

# THE NON-EURO EUROPEAN COMMERCIAL PROPERTY CHART BOOK

Sep. 2011



## CEE markets still outperforming, but outlook is cloudy

- **In contrast to Western European property markets, investment volumes in CEE have continued to rise. But the latest batch of disappointing economic data from Emerging Europe suggests that investor sentiment toward this region could rapidly deteriorate.**
- **Economic indicators in the UK, Scandinavia and Switzerland** show that, in common with core euro-zone economies, in the UK and Switzerland, quarterly GDP growth slowed sharply in Q2. However, the non-euro-zone Scandinavian economies bucked that trend. (See page 2.)
- **Emerging European economic indicators** show that the recovery in industry is beginning to falter. As a result, annual GDP growth slowed in Q2 in Romania, Hungary, the Czech Republic and Russia. Surveys suggest that growth in Poland will also soften in the second half of the year. (See page 3.)
- **Commercial property investment market indicators** suggest that the upward trend in European investment volumes has come to an end. Within the region, however, investment activity in CEE markets is still increasing, albeit at only a moderate pace now. Survey evidence suggests that activity levels may increase in Q3. But we suspect that the recent spell of disappointing economic news and renewed financial market turbulence will have dampened investor sentiment. (See page 4.)
- Falls in commercial property yields were not widespread in the second quarter. Where falls did occur, they were mostly concentrated among office and retail markets and typically amounted to no more than about 15bps. By region, falls in Emerging European all-property yields continued to outpace those in other parts of Europe. (See page 5.)
- **Commercial property occupier market indicators** suggest that there is still no uniform upward trend in office occupier market activity. Compared to the previous quarter, take-up in Q2 was higher in half of the markets we have data for, but was flat or lower in the other half. (See page 6.)
- Nevertheless, the majority of non-euro-zone European office and retail markets saw some degree of rental value growth in the second quarter. But there were far fewer cases of industrial rental growth. Across all sectors, rental values in Oslo, Stockholm and Moscow increased by more than elsewhere. As a result, by region, all-property rents in Emerging Europe and Scandinavia are on the clearest upward trend. (See page 7.)

### North America

2 Bloor Street West, Suite 1740  
Toronto, ON  
M4W 3E2  
Canada  
Tel: +1 416 413 0428

### Europe

150 Buckingham Palace Road  
London  
SW1W 9TR  
United Kingdom  
Tel: +44 (0)20 7823 5000

### Asia

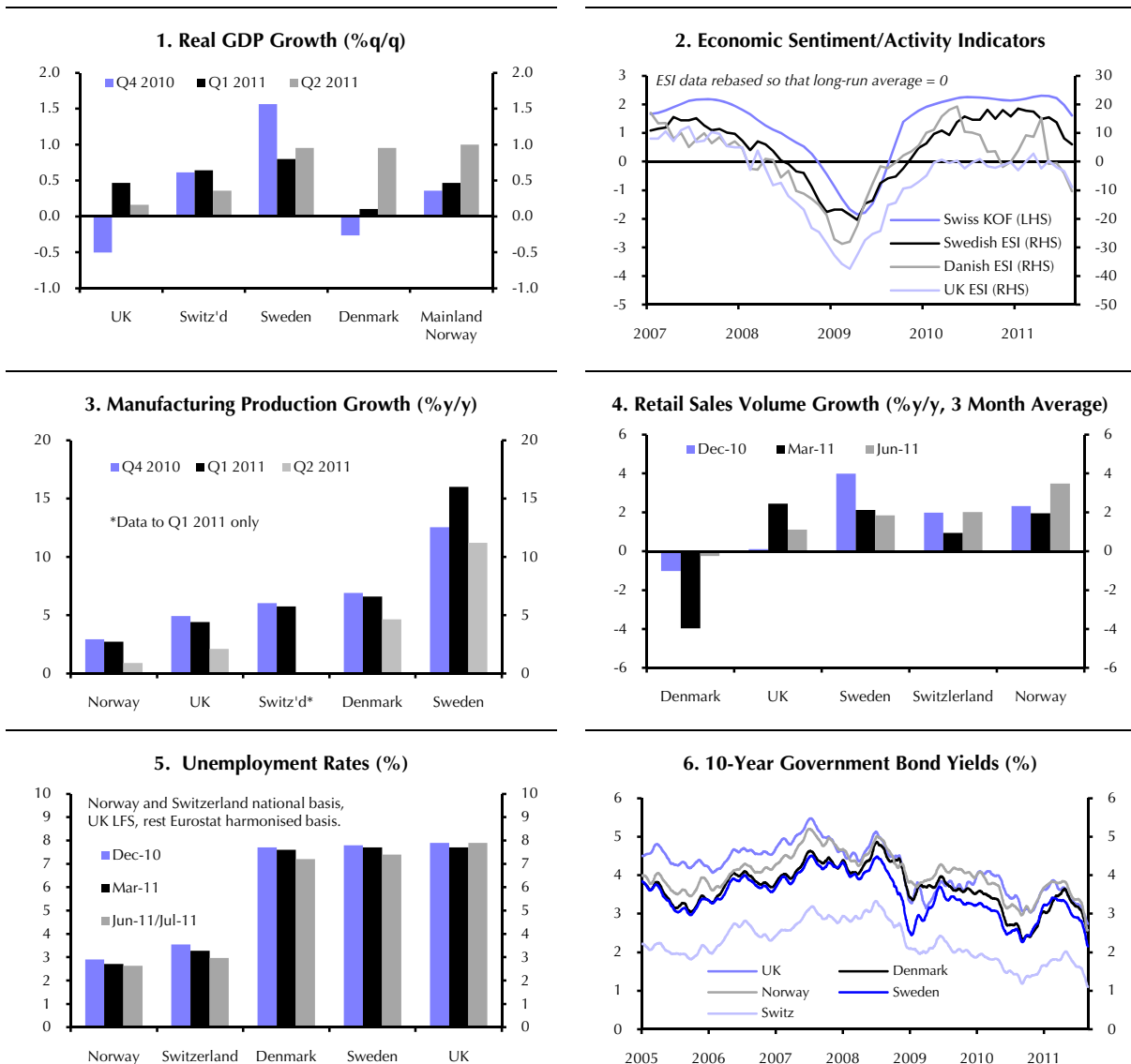
#26-03  
16 Collyer Quay  
Singapore 049318  
Tel: +65 6595 5190

