

EUROPE CRE 180

ECONOMIC OUTLOOK

REAL ESTATE PERSPECTIVES

GLOBAL RESEARCH
October 2023



BNP PARIBAS
REAL ESTATE

Real Estate for a changing world

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EXECUTIVE SUMMARY

IN A NUTSHELL

ECONOMIC RESILIENCE IS FADING

After a slightly positive first half-year, eurozone activity is likely to stall in the second half-year. The labour market should also lose momentum. However, the extent of this decline and an increase in the unemployment rate should be relatively limited given persistent recruitment difficulties.

THE RATE HIKE CYCLE IS COMING TO AN END

The further weakening of economic activity and lower inflation that we expect to see by the end of this year should prompt the Fed, like the ECB and the BoE, to stop raising their policy rates. However, a further tightening cannot be ruled out.

INVESTMENT STILL PLUMMETING

All asset classes experienced a strong reduction. Logistics (-58%) was the most affected as prices were already expensive before problems arose. Offices (-62%) suffered as well as complicated pricing adds difficulties to a sector where structural change seems to be underway. Hotels (-26%) and retail (-43%) incurred the least declines.

YIELDS STILL EXPANDING

The principal factor behind yield expansion is the change in the macro-financial environment. Persistent inflation is prompting more robust response from central banks. It is accelerating normalization of monetary policy. Bond yields are subsequently growing very rapidly, reducing the yield gap with real estate and prompting rethinking about the prices being paid for assets.

OFFICE: LETTING ACTIVITY IS REMAINING SUBDUED

2023 letting activity is struggling to regain the volumes seen in 2022 when take-up returned to its long-term average. Take-up after 9 months shrank 22% relative to 2022. This decline is mostly due to a reduced number of very large transactions. Occupiers are looking for space optimization to meet hybrid working patterns and reduce costs.

THE FLIGHT TO QUALITY CONTINUES

While hybrid work models are here to stay, workplace plays a key role in attracting and retaining talent, both in terms of space quality and location. Demand is also high for energy-efficient and sustainable buildings. These increasing quality requirements drive values up for modern buildings located in the most established districts.

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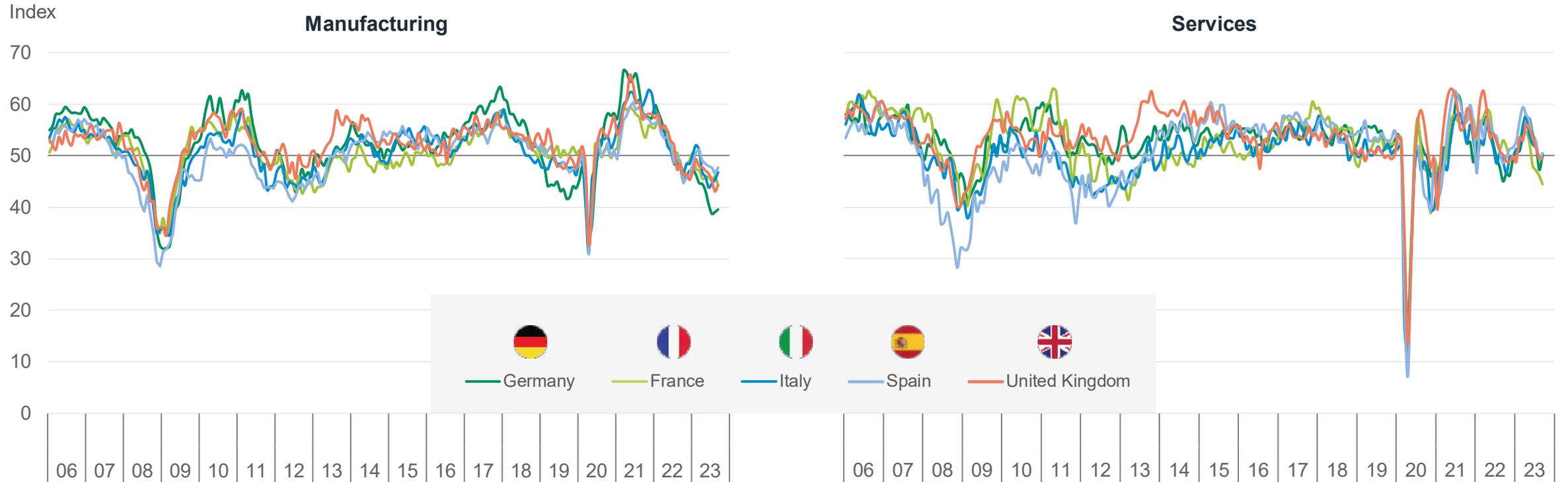
ECONOMIC OUTLOOK



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PURCHASING MANAGER INDEX SURVEYS

ACTIVITY IS LOSING MOMENTUM



Sources: Markit, BNP Paribas Economic Research.

Global activity is down at the end of the third quarter

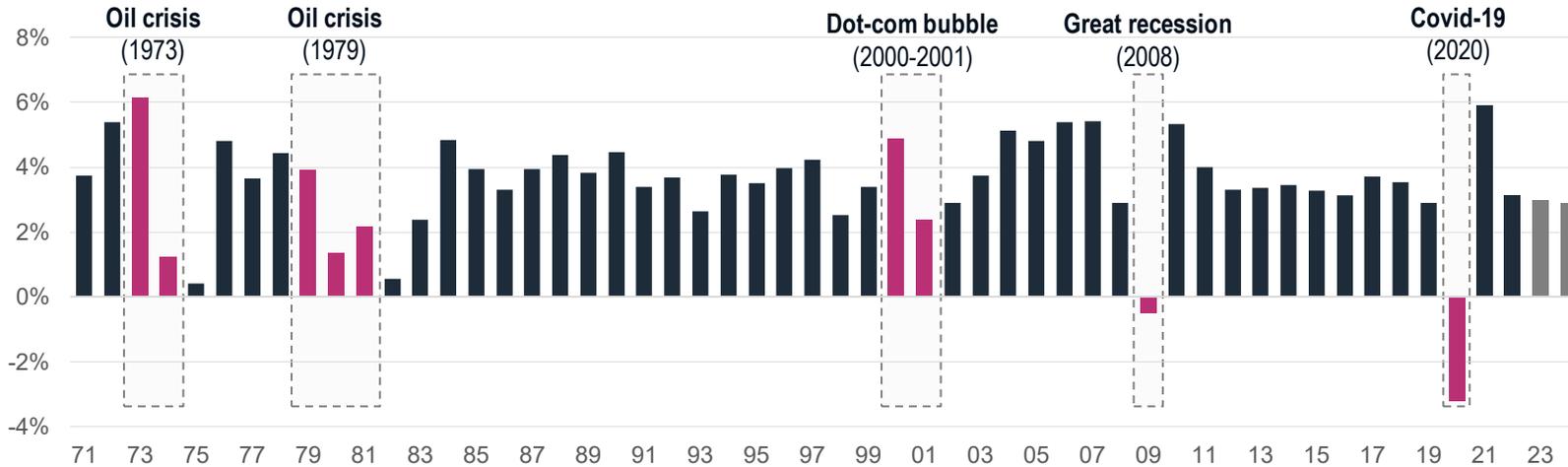
The third quarter of 2023 ended with the eighth consecutive decline in the Global composite PMI. This is an increasingly tangible evidence of a slowdown in the world economy. This negative signal is reinforced by an index level now close to the 50-point threshold that separates expansion from contraction (50.5 compared to 50.6 in August).

The main drag continues to come from the manufacturing sector. Indeed, in the face of borrowing costs and higher prices, consumers continue to reduce their spending.

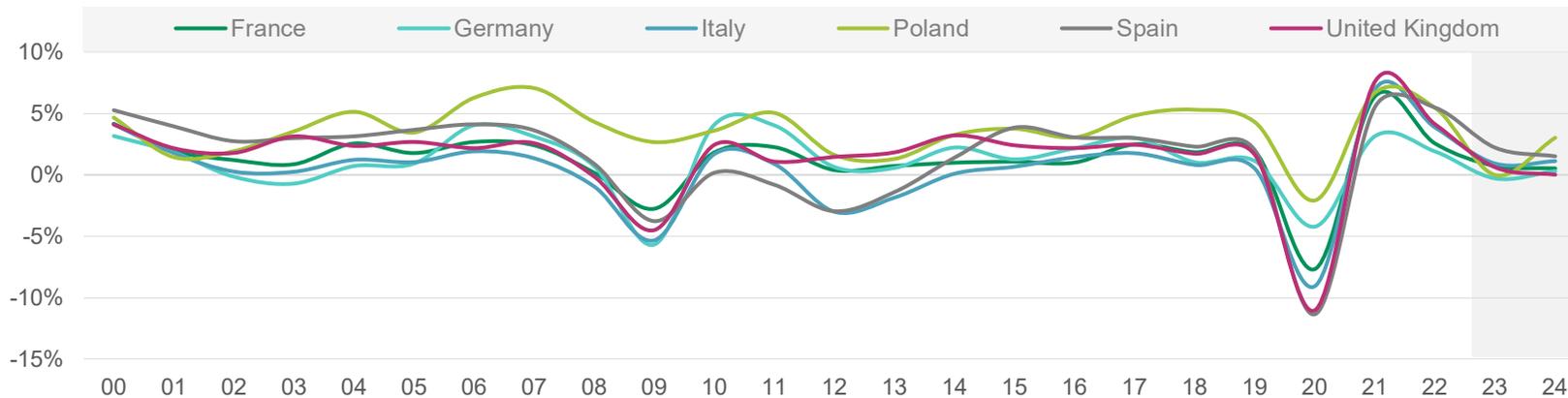
ECONOMIC OUTLOOK

WHAT OUTLOOK FOR THE MAIN ECONOMIES?

