U.S. or U.K., they all offered very strong stimulus package to help consumers. So that in term showing very strong demand for China's exports. So that's why we saw industrial production and exports saw very quick recovery last year and drive the overall economic growth.

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However, in contrast, recovery of retail sales and also in factory or services related consumption have been lightened. For example, last year, our industrial production grew about three percent, but nominal retail sales fell over four percent. So there's really a contrast between the production side and also the consumption side. So looking forward, we are expecting consumer consumption and also services to see a stronger recovery this year. I think that certainly depends on how the vaccine is rolling out and how the pandemic is being controlled.

But as Constance said, I think we are seeing faster vaccination rate not only in China, but also around the world as (Inaudible) expecting consumption on retails to be a more important driver for China's economy this year. So, for example, in the first two months, retail sales increased almost 35 percent and also dining(?) grew almost 17(?) percent. So even though those very high growth rates are from a very low base comparison, but indeed, we are seeing some recovery from consumption.

For the retail markets, last year, real estate investment grew about seven percent, it's doing pretty well. But when we are looking to individual market, we are showing very different trends. Residential are doing well. I think that's probably true not only in China, but also around the world. If you have people stay in their home for six or seven months, the (Inaudible) you're leaving a larger apartment or better place. So (Inaudible) are seeing residential like housing sales in China are increasing.

Also, we are seeing the bigger cities, like tier one or tier two cities, they are seeing stronger increase for the housing crisis. For example, this year, for the first two months, the tier one cities in China like Beijing, Shanghai, Chongqing and Shenzhen, their housing price increased almost ten percent. So we are seeing people still want to move to, want to live in the bigger cities, so that's why we are seeing stronger price momentum for the higher, tier one cities. For the non-residential market, it's not doing so well, like offices and other commercial real estate did fall about five to ten percent last year. But we are seeing the decline has been narrowed in the second half last year, and also started to turn positive this year.

So when you think about office and also think about the shopping mall, the commercial real estate, we do have to think about the impact of the pandemic on those markets. For example, right now, about one quarter of China's good sales are being done online. So, we are seeing increasing online shopping. So then (Inaudible) put some pressure on the shopping malls or other commercial real estate.

But for those like shopping malls offer more secure space services like dining or other services related, they are doing better. For offices, definitely we are seeing the vacancy rates are higher this year, or last year (Inaudible) this year. But we are seeing better momentum this year.

So people in China, people have started to go back to office since almost last May, so we have been kind of back normal in the second half last year. So I think the impact of remote working on China's offices real estate has been probably smaller than other markets. But many companies are rethinking how they're going to think about the new office building in the future. Thank you, Hans.

HVV:

Thank you very much, Kevin, and thank you very much for sharing this view, of course, of an economy which is ahead of the crisis due to the fact that you started earlier into the pandemic and have been able to really conquer the pandemic and the effects quite efficiently, as well as the U.S., which really makes big steps forward in fighting the pandemic. Richard, anything to add from your point of view? You started off and gave us a framework and the colleagues commented on it. What's in your mind? What would you like to mention in addition?

RB:

Yes, I think it was a great summary from all of my colleagues here. And the thing that I think didn't come quite, that's front of mind as well is just the return to the office. I think it's obviously proceeded quite nicely in Asia, and as Yael pointed out, I think it'll proceed quite nicely in Europe. But it's still something of an issue for us in the United States. And we're wondering a little bit about how much the technological developments will overall reduce the amount of space that is demanded by occupiers.

I think we think there will be some, something like … our current estimate is that workers will spend maybe 36 percent of their time remote working, up from maybe 16 percent pre-crisis. Because you get job growth and because of the densification in the office sector and the office layout is being rethought around more collaborative ways of working. That increase in remote working doesn't one for one lead to a decline in demand for space. But there will be a small decline, overall decline in demand for space.

So, it'll take a while for those vacancy rates in the United States, which have gone from maybe 12 percent, ten to 12 percent, up 14 or 15 percent, it'll take four or five years for those vacancy rates to come down. And I think there are nuances in obviously the south and the southeast of the country is growing quite strongly.

And I think also, and this would be true I think around the world, not just the United States. We're probably likely to see a marked reduction in new office development. So it might surprise us coming out of the COVID crisis in one, two, three years' time, we actually start running into a shortage of new space because people will be a little bit cautious on development. So, some interesting things around the office sector is what I would add into the pre-going discussion.

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HVV:

And that's a very interesting remark, running short of office space because probably a lot of us experience that we run into times with low occupancy rates and problems in at least certain areas. So this is again a very optimistic view from you, Richard, which encourages us to move on in the conference.

Let me end this wonderful round and thank you again, everybody for sharing your thoughts. Let me ask you one simple question, which is probably not that simple. Looking back in ten years, today in ten years on the years 2020 to 2021, what is the lesson, the one or two lessons that we learned after we overcame the crisis and we look back at these very dynamic, very difficult years 2021, maybe beginning of 2022. Kevin, may I kick it off with you?

KK:

Sure. Thank you, Hans. I think that's a very interesting question. So when we look back, I think there's three lessons I will probably take are the first ones are the digital transformation. So we talked about people are doing shopping online are doing like taking lessons online or having conference online. So that the digital transformation is one lesson we can learn. I think this should be pretty straightforward.