Managing Director  
Chief Property Economist  
Property Economist

Roger Bootle (roger.bootle@capitaleconomics.com)  
Ed Stansfield (ed.stansfield@capitaleconomics.com)  
James Purvis (james.purvis@capitaleconomics.com)

## Economic Indicators (UK, Scandinavia and Switzerland)

- In common with the core euro-zone economies, in the second quarter, quarterly GDP growth in the UK and Switzerland slowed sharply. But the non-euro-zone Scandinavian economies managed to buck that trend, each seeing growth accelerate to a relatively healthy 1%q/q (1). And in Denmark, revisions to Q1's data release revealed that the economy did not, as had previously been reported, tip back into recession at the start of the year. Nevertheless, in recent months economic sentiment has plummeted in Denmark. And the same is true in the rest of the region (2).
- The impressive recoveries seen in manufacturing sectors across Europe over the past couple of years are clearly coming to an abrupt end. Where second quarter data are available, annual manufacturing production growth in non-euro-zone Western Europe slowed sharply (3). For now, indicators of consumer activity are more mixed. In June, annual retail sales volume growth slowed in the UK and Sweden, and sales continued to decline, albeit moderately, in Denmark (4). By contrast, retail sales volume growth accelerated in Switzerland and Norway.
- That is consistent with the fact that unemployment in both economies is considerably lower than elsewhere (5). Indeed, unemployment rates in Denmark, Sweden and the UK all remain above 7%. Meanwhile, the weakening global economic outlook has caused risk aversion to rise and interest rate expectations to be revised downwards. Reflecting this, yields on government bonds have fallen significantly in the UK, Scandinavia and Switzerland (6).

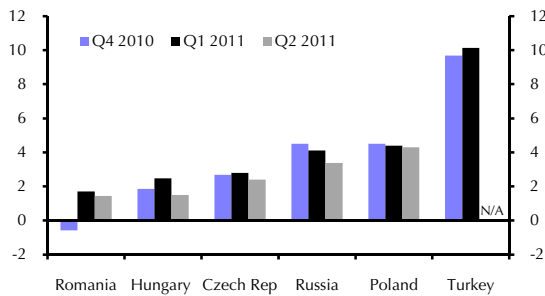


Sources – Thomson Datastream, Capital Economics

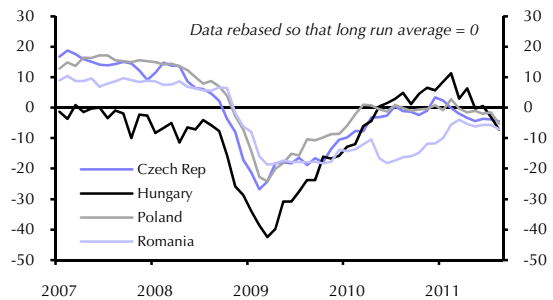
# Economic Indicators (Emerging Europe)