World GDP



GDP Growth in European countries



Sources: BNP Paribas Real Estate, OECD.

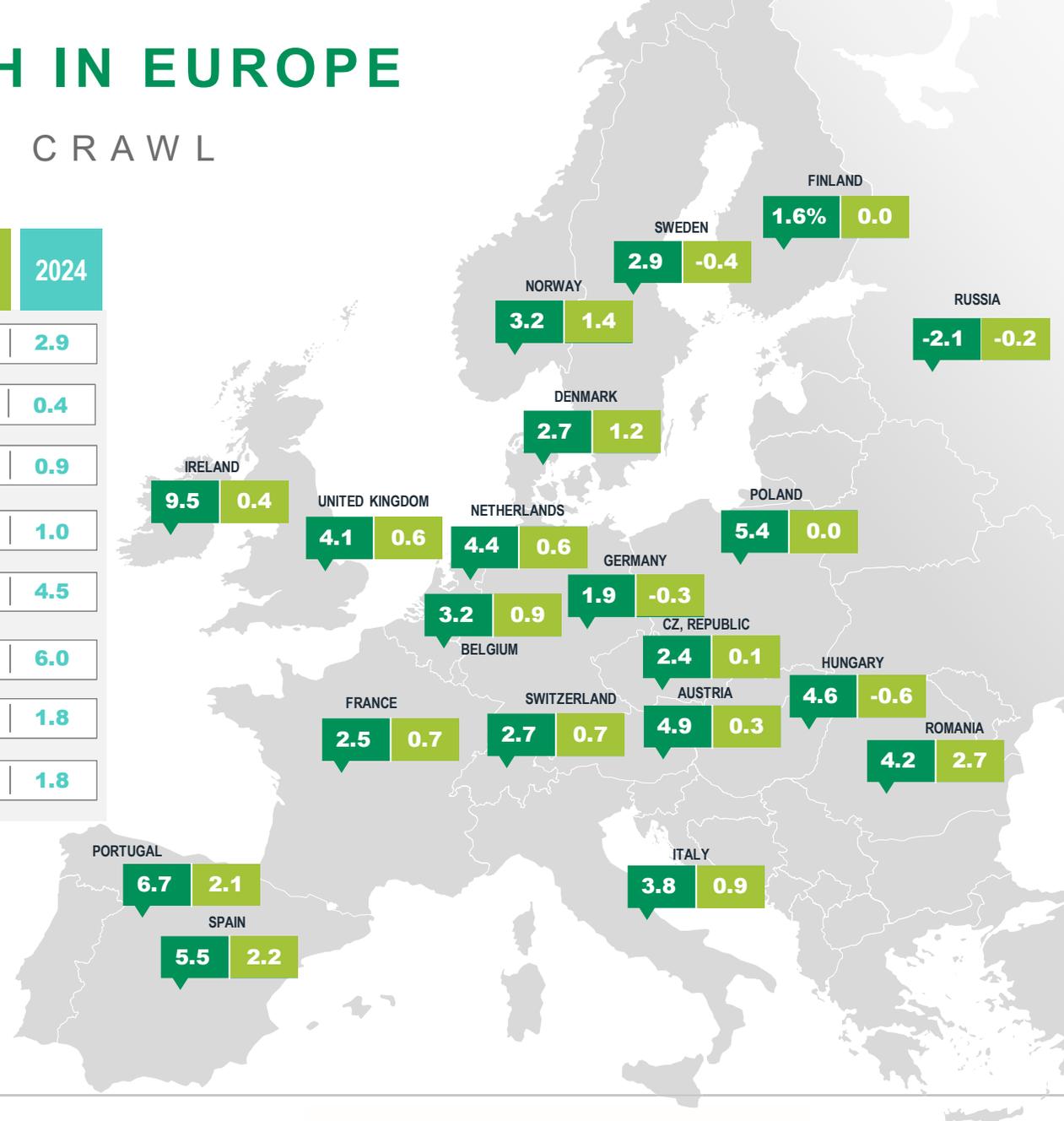
Economic resilience is fading

- Economic activity proved resilient in the first half of 2023, despite an aggressive tightening in monetary policy. Warm weather and diversification away from Russian energy supplies helped to bring down prices.
- Headwinds from monetary policy were mitigated by several (albeit fading) buffers including savings built up during the pandemic, labour hoarding and supportive fiscal policy. Principle growth has come from the service sector, tourism especially. This prevented Eurozone real GDP from contracting in the first quarter and helped growth to accelerate to 0.3% q/q in the second quarter.
- Economic growth was stronger in Ireland, France and Spain, and weaker in Germany and Italy.
- Looking ahead, the resilience in activity is likely to prove short-lived as the impact of these mitigating forces begins to fade. Europe cannot rely on external growth due to fading momentum in China and the US. Additionally service sector output is likely to witness reduced momentum.
- As a result, monetary policy is set to weigh more heavily on the economy in the coming quarters.

GDP GROWTH IN EUROPE

SLOWING TO A CRAWL

FORECAST (%):	2022	2023	2024
World	3.5	3.0	2.9
United States	1.9	2.2	0.4
Euro area	3.4	0.5	0.9
Japan	1.0	2.0	1.0
China	3.0	5.1	4.5
India	7.2	6.1	6.0
Russia	-2.1	-0.2	1.8
Brazil	2.9	3.1	1.8



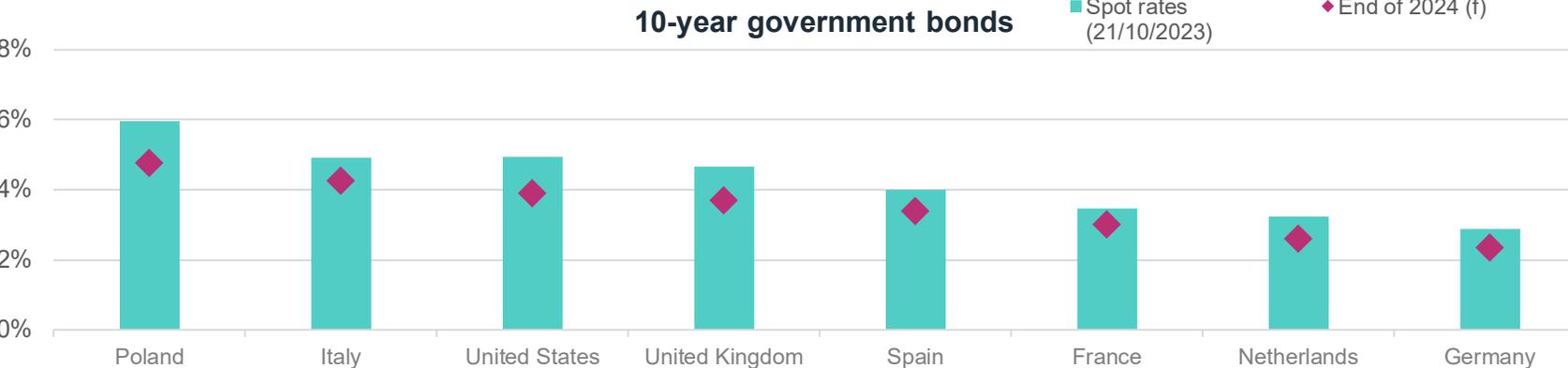
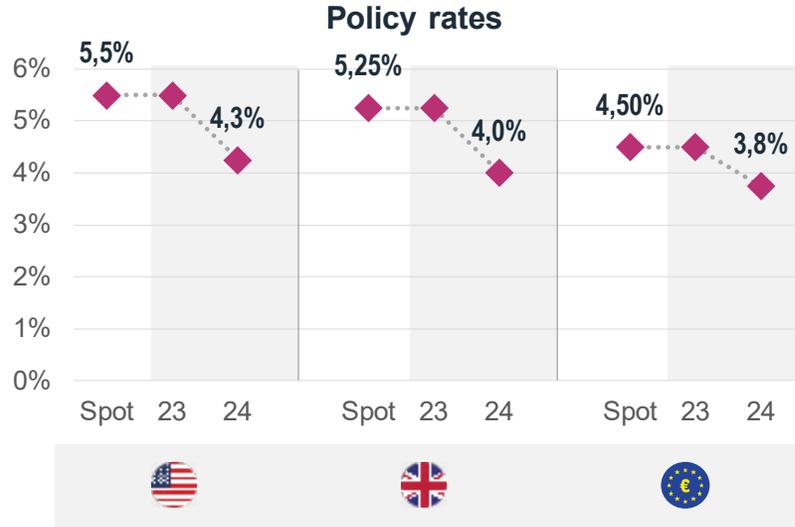
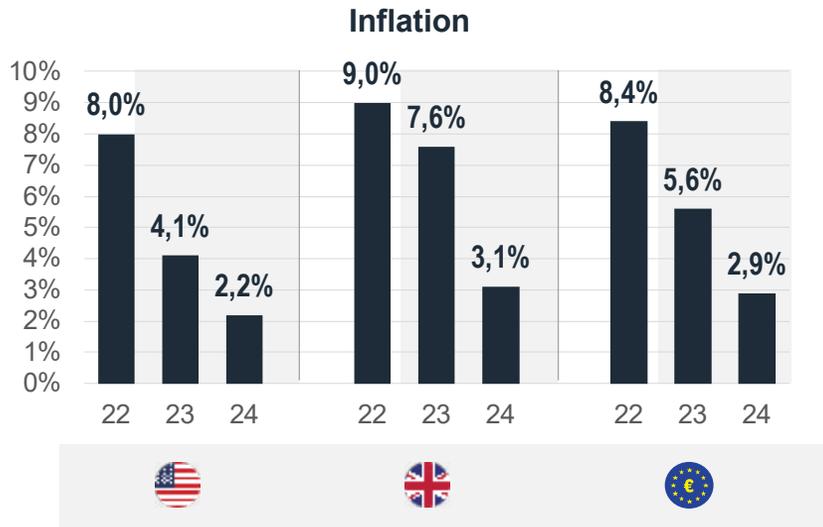
Growth is slowing globally