The second lesson I would learn is that truly the pandemic showed how resilient and how agile company need to be. Because I remember at the end of December of 2019, I was attending a conference. So, the moderator asked each panelist to think about the black swan event or the risk for 2020. The people talk about high tax libel in China or U.S. China trade frictions, or geopolitical issues and all sorts of risks for 2020. So nobody expects the world would be hit by the pandemic in 2020. I'm not saying the economies are doing a bad job, but I really think because the world is trending so fast companies need to think about how to be agile, how to be resilient going forward.

I think the third lesson I would take is the pandemic really showed how the world is interconnected. So, I think starting from 2018 or 2019, people talk about the geopolitical issues may be pushing back globalization, so people may be saying even globalization has been reversed. But I think the pandemic showed us a hard lesson, how the world is interconnected, no matter whether you like it or not, but we are truly global, you know (Inaudible) global world. So the pandemic is good example, but also like climate change, data governance. There are many issues all the world need to work together.

So I think for our real estate market, people need to think about green development. For example, China this year, they have very high goal to reach carbon, take out carbon emissions by 2030 and also achieve carbon neutrality by 2060. So green development exactly is a very important thing for China. Not only for this year, but I think it will be an important thing for the next five or ten years or 20 years.

So, from (Inaudible) perspective, a company or real estate markets had to thing about how they can build energy saving buildings or how they can build green buildings. So I think that's really important for the market to think about. Thank you.

HVV:

All right. Kevin, thank you very much. This is a broad range of different lessons we learned, and taking one thing it's the world is too small and on the other side, too big to not collaborate across borders. Yael, let me ask you, what is you lesson in ten years potentially to look at the years 2020 until '21, '22?

YS:

Thank you, Hans. So, I think I will build up a little bit on what Kevin said and I really agree with him on the speed of technological adaptions that we can actually adopt. And I'll add to that and say actually the speed that which we can all adapt to new way of doing things and that is a lesson to us and something to strive to not even, not in times of crisis, but actually continue with that going forward.

So, my second lesson is not to underestimate the extent of government support, especially in terms of the fiscal spending but also other spending and other types of assistance, if it be changes to the legislation temporarily or more imaginative ways of actually supporting businesses and economies. And finally, my last takeaway is the term black swans are probably less rare than what we thought.

HVV:

Yes, that's probably true, as you and also Kevin are saying, nobody thought of this black swan in 2019 and now it's just everywhere. Richard, we kicked off this panel discussion with you with your opening remarks and we will close with you. What is your lesson you will take away potentially in ten years?

RB:

Well, I don't disagree with Kevin and Yael about the acceleration of the digital economy which is kind of reshaping patterns of demand for real estate. But I think there's a couple of other things.

One is the 1980s kicked off with Ronald Reagan and Margaret Thatcher talking about getting the state off our shoulders. But I think the government response to the crisis, both fiscal response, the Central Bank response, the acceleration of vaccine programs, has shown the world just how good government can be in helping people see their way through crisis. And so, I think we come out of the crisis maybe for the next decade, a sense in which government will feel and people will allow government to intervene more in the economy. So, I think that's another thing.

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And perhaps a third thing a little bit, just to hark back to something that Constance said, which we've been faced in the Western World with a low level of productivity over the last ten years, and people have scratched their heads and wondered why that is and 101 theories have come out. I think when you look at it, it might just be a simple demand deficiency. And when we get this surge in demand that's coming in the next 24 or 36 months and it boosts productivity, there might be a sense in which, as I say, the big government, the typical, if you want to put it in very old-fashioned terms Keynesian response of more government, more government spending, we might see a productivity surge that would surprise us as well. So those are my three lessons.

HVV:

Thank you so much, Richard. And Constance, any lesson that we missed that we should look at in ten years and say yes, that was the pandemic and that's what we learned from the pandemic to make the world better or more resilient?

CH:

Sure. Well, I guess the first thing is that economies are anti-fragile organisms, right. So, while stress is terrible and there have been many tragedies associated with this pandemic, it has forced us to do certain things more efficiently and it has forced companies to think about things like their supply chain, their digital footprint. And all of that is forcing everybody to operate more efficiently, again buttressing this idea that we could have a productivity surge.

And then the second thing is that we did something very different with the way we target fiscal assistance. So, by increasing the duration of unemployment insurance, which is something we've done in the past, and increasing the amount of unemployment insurance, we really reduced economic scarring. And so you see things like a reduction in delinquencies, for example, as evidence that people use this money to remain fiscally solvent. And so, this is a lesson I think we will take away to future significant recessions. And I think it will change the way we do fiscal policy going forward. It appears to have worked really, really well.

RB:

Hans, may I just add one final comment? And I wouldn't … I agree with everything. It might be something that you'll reflect it later in the day, but I do also think that higher taxes are on their way. And it seems to me as if higher taxes are coming on the corporate sector. So, that's another thing I think you'll see develop over the next ten years or so, which is the logical response of all of the things we've been saying on this panel.

HVV:

And now we close with something that is not quite as optimistic for at least the colleagues and clients that are in the call, because higher taxes of course, is a sensible issue. But I totally share your view. Strong states of course need appropriate funding.

Thank you very much ladies and gentlemen for sharing your distinctive views, for sharing your ideas and thought leadership and it is a well base now for us to discuss on specific issues around sustainable finance, about the resilience of real estate around the globe and the technical development of cities and buildings. Thank you so much. All the best, and stay healthy.

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