- In the second quarter, economic growth in Emerging Europe typically surprised to the downside. Annual GDP growth slowed in Romania, Hungary, the Czech Republic and Russia (1). However, the Polish economy is still growing robustly. Nevertheless, even in Poland, recent business surveys have fallen further below long-run average levels (2). We expect growth in Poland to slow in the second half the year.
- Another factor behind our downbeat view for the rest of the year is the growing evidence that the recovery in the Emerging European industrial sector is beginning to falter. Manufacturing production growth slowed sharply everywhere in Q2, particularly in Romania and Hungary (3). In addition, the latest raft of manufacturing PMI data from the region were also, without exception, disappointing. Meanwhile, there remains little sign that domestic demand will be strong enough to support the wider economic recoveries as manufacturing production grinds to a halt. Indeed, aside from in Russia, retail sales volumes are either flat or falling (4).
- On a more positive note, in most Emerging European economies, unemployment rates have fallen quite sharply since the beginning of the year (5). But they are still relatively high in Poland, Turkey and Hungary. And given the softening economic outlook, further steep falls in unemployment are looking increasingly unlikely. In much of the region, we expect GDP growth in 2012 to be slower than in 2011 (6). In fact, given the sharp rise in its current account deficit, we now expect the Turkish economy to suffer a very hard landing next year.

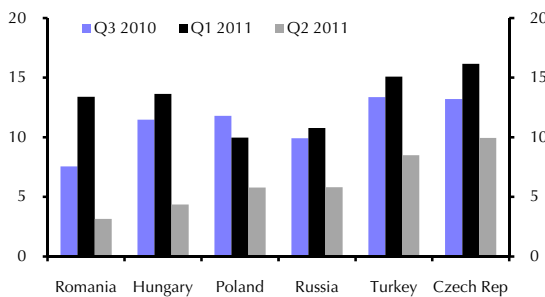
1. Real GDP Growth (%y/y)



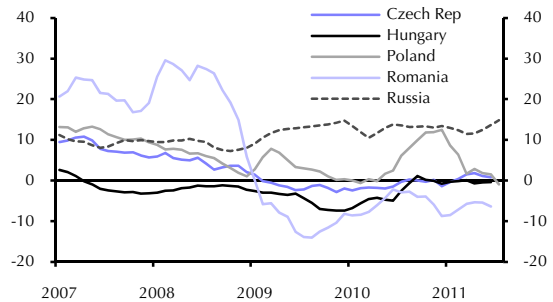
2. Economic Sentiment Indices



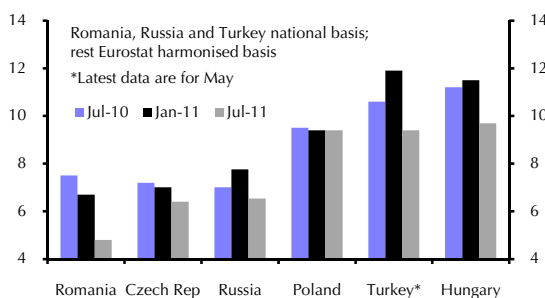
3. Manufacturing Production Growth (%y/y)



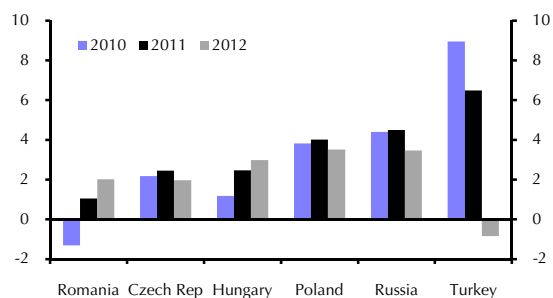
4. Retail Sales Volume Growth (%y/y, 3mma)