- According to our forecasts, eurozone activity is likely to stall in the second half of 2023, under the effects of a contraction in GDP in Germany (Q3 and Q4) and France (Q3 only) which should be offset by growth in Italy and, above all, Spain.
- The labour market should also lose momentum. However, the extent of this decline and an increase in the unemployment rate should be relatively limited given persistent recruitment difficulties. The unemployment rate remained at a record low of 6.4% in September in the Euro area.
- The US economy keeps growing, postponing the onset of a recession. While household consumption has so far proven resilient to the monetary tightening, it is unlikely to defy gravity forever. Contraction here may slow output in the US economy over 2024.
- After some hesitation, the Chinese authorities finally stepped up their stimulus measures over the summer. The recent slight upturn in economic growth is set to continue in Q4 2023.
- We do not expect a recession in the euro zone as a whole in 2023, but moderate growth at 0.5%, mainly due to a favorable carry-over effect in 2022. After a slightly positive first half-year, eurozone activity is likely to stall in the second half-year

Source: BNP Paribas Real Estate Research.

FINANCIAL OUTLOOK

THE RATE HIKE CYCLE IS COMING TO AN END



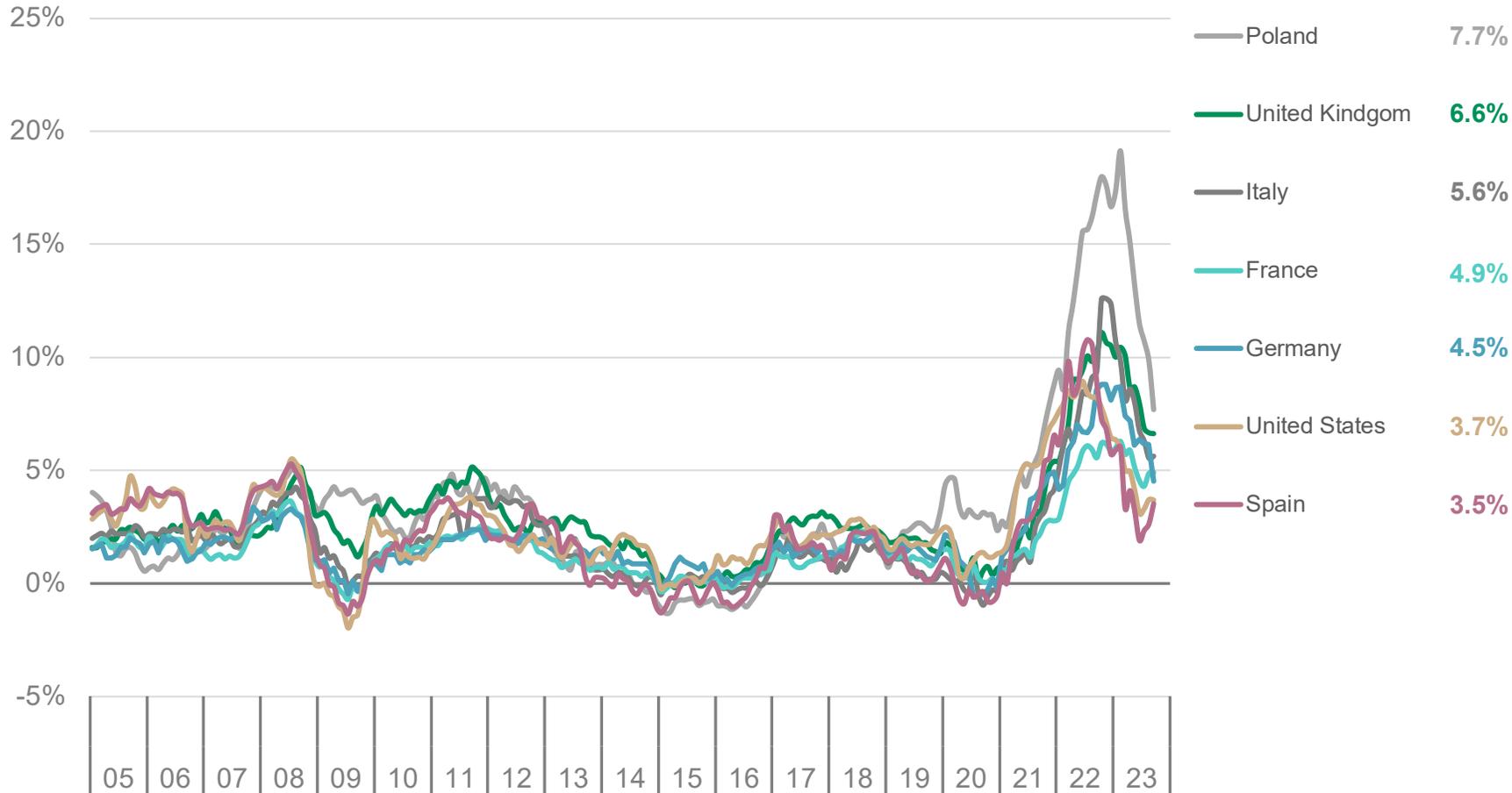
Sources: BNP Paribas Economic Research, OECD.

The end is near for monetary policy tightening

- The further weakening of economic activity and lower inflation expected by the end of 2023 should prompt the Fed, like the ECB and the BoE, to stop raising policy rates. However, a further final tightening round cannot be absolutely ruled out.
- Interest rate hikes are unlikely to be followed immediately by cuts. To continue the fight against inflation, monetary response is expected to hold policy rates at their current high level for an extended period, until mid-2024 according to our forecasts.
- The first rate cuts may accompany a sharper fall in inflation and offset its positive impact on real policy rates.
- Given the trajectory of inflation, monetary policy may remain restrictive until the end of 2024.
- As part of its monetary tightening, the ECB also announced a complete halt, starting in July 2023, of its reinvestments under the APP. European long-term rates remain on an uptrend, moving in line with US rates, but in a more muted way. They are expected to ease gradually as the fall in core inflation should become more visible, dissipating uncertainty over the continuation of monetary tightening.

INFLATION IN EUROPE

DISINFLATION SLOWED BY CHANGES IN DRIVERS



Sources: Macrobond.

Disinflation is proving a slow process

- The peak in inflation was reached in mid-2022 but disinflation in the core measure remains gradual. Headline inflation should approach the 2% target in 2024.
- However, the slow pace of core prices disinflation argues in favor of keeping monetary policy in restrictive territory, even if headline inflation fades more quickly than expected. This may limit the scope for economic rebound in 2024.
- Eurozone annual inflation reached 4.3% in September. Prices rose at a slower pace than in August (5.2%).
- Core inflation decreased to 4.5% in September, from 5.3% last month.
- An escalating Middle East conflict could create a spike in inflation. Indeed, credit rating agency S&P warned that the global economy risks a renewed inflation shock if the conflict were to further deteriorate. So far, the market reaction remains limited with a small increase of oil prices.