5. Unemployment Rates (%)



6. GDP Growth Forecasts (%y/y)

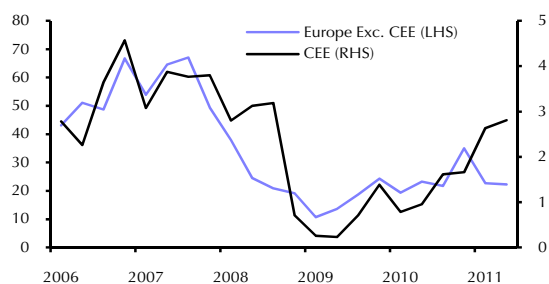


Sources – Thomson Datastream, Bloomberg and Capital Economics

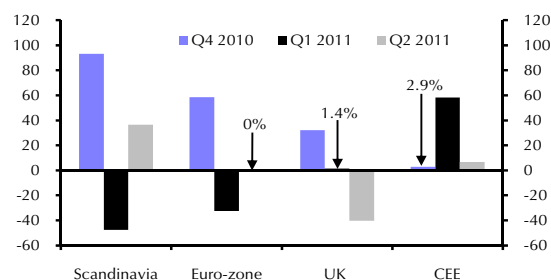
## Investment Market Indicators

- European commercial property investment volumes have fallen in both of the past two quarters. However, the total has been dragged down by Western European markets, while deal volumes in Central & Eastern Europe (CEE) have continued to trend upwards (1). Admittedly, investment volumes in CEE increased only marginally in the second quarter. But that was a much better outcome than that seen in the euro-zone or in the UK (2). Activity in Scandinavia increased by more, but that followed a sharper fall in Q1.
- Comparing Q2 2011 investment volumes to the same period in 2010, at nearly 200% higher, the CEE region is clearly leading the way within Europe (3). Investment volumes in Scandinavia and the euro-zone are also higher now than a year earlier, but the UK has seen a significant drop in activity levels. Reflecting that, according to the latest RICS global survey, surveyors' responses suggest that investment demand was weakest in the UK (4).
- Surveyors were equally downbeat about UK investment demand prospects for Q3. By contrast, the survey suggested that demand would increase rapidly in Russia, Scandinavia, the Czech Republic and Poland (5). Note that the survey was carried out before the recent spell of disappointing economic news and sentiment may have since weakened. In a further sign that risk aversion is creeping upwards, the spread between government bond yields in most Emerging European markets and Bund yields has increased a little recently (6).

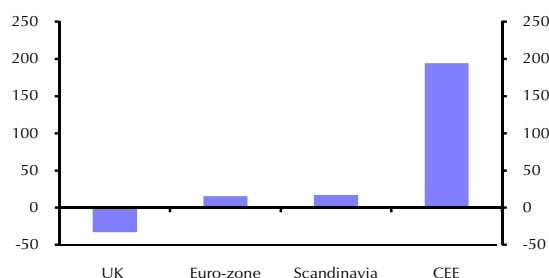
1. Commercial Property Investment Turnover (Euro Billions)



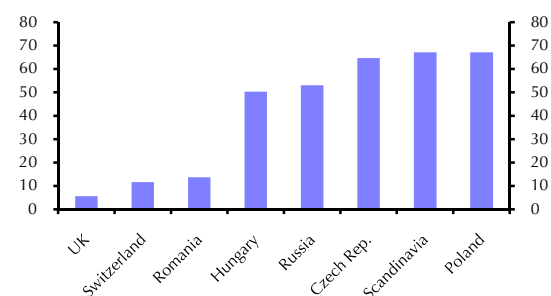
2. Commercial Property Investment Turnover (Q2 2011, %q/q)



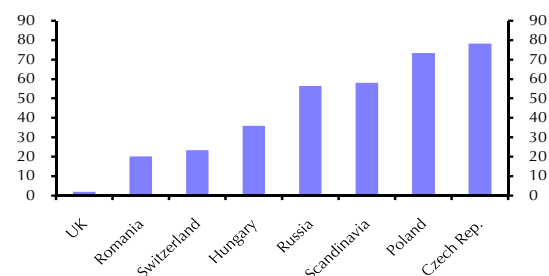
3. Commercial Property Investment Turnover (Q2 2011, %y/y)



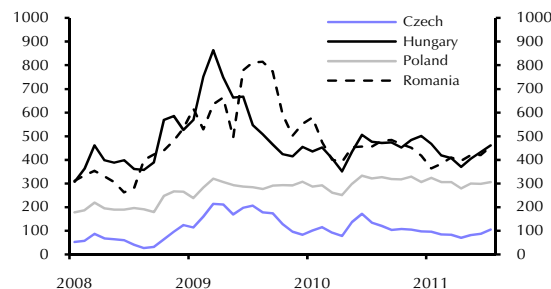
4. Surveyors Reporting a Rise in Investment Enquiries in Q2 2011 (% Net Balance)



5. Surveyors Expecting a Rise in Investment Demand in Q3 2011 (% Net Balance)



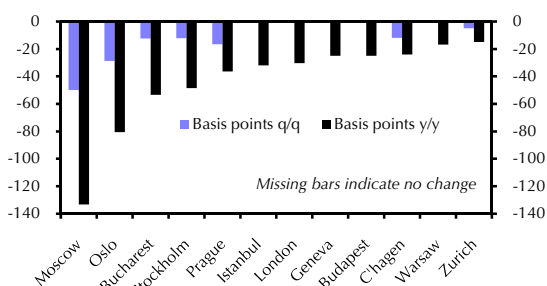
6. Difference Between National Government 10-Year Bond Yields and 10-Year German Bund Yields (Basis Points)



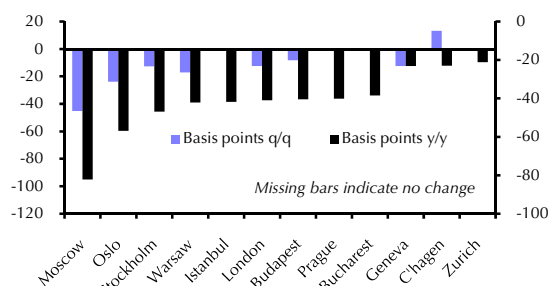
## Investment Market Indicators (Continued)