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REAL ESTATE PERSPECTIVES



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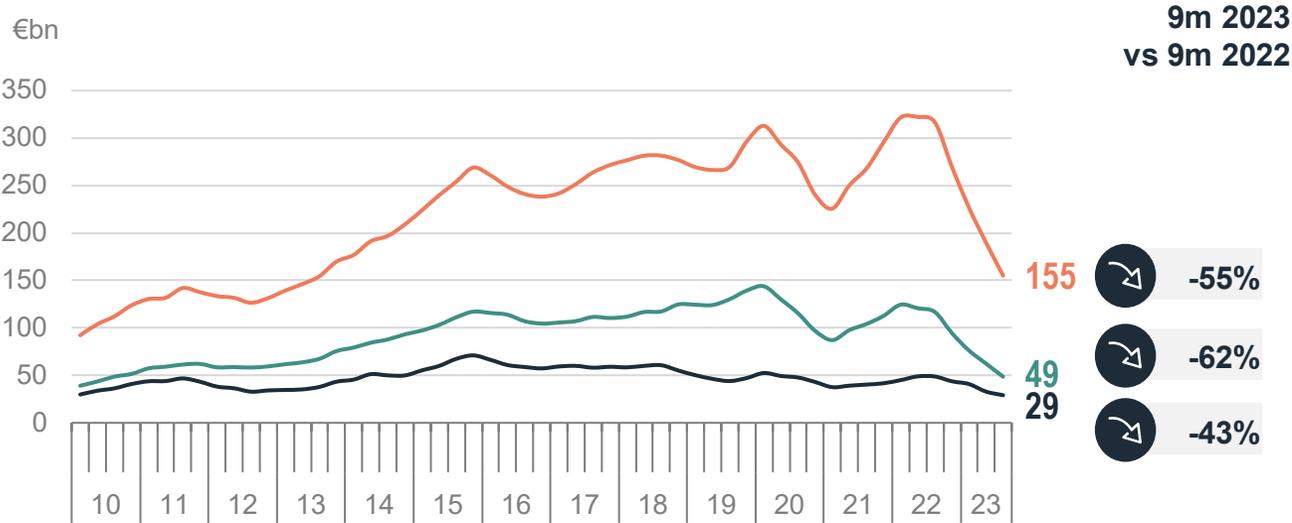
REAL ESTATE PERSPECTIVES

COMMERCIAL REAL ESTATE
INVESTMENT MARKETS



INVESTMENT IN COMMERCIAL REAL ESTATE IN EUROPE

BREAKDOWN OF INVESTMENT BY ASSET CLASS



Investment scales back as buyers and sellers assess pricing

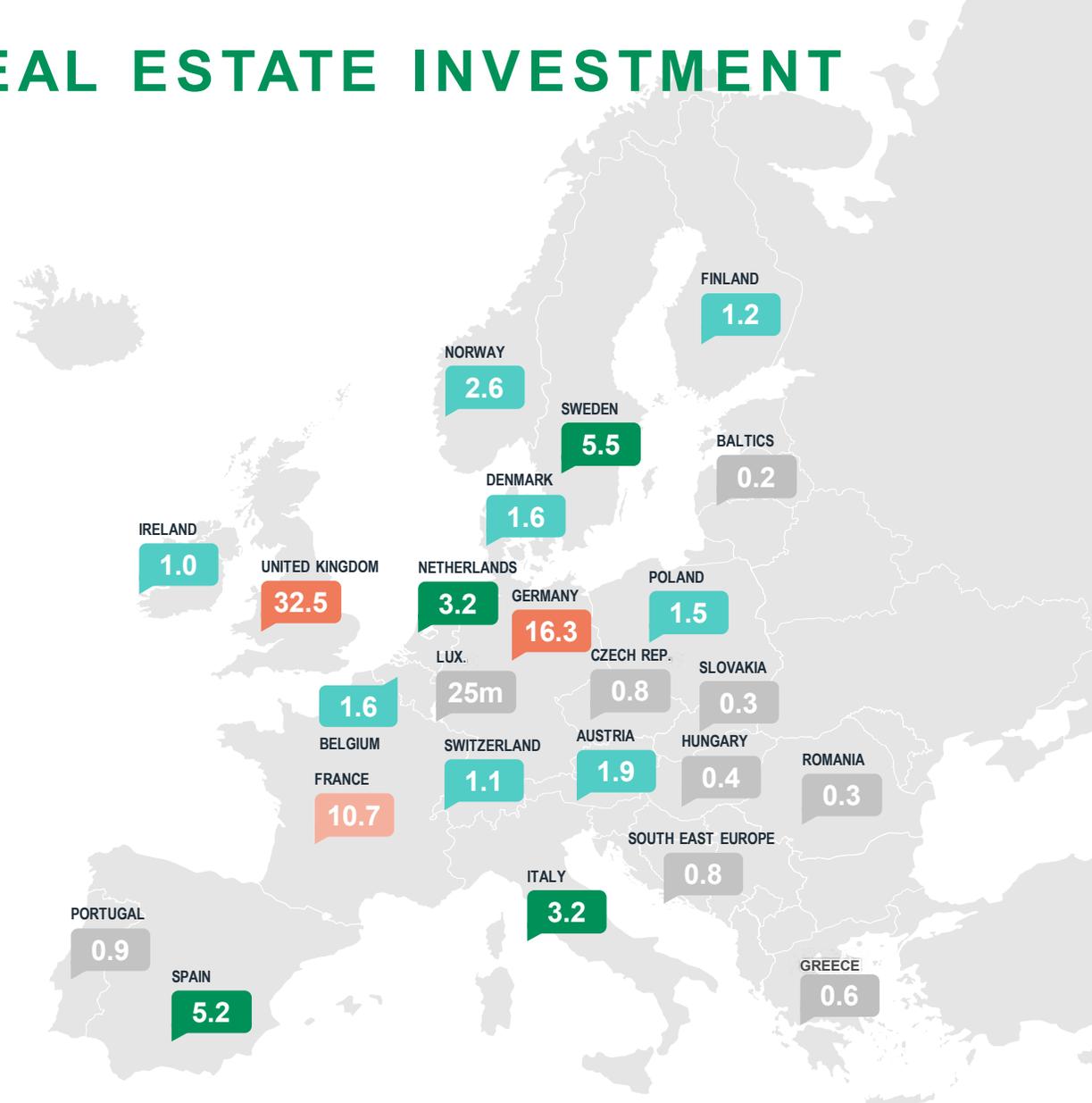
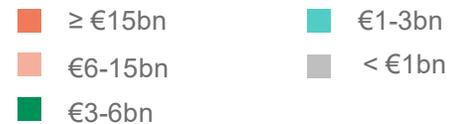
- Over the 12 months ending with Q3 2023, investment reached €155m, far below Q1 2021's low point and back to 2013 levels. This compares with the high in investment of €322bn reached in Q2 2022. Overall, between Q3 2022 and Q3 2023, investment decreased by 55%.
- The basis for subdued activity remains the unsettled macroeconomic backdrop. The aftershocks from the Covid pandemic and then the Ukraine war triggered the economic turmoil that led to the sharpest fall back in market activity in a decade.
- The rapid acceleration in financing costs from mid-2022, destabilized pricing in the market resulting in investment plummeting by Q4 as buyers and sellers pulled back. All asset classes experienced a strong reduction. Logistics (-58%) was the most affected as prices were already expensive before problems arose. Offices (-62%) suffered as well as complicated pricing adds difficulties to a sector where structural change seems to be underway. Hotels (-26%) and retail (-43%) incurred the least declines.



This excludes residential investment.

COMMERCIAL REAL ESTATE INVESTMENT

9m 2023 vs 9m 2022



- €94.6bn were invested in Europe over the first three quarters of 2023, which represents a 55% decrease vs Q3 2022.
- Most countries experienced a strong decline: Germany (-63%), the Netherlands (-66%), Italy (-62%), Poland (-64%), Ireland (-71%), Belgium (-65%) or Luxembourg (-96%) while declines in the United Kingdom (-48%), and in France (-51%) were of lower magnitude.