- In the second quarter, in most non-euro-zone Western European office markets, prime yields were either stable or fell by about 15bps or less (1). The only exceptions were Oslo and Moscow, where office yields fell by 30bps and 50bps respectively. It was no surprise, therefore, that annual falls in yields in those markets were steeper than elsewhere. A very similar picture was evident among retail markets (2). Notably, prime retail yields in Copenhagen edged a little *higher* in Q2. We raised concerns over that possibility at the start of the summer. (See *European Commercial Property Update*, "Copenhagen retail market looking increasingly overpriced", 2<sup>nd</sup> June.) Meanwhile, there was very little movement in non-euro-zone industrial yields over the quarter (3).
- At the regional level, all-property yields in Emerging Europe continued to fall at a slightly faster pace than in other parts of Europe, with the result that the spread between yields in Emerging Europe and the rest of Europe narrowed further (4).
- Since the end of Q2, 10-year government bond yields have fallen everywhere. Therefore, the relative attractiveness of property compared to bonds has increased over the same period (5). At 245bps or more, property/bond yield spreads are now relatively high everywhere. Compared to equities, however, the picture is more varied (6). Indeed, global falls in equity prices have made property look comparatively *less* attractive, especially in Prague and Zurich.

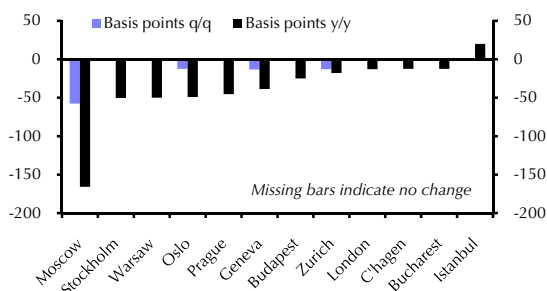
1. Change in Office Yields (Q2 2011, Basis Points)



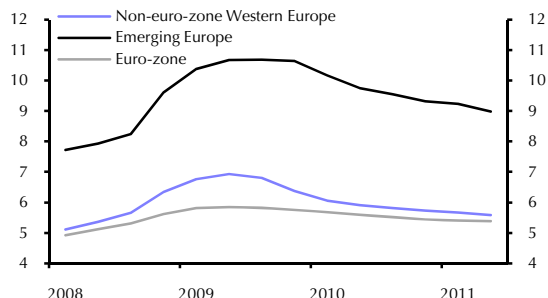
2. Change in Retail Yields (Q2 2011, Basis Points)



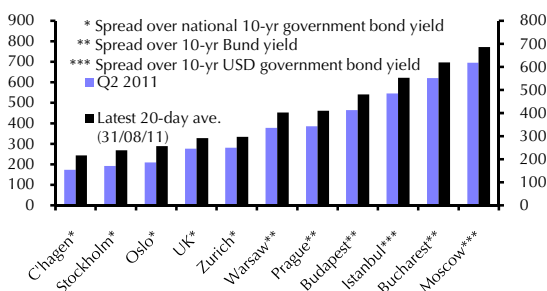
3. Change in Industrial Yields (Q2 2011, Basis Points)



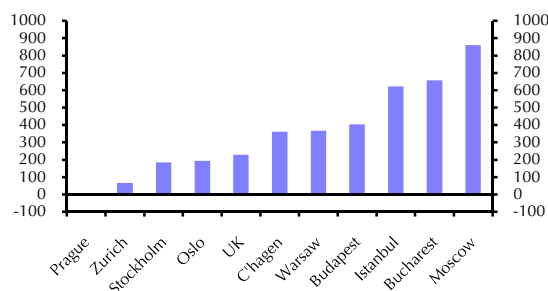
4. All-Property Yields by Region (%)



5. Non-Euro European All-Property Yields – Spread Over 10-Year Government Bond Yields (August 2011, Basis Points)



6. Non-Euro European All-Property Yields – Spread Over Equity Dividend Yields (August 2011, Basis Points)

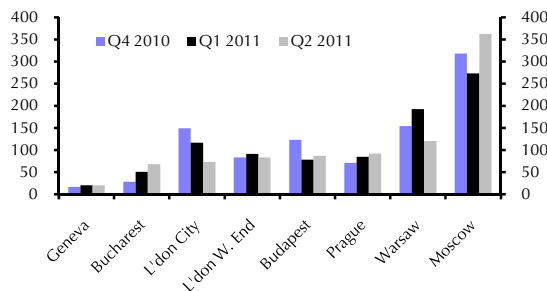


Sources – Thomson Datastream, Various Agents, Capital Economics

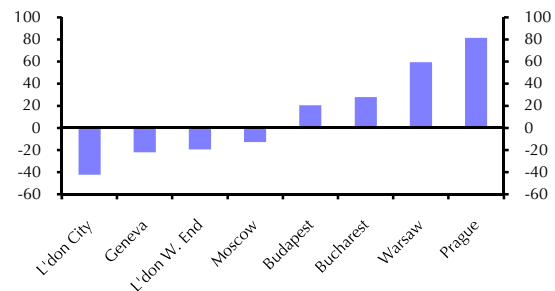
# Occupier Market Indicators

- The available second quarter take-up data for non-euro-zone European office markets suggests that there is still no uniform upward trend in occupier market activity (1). Compared to first quarter levels, take-up increased substantially in Moscow, while moderate quarterly increases were also recorded in Bucharest, Budapest and Prague. But the remaining markets, including the previously strong Warsaw office market, saw declines. Even so, supported by a strong first quarter, H1 take-up in Warsaw was still far healthier this year than in 2010 (2).
- On a quarterly basis, in the majority of non-euro-zone European office markets, vacancy rates declined in the second quarter (3). Falls were particularly steep in Oslo, London's West End, Prague and Bucharest. Istanbul was the only office market to see a meaningful increase in vacancy rate. As things stand, vacancy rates typically range between 6% and 10%, but they are substantially lower in Geneva, and higher in Prague, Bucharest, Moscow and Budapest (4).
- Despite the vacancy rate hovering at such a high level in Moscow, for now, prime office rental values are still rising strongly (5). Quarterly office rental value growth was also fairly robust in Oslo, Warsaw and Geneva while, in most other office markets, rents continued to track sideways. On an annual comparison, office rental values in Moscow have increased markedly. Annual rental growth has also exceeded 10% in Warsaw, London's West End and Oslo. But in a handful of markets, rents have failed to increase at all over the past year (6).

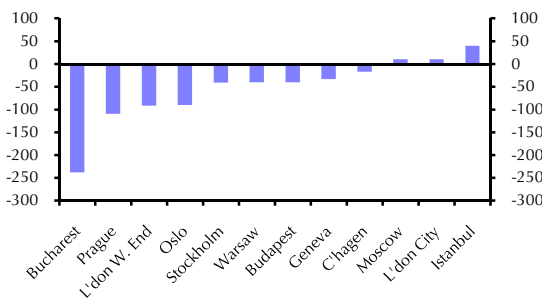
1. Office Take-Up in Selected Cities (000s Sqm)



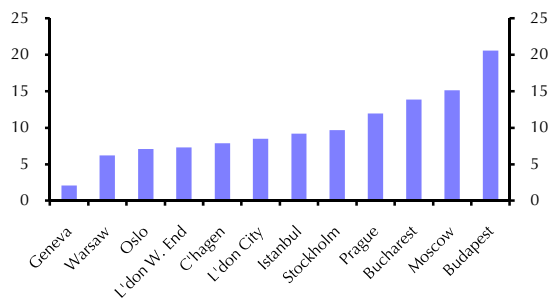
2. Office Take-Up in Selected Cities (H1 2011 v H1 2010, %)



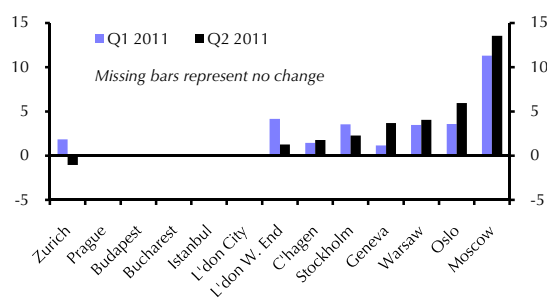
3. Change in Office Vacancy Rates (Q2 2011, Bps q/q)



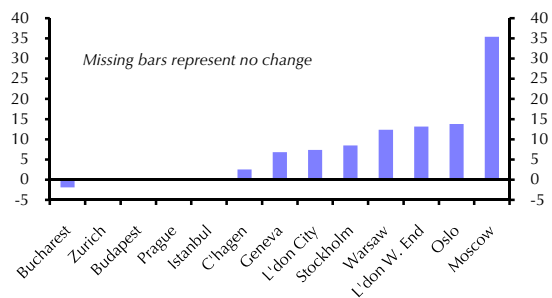
4. Office Vacancy Rates (Q2 2011, %)