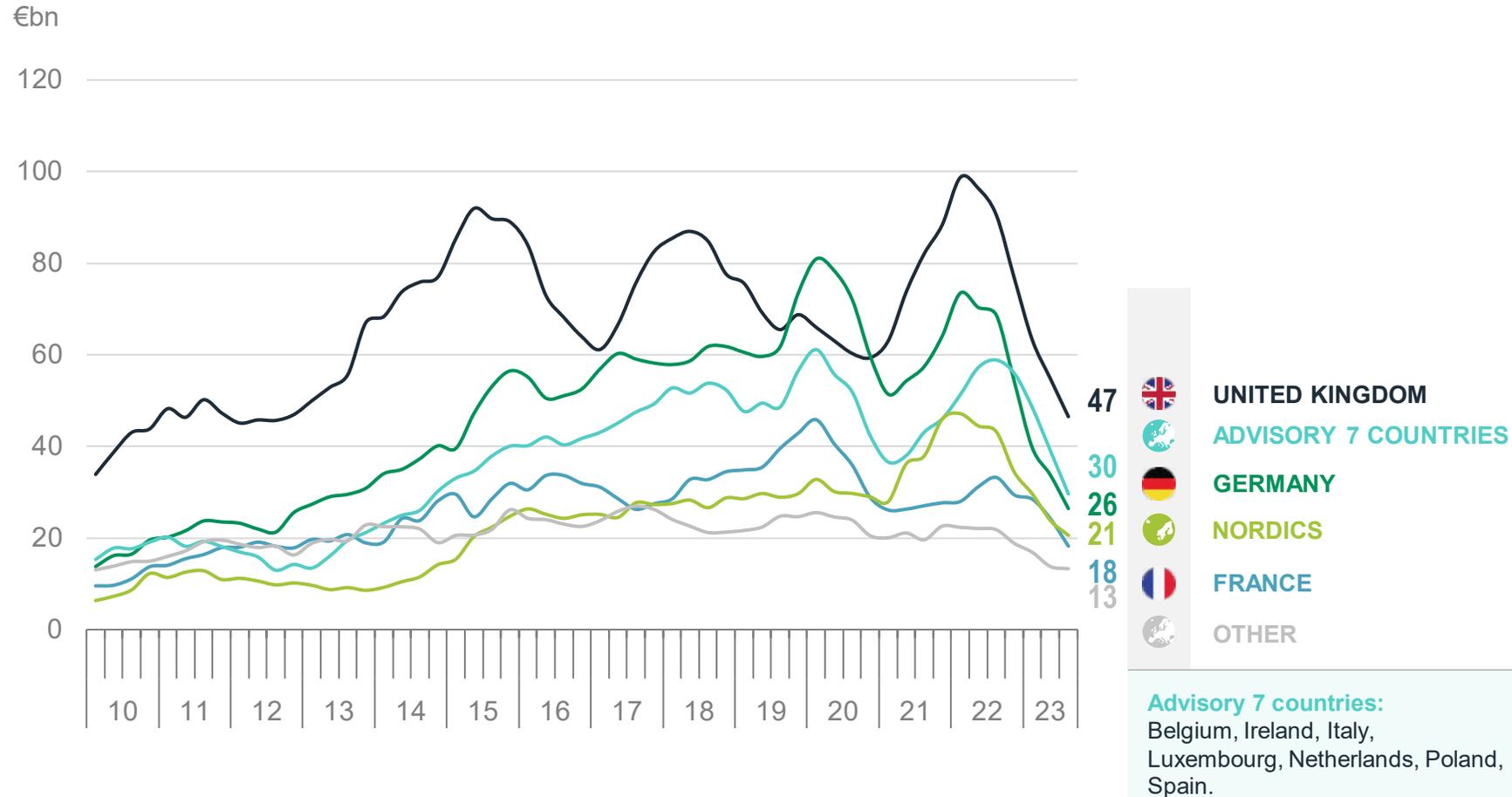
(excludes residential investment)

Source : BNP Paribas Real Estate

COMMERCIAL REAL ESTATE INVESTMENT VOLUME

INVESTMENT REMAINS HIGH EVEN WITH BUYER CAUTION

CRE Investment volume (€ billion)



Source: BNP Paribas Real Estate Research.

- Early 2022, markets were posting investment volumes similar to pre-pandemic levels.
- From mid 2022, high inflation and subsequent acceleration in monetary policy tightening, resulted in rapid bond yield expansion. As this situation has not yet stabilized, extensive pricing uncertainty in real estate now exists. It is also creating difficulty in lending which is now more expensive.
- The outcome is that a more selective approach to property from buyers emerged at the end of 2022. All countries are now trending down in absolute investment volumes.

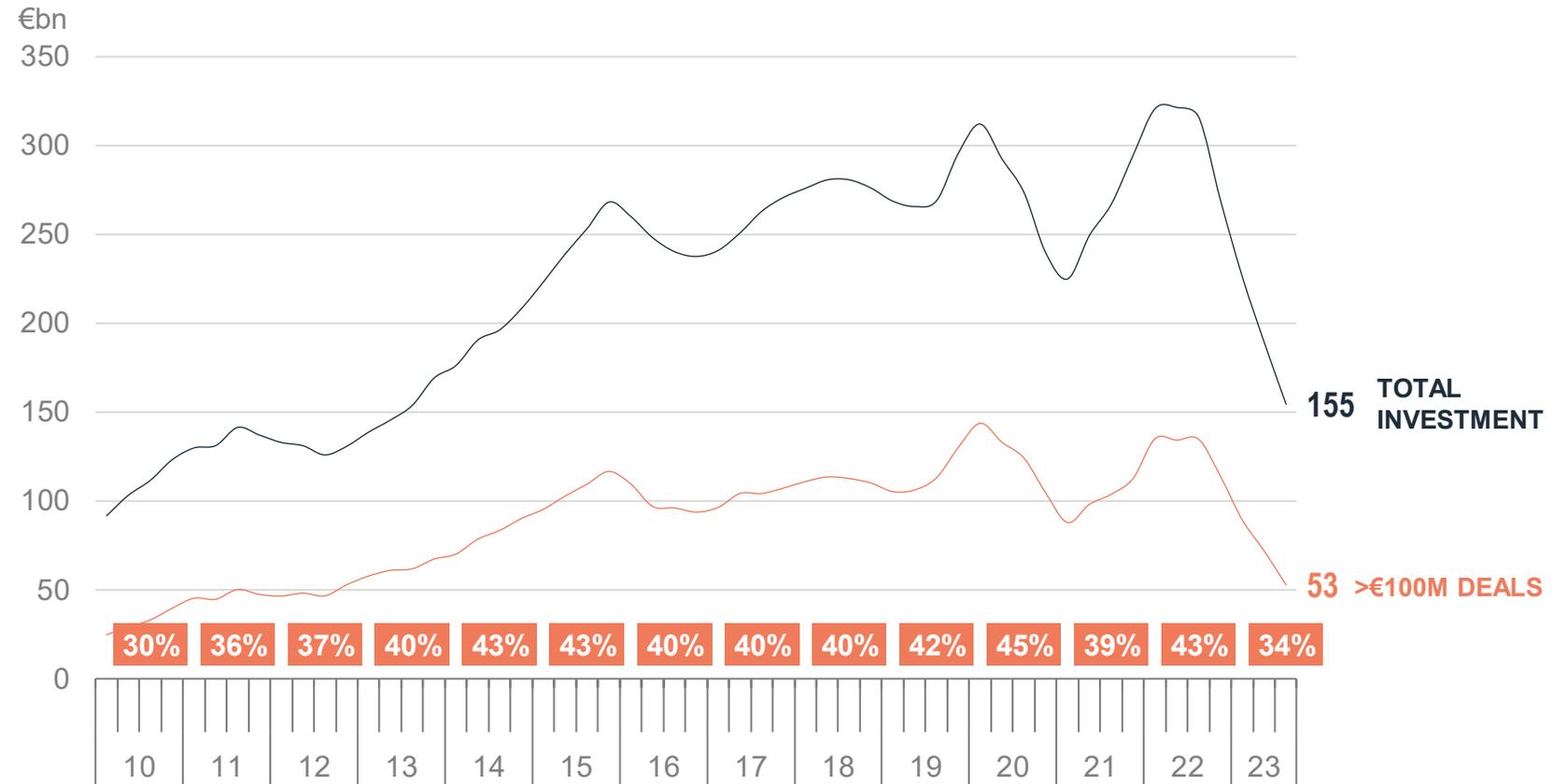
INVESTMENT BY SIZE BAND

Mega deals also scaling back

- The peak in mega deals (>€100m) occurred in Q1 2020 with a record figure of €144bn (on a rolling-year basis). That is 49% of the total investment, an unusually big share for a Q1 and may not reappear for the time being.
- The pandemic induced low point of €88bn occurred in Q1 2021. This was down 39% over Q1 2020 figure. Prior to global interest rate cycle tightening, the segment was regaining momentum reaching €135bn at Q3 2022.
- The mega deals volume dropped over Q4 2022 but to a lesser extent than other size bands of deals. The delayed response to interest rates may be a timing issue as these sort of deals take a long time to complete. Consequently the share of mega deals increased (46%). But it then decreased strongly and they now represent only 34% of investment with €53bn spent over the last 12 months, which is a very low level when put in perspective with the historic figures.

Commercial Real Estate Investment in Europe

Total and >€100m size band - volume and share



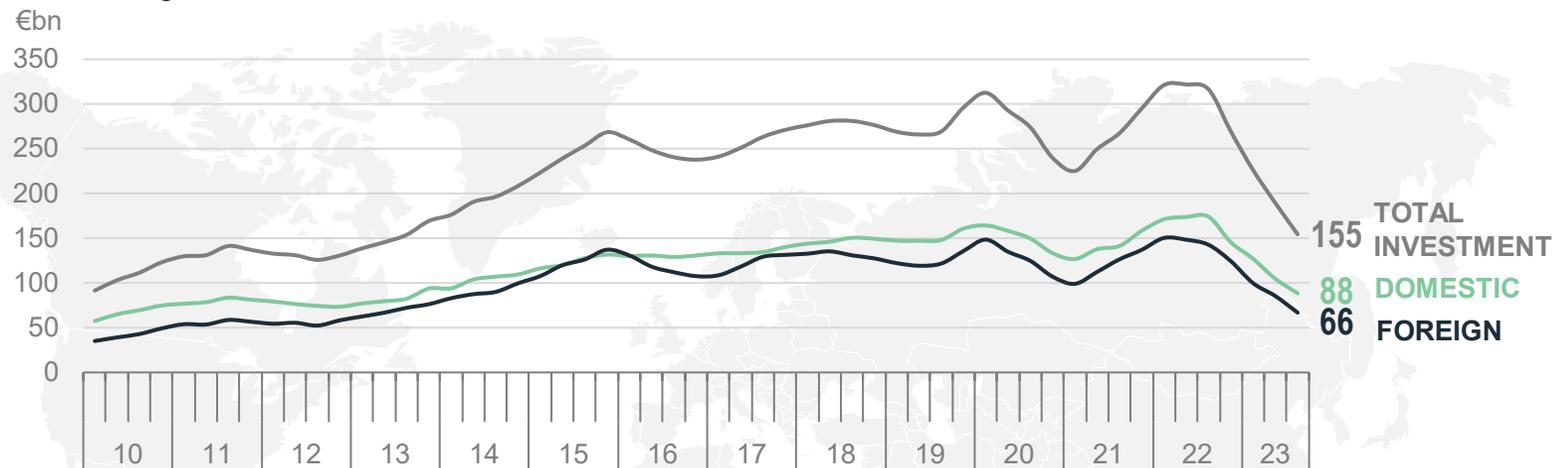
Source: BNP Paribas Real Estate.