5. Headline Office Rental Value Growth (%q/q)



6. Headline Office Rental Value Growth (Q2 2011, %/y)

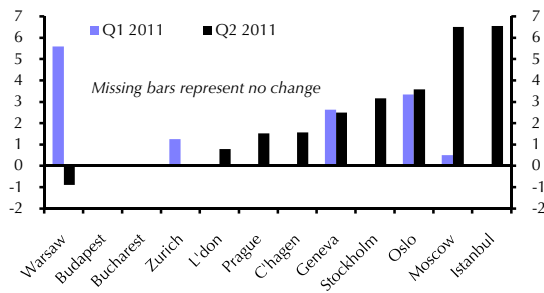


Sources – Various Agents, IPD, Capital Economics

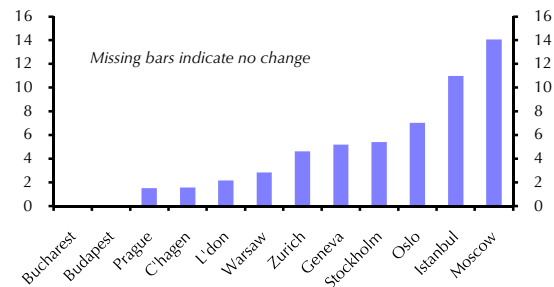
## Occupier Market Indicators (Continued)

- Retail sales volumes growth slowed in many non-euro-zone European economies. Even so, on a quarterly comparison, retail rental values increased in most markets in the second quarter **(1)**. Moscow and Istanbul recorded the fastest quarterly rates of rental growth. This helped push annual retail rental growth rates in Moscow and Istanbul into double-digits **(2)**. At the other end of the spectrum, only retail markets in Bucharest and Budapest have not seen an increase in retail rental values over the past year.
- There were far fewer cases of quarterly rental growth among non-euro-zone European industrial markets than for the office or retail sectors **(3)**. Nevertheless, industrial markets in Moscow and Oslo were once again among the strongest in the region. Warsaw also registered fairly solid industrial rental growth. But that was not enough to lift the annual rental growth rate into positive territory. Indeed, alongside Budapest, industrial rents in Warsaw in Q2 2011 were lower than in the same period last year **(4)**.
- By sector, outside of the euro-zone, office rental values have outperformed retail and industrial rents over the past year **(5)**. And in Scandinavia and Emerging Europe, industrial rents have increased faster than retail rents. By region, thanks to the strength of rental value growth across all sectors in Moscow, Oslo and Stockholm, all-property rents in Emerging Europe and Scandinavia have been on the clearest upward trend **(6)**. All-property rental values in the UK and euro-zone have done little more than stabilise over the past 18 months.

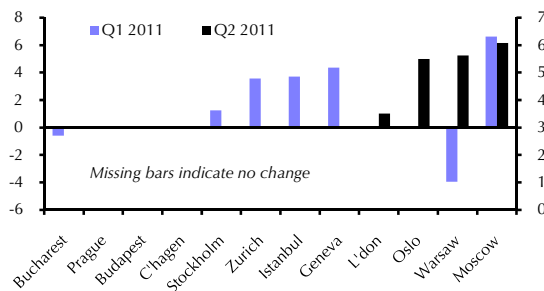
1. Headline Retail Rental Value Growth (%q/q)



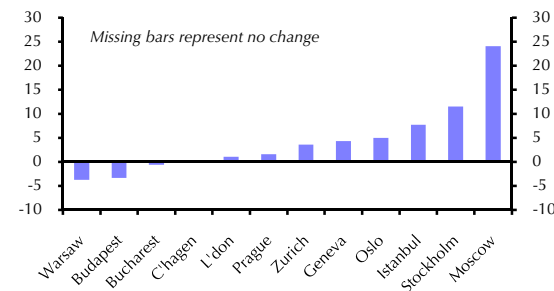
2. Headline Retail Rental Value Growth (Q2 2011, %y/y)



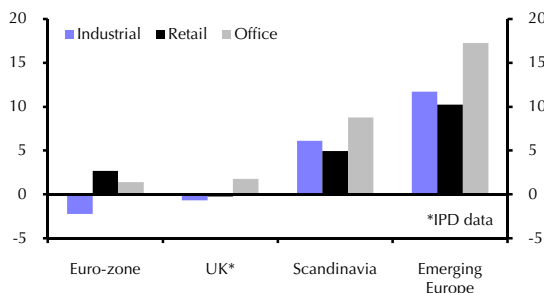
3. Headline Industrial Rental Value Growth (% q/q)



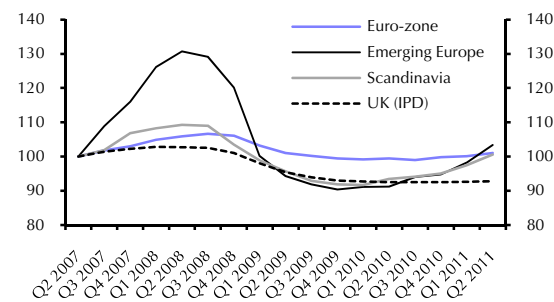
4. Headline Industrial Rental Value Growth (Q2 2011, %y/y)