CROSS-BORDER INVESTMENT MARKET

- Over 2022, foreign investment was very high during the first three quarters, peaking at €150bn (on a rolling-year basis) in Q1. It then declined sharply over Q4 reaching €67bn in Q3 2023 (-53%).
- Within foreign investment, **European cross-border investment declined in line with the overall reduction in activity (-53%)**. It represents 35% of foreign investment, a smaller share than during the Covid-19 years, and comparable to pre-pandemic times.
- Investment from other continents shows contrasting developments. **American investors** showed less interest in the European markets (-61%) but are still very present with 31% of foreign investment.
- Investments from Asia Pacific were also very important over the last 12 months. **With more than €11bn invested, (-39%)**, the Asian investor share increased significantly (17%).
- Middle East investors have more interest in the European markets. **They represented 6% of the last 12 months foreign investment with €3.9bn invested (+51%)**.

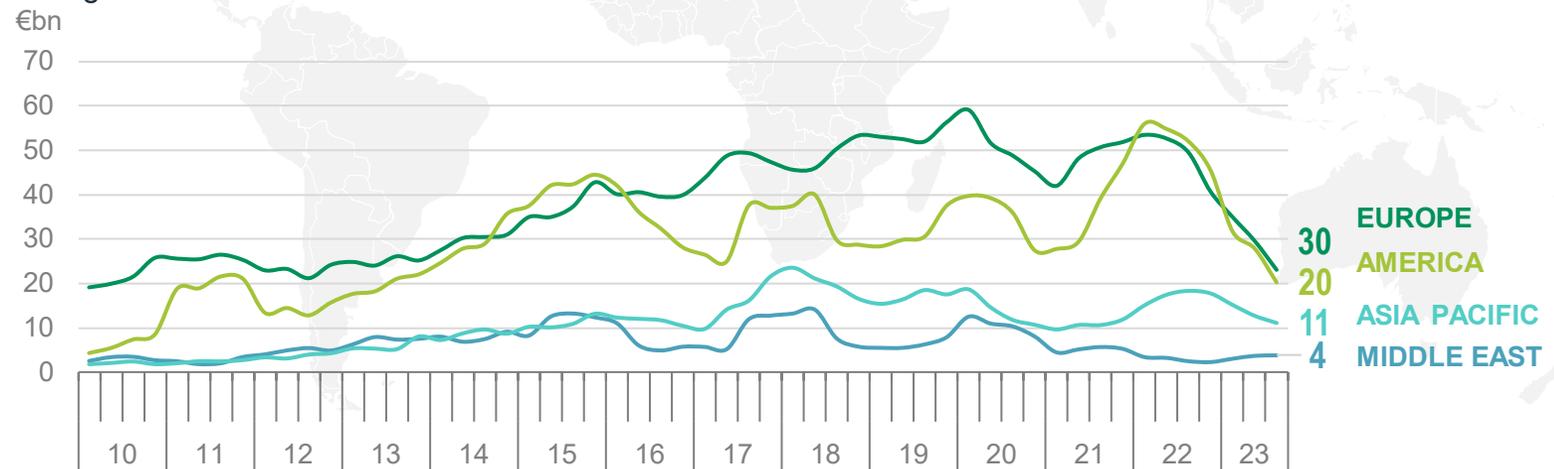
Commercial Real Estate Investment in Europe

Total, foreign and domestic investment



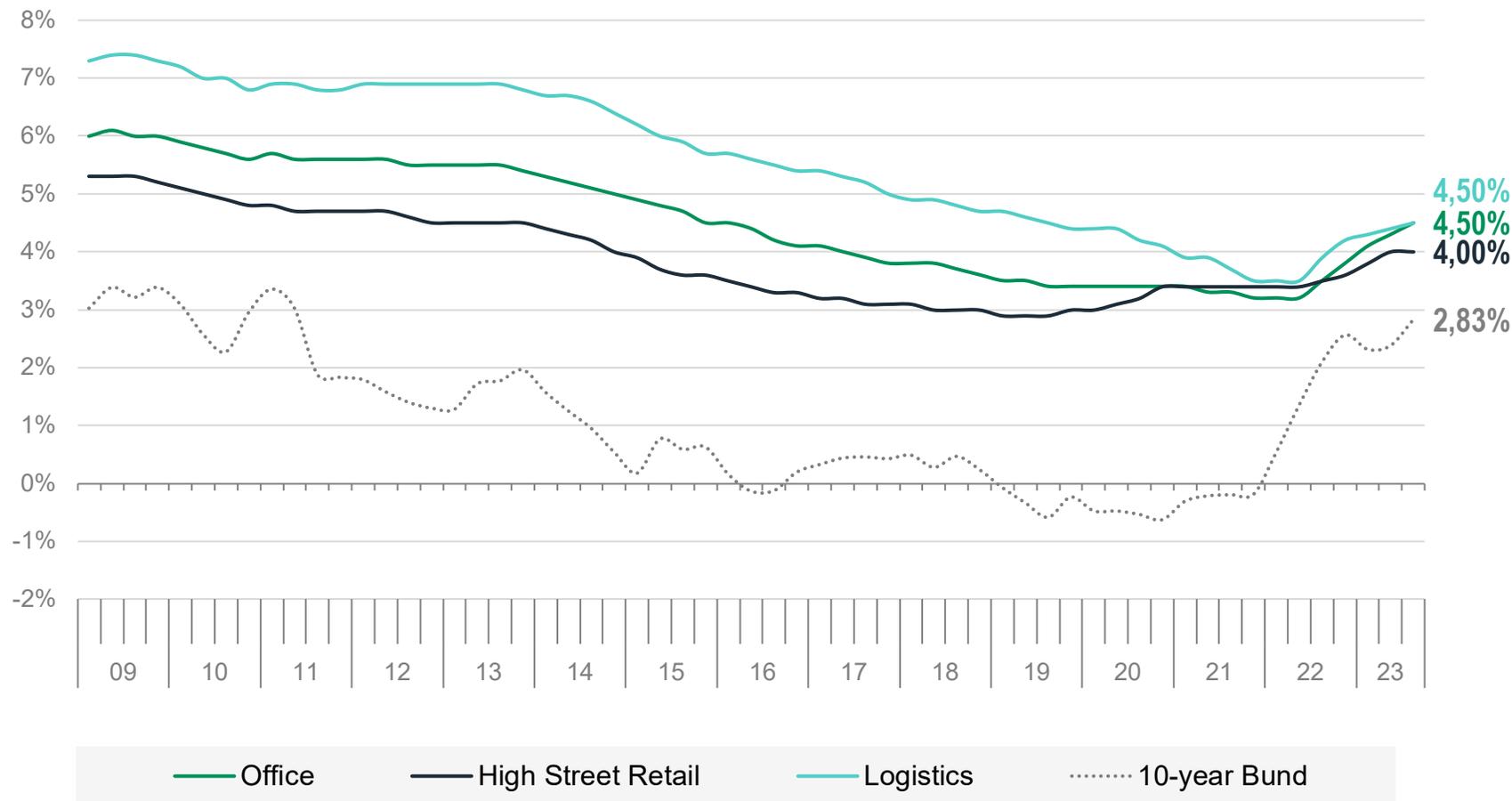
Commercial Real Estate Investment in Europe

Foreign investment detail



AVERAGE PRIME YIELDS IN EUROPE

BASED ON 16 MARKETS



- Prime yield compression, came to an end in 2022 closing off ten years of decline.
- The European market has now experienced almost a full year of yield decompression, affecting all sectors.
- The principal factor behind yield expansion is the change in the macro-financial environment. Persistent inflation is prompting more robust response from central banks. It is accelerating normalization of monetary policy.
- Bond yields are subsequently growing very rapidly, reducing the yield gap with real estate and prompting rethinking about the prices being paid for assets.

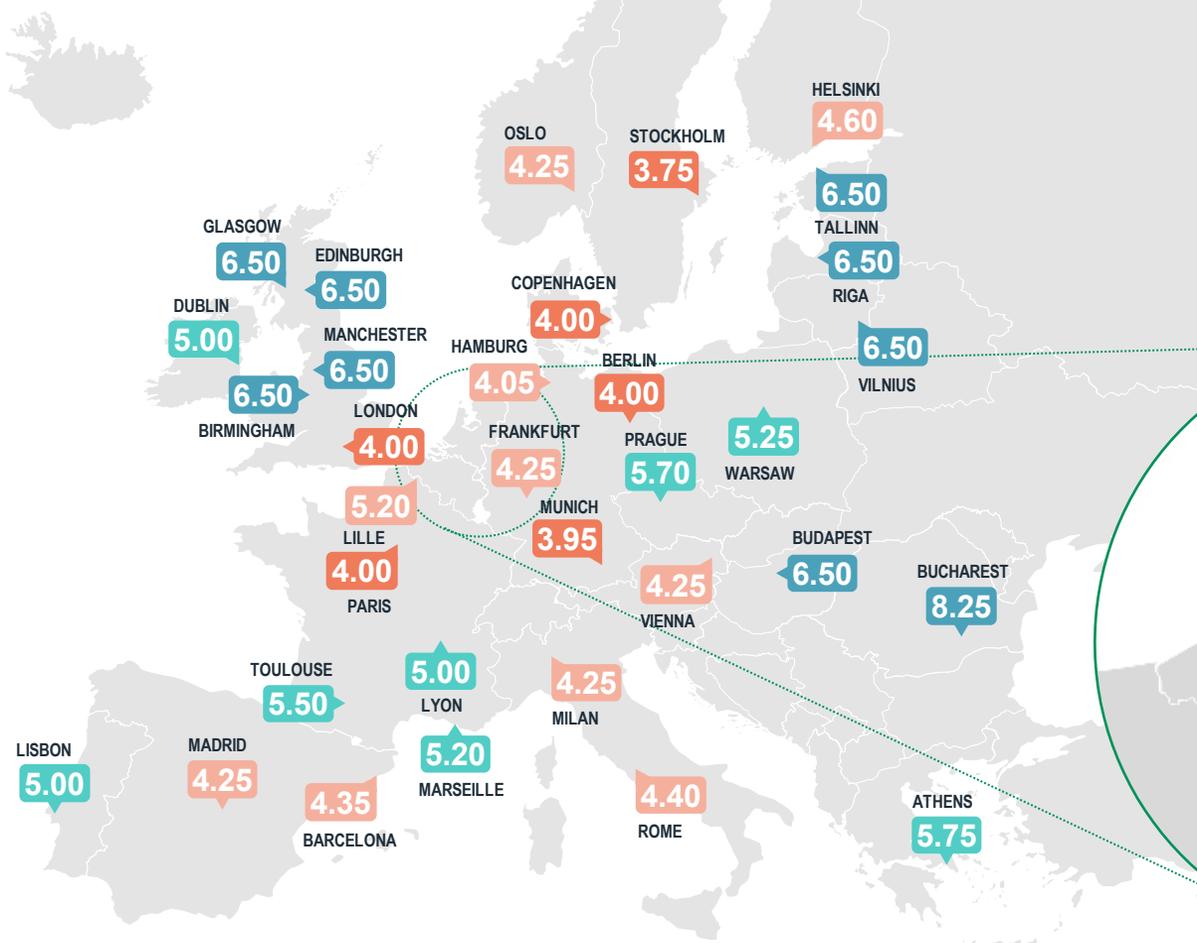
Based on 16 cities: Amsterdam, Berlin, Brussels, London, Paris, Dublin, Frankfurt, Hamburg, Lisbon, Luxembourg, Madrid, Milan, Munich, Prague, Vienna and Warsaw.

Source: BNP Paribas Real Estate Research.

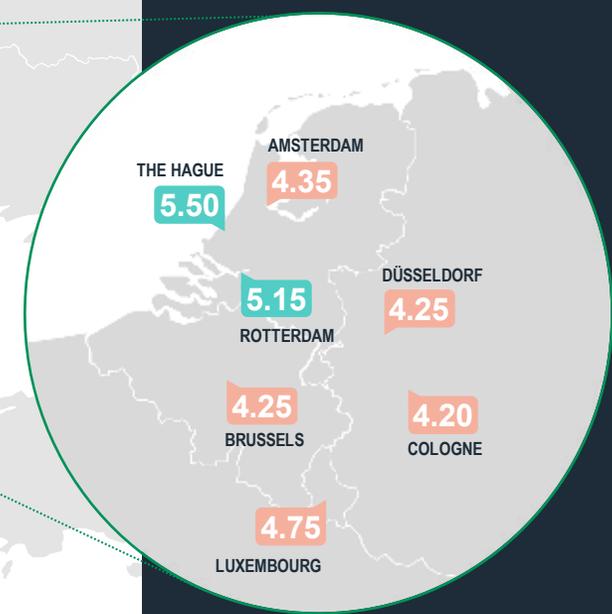
PRIME OFFICE YIELDS

Q3 2023 vs Q3 2022

	BERLIN	+115bp ↗
	PARIS	+100bp ↗
	AMSTERDAM	+95bp ↗
	MADRID	+75bp ↗
	MILAN	+100bp ↗
	LONDON	+75bp ↗
	LUXEMBOURG	+100bp ↗
	BRUSSELS	+65bp ↗
	DUBLIN	+90bp ↗
	PRAGUE	+120bp ↗
	WARSAW	+75bp ↗



- Office yield compression effectively ceased in Q1 2022. By Q2 and Q3 2022 the first signs of yield expansion were occurring, becoming strong and universal by Q4. Expansion has rolled forward into Q3 2023.
- The strongest decompression in the last 12 months were observed in the German markets (+115 bp for Berlin), Paris, Milan, and Luxembourg (+100 bp).



Source : BNP Paribas Real Estate

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REAL ESTATE PERSPECTIVES

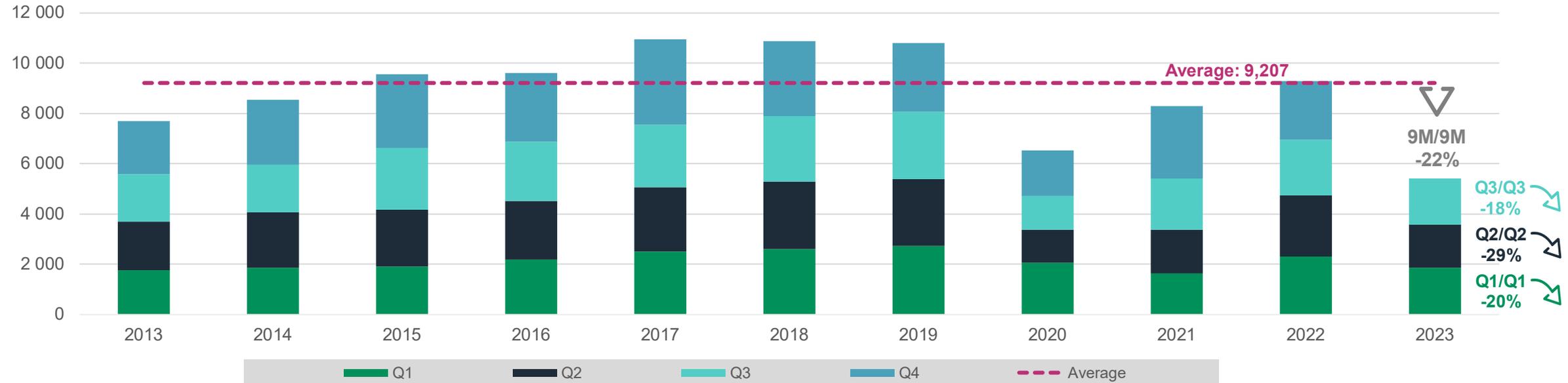
OFFICE
MARKETS



OFFICE TAKE-UP IN EUROPE – 9M 2023

17 MAIN EUROPEAN OFFICE MARKETS *

thousand sqm



Letting activity remained subdued in Q3 2023

- 2023 letting activity is struggling to regain the letting volumes seen in 2022 when take-up returned to its long-term average.
- Consequently, volumes after 9 months are below their 10-year average (-17%).
- Around 5.41m sqm was transacted since January 2023 in the 17 main European markets, down by 22% vs 2022.
- Most European markets experienced significant declines in volumes including Barcelona (-39%), Central London (-27%) and the six main German markets (-33%).
- Rome (+60%), Madrid (+11%) and Brussels (+5%) stand in contrast with some acceleration.

Source: BNP Paribas Real Estate Research.