5. Rental Values by Region and Sector (Q2 2011, %y/y)



6. All-Property Rental Value Indices (Q2 2007 = 100)



Sources – Various Agents, IPD and Capital Economics

## Economic and Financial Market Data and Forecasts

### LATEST MARKET DATA

Instrument/rate	1 mth ago	1 week ago	Latest*	Instrument/rate	1 mth ago	1 week ago	Latest*
Official Rates				Germany yield curve (20-2)	230	222	222
ECB refi	1.50	1.50	1.50	Global yields			
UK repo	0.50	0.50	0.50	US 10 year	2.25	2.18	1.99
US Fed funds	0-0.25	0-0.25	0-0.25	UK 10 year	2.71	2.50	2.34
Japan o'night	0.10	0.10	0.10	Japan 10 year	1.05	1.02	0.99
Market rates				Equity indices			
3mth Euribor	1.51	1.48	1.48	German DAX	5917	5644	5304
12mth Euribor	2.08	2.05	2.04	French CAC	3176	3160	3030
Bond yields				Italian MIB	15721	15106	14385
Germany 2 yr	0.78	0.66	0.47	Exchange rates			
Germany 10 yr	2.37	2.15	1.91	\$/euro	1.42	1.44	1.42
Germany 20 yr	3.07	2.88	2.69	£/euro	0.88	0.89	0.88
France 10 yr	3.23	2.83	2.72	¥/euro	109.7	110.6	109.5
Italy 10 yr	5.18	5.13	5.48	Brent crude oil price (\$ pb)	104.1	114.8	111.2

\*Latest as at 11.40am on 6<sup>th</sup> September 2011

### FORECASTS OF ECONOMIC ACTIVITY

% y/y	Real GDP			Real Consumer Spending			Employment		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
<b>Developed Europe</b>									
Denmark	1.5	1.0	0.7	2.3	-0.3	1.0	-2.1	-0.2	0.0
Norway	0.3	1.0	2.5	3.6	3.0	3.0	0.0	0.8	1.2
Sweden	5.4	4.5	2.0	3.4	2.0	2.0	1.0	2.3	1.0
Switzerland	2.7	1.7	0.8	1.7	1.1	1.2	0.4	1.4	0.3
UK	1.4	1.0	1.5	0.9	-1.5	-1.0	0.1	0.9	-0.7
<b>Emerging Europe</b>									
Czech Republic	2.3	2.5	2.0	0.3	1.0	1.5	-1.0	0.5	1.0
Hungary	1.2	2.0	2.0	-2.2	1.5	2.0	0.0	0.5	1.0
Poland	3.8	4.0	3.5	3.2	4.0	4.0	0.6	0.5	1.0
Romania	-1.3	1.5	2.0	-1.8	1.5	2.5	0.2	0.5	1.0
Russia	4.0	4.0	3.5	2.7	4.5	3.0	0.8	2.0	1.0
Turkey	8.9	6.5	-1.0	6.6	7.5	-2.5	6.0	5.0	-1.0

### FORECASTS OF INTEREST RATES, BOND YIELDS AND CURRENCIES

End year	Official interest rates, %			10-year government bond yield, %			Local currency per euro		
	2010	2011	2012	2010	2011	2012	2010	2011	2012
<b>Developed Europe</b>									
Denmark	1.05	1.35	1.05	3.02	2.90	2.65	7.45	7.46	7.46
Norway	2.00	2.75	5.00	3.71	3.25	4.00	7.80	7.70	7.00
Sweden	1.25	2.50	2.50	3.27	3.00	3.25	9.02	8.50	8.00
Switzerland	0.25	0.25	0.25	1.59	1.50	1.50	1.25	1.20	1.10
UK	0.50	0.50	0.50	3.58	2.50	2.75	0.86	0.88	0.84
<b>Emerging Europe</b>									
Czech Republic	0.75	0.75	0.75	3.89	3.75	4.00	25.5	25.5	25.5
Hungary	5.75	6.00	5.50	7.92	6.50	7.00	279	270	260
Poland	3.50	4.50	4.00	6.06	5.25	5.50	3.96	3.90	4.00
Romania	6.25	6.25	6.25	7.09	6.50	6.50	4.09	4.40	4.00
Russia*	7.75	8.25	8.25	5.00	4.75	5.25	30.5	30.5	34.5
Turkey*	6.50	5.50	5.50	5.00	5.50	5.50	1.54	1.60	1.60

\* Local currency per USD & USD bond yields

Sources: Thomson Datastream, Bloomberg & Capital Economics