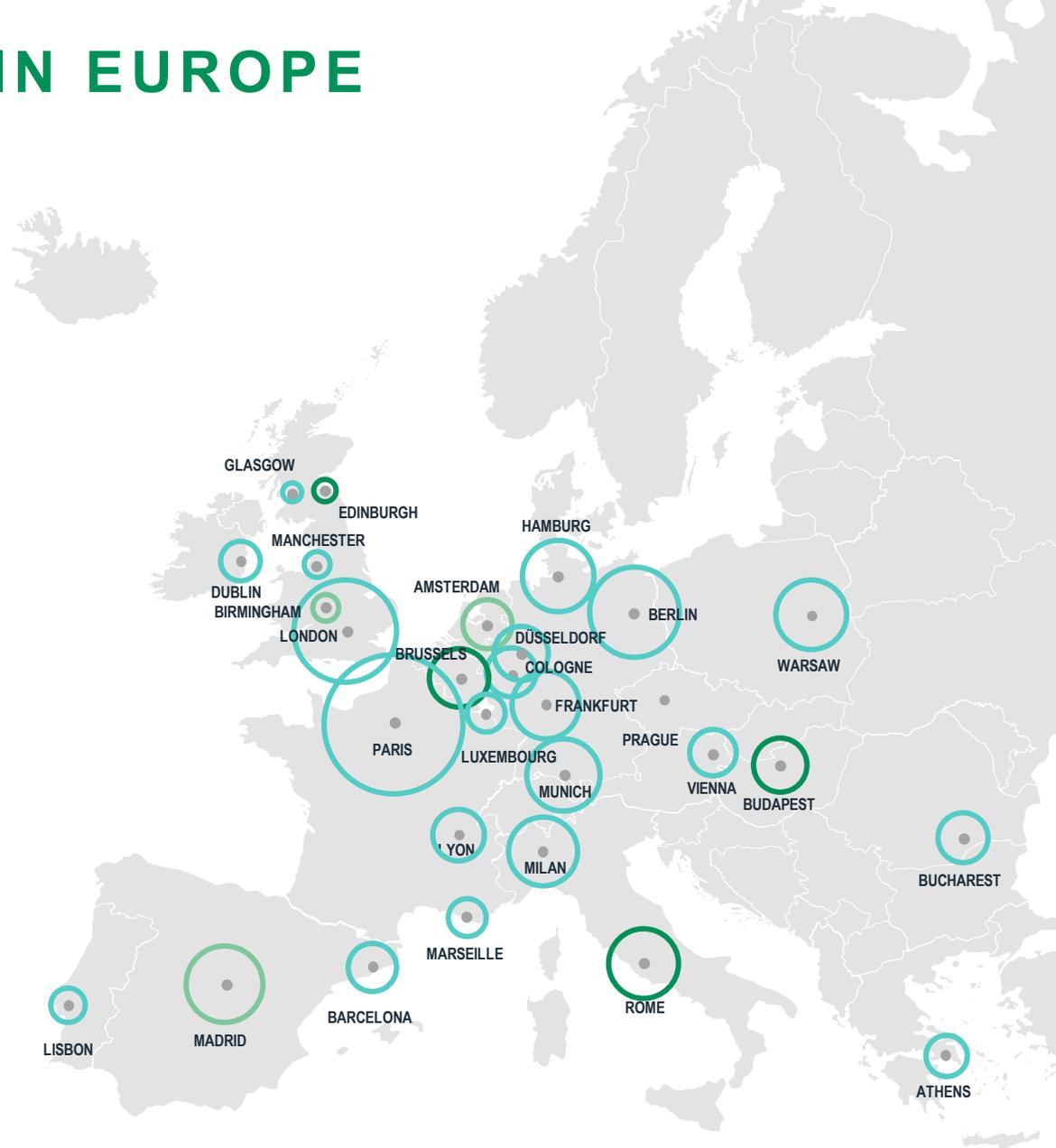
* Berlin, Cologne, Düsseldorf, Frankfurt, Hamburg, Munich, Central Paris, Central London, Brussels, Barcelona, Madrid, Dublin, Milan, Rome, Luxembourg, Amsterdam, Warsaw

OFFICE TAKE-UP IN EUROPE

9M 2023 vs 9M 2022

	CENTRAL LONDON	-27%
	BERLIN	-32%
	CENTRAL PARIS	-14%
	AMSTERDAM	-4%
	MADRID	+11%
	MILAN	-18%
	WARSAW	-18%
	BRUSSELS	+5%
	DUBLIN	-44%
	LUXEMBOURG	-47%

Deals in thousand sqm



Take-up is contracting

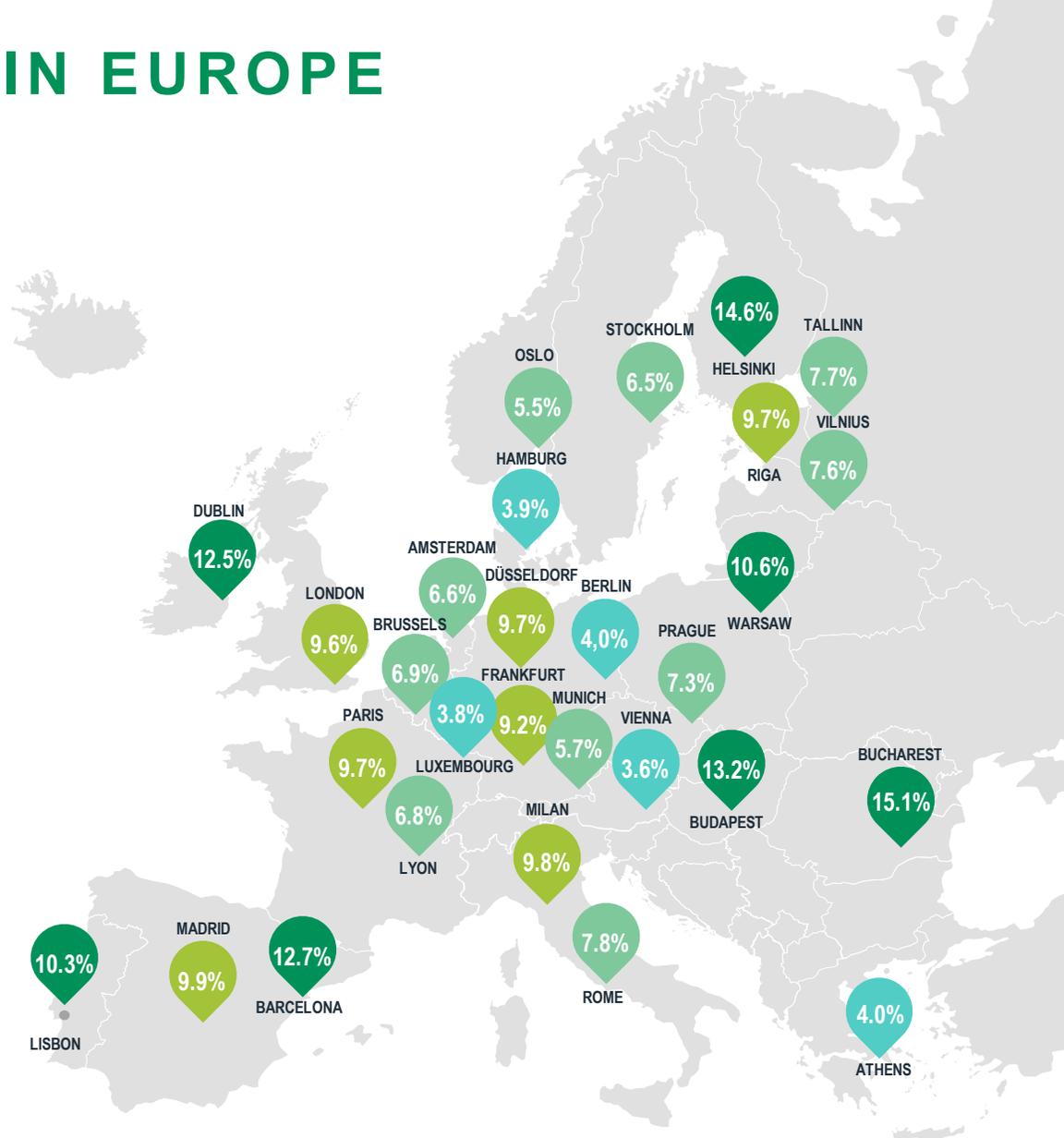
- Take-up after 9 months in 2023 declined by 21% compared to last year.
- Most markets have experienced a decline in volumes, mostly due to a reduced number of very large transactions (over 10,000 sqm).
- However, a few markets such as Madrid, Milan and Rome continue to show good momentum with 9-month volumes surpassing their long-term average.

Source: BNP Paribas Real Estate Research.

OFFICE VACANCY IN EUROPE

Q3 2023 vs Q3 2022

	CENTRAL LONDON	-10 bp ↘
	BERLIN	+90 bp ↗
	CENTRAL PARIS	+110 bp ↗
	AMSTERDAM	+40 bp ↗
	MADRID	+10 bp ↗
	MILAN	-10 bp ↘
	WARSAW	-160 bp ↘
	BRUSSELS	-90 bp ↘
	DUBLIN	+110 bp ↗
	LUXEMBOURG	+20 bp ↗



Vacancy remains under control in Europe

- The overall vacancy rate in Europe stood at 7.8% at Q3 2023 (+40bp vs. Q2 2022).
- Trends vary between markets: a sharp increase occurred in Barcelona (+220 bps vs. Q3 2022) due to numerous completions in 2022 while Berlin and Central Paris experienced a more moderate rise. In Warsaw, the vacancy rate markedly declined due to limited new supply.
- Most markets are seeing two-speed dynamics, with low availability in central submarkets and in new buildings, and much higher vacancy rates in peripheral office districts.

Source: BNP Paribas Real Estate Research.

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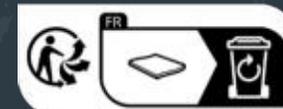
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