EMPIRA

Economy & Real Estate

Research Quarterly View

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Dear Reader,

Following a period of high inflation rates and significant interest rate hikes, a large number of western economies are, expectedly enough, now being confronted with low economic growth. The focus of economic policy is thus being shifted from combatting inflation to reviving the economy.

In a comparison with the German-speaking regions of Europe the US economy is developing extremely positively. Its relatively strong macroeconomic performance and the historically low rate of unemployment indicate that the world's leading economic power is still excellently positioned and is rightly regarded as an attractive international investment location.

On the whole the German housing market is characterised above all by a low level of construction approvals with the forecast number of completions also low. As a consequence of the increase in interest rates, liquidity problems also play a role for private households, with previously planned purchases and new constructions now being postponed. All in all this means that in the long term there is a stable rental market with strong potential, as the sparse offering contrasts with a simultaneous increase in demand. New housing construction continues to be dominated by multi-family residential buildings, and therefore also by professional investors.

For the much less heavily regulated yet more volatile real estate market in the USA the forecast for the rest of this year is a slight rise in rents with purchase prices stagnating at the same time. Real estate thus also benefits from stable cash flows when compared with other asset classes. In this respect the real estate markets in the various metropolitan areas have proved themselves to be highly heterogeneous with differing degrees of dynamism.

Speak with us so we can jointly evaluate the opportunities offered by the residential investment sector in the current market environment.

Regards,

Lahcen Knapp
Founder and Chairman, Empira Group

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Overview

Following a period of high inflation rates and steep rises in interest rates, many western economies are currently in a period of economic stagnation, while inflation rates are returning to normal. The focus of economic policy is therefore shifting away from combating inflation and towards reviving the economy.

Economic climate

Many western economies were in recession in 2023. In the DACH region, economic growth is expected to remain sluggish this year, whereas the US economy is performing very strongly.

DACH region

From an economic perspective, 2023 in the DACH region was dominated by recession. Economic output stagnated in Germany and Austria. Given that the previous brief period of growth in 2021 and 2022 was largely shaped by catch-up effects following the pandemic-related downturn, the DACH region has not seen any substantial growth since the start of the 2020s.

At the end of 2023, Germany's economic output was just 0.7% above the level recorded in 2019, the year prior to the pandemic. The outlook for Germany this year is not very positive. The German government has downgraded its growth forecast by over one percentage point to just 0.2% – an unusually sharp reduction in growth expectations. Meanwhile, the Joint Economic Forecast produced by leading German economic research institutes was lowered to just 0.1%, meaning the general consensus is now that 2024 will be a year of stagnation. For 2024, the German government expects that consumer spending by private households (+1.1%), government expenditure (+0.7%), and investment in machinery and equipment (+0.5%) will make positive contributions to economic growth. However, the anticipated sharp decline in construction investment (-2.2 %) is set to dampen growth.

There are also signs of a deterioration in the labor market situation. The average unemployment rate rose 0.4 percentage points year on year in 2023, and a further increase to 5.9% is forecast for 2024. However, a rise in the working population from around 45.9 million to approximately 46.1 million is forecast as a consequence of ongoing population growth. Employment income increased by 6.1% last year, and a further rise of 5.3% is expected this year.

The decrease in Austria (-0.8 %) was even sharper than in Germany (-0.3 %), as the country's recessionary trend becomes increasingly pronounced. Weak growth at best is anticipated for 2024, and the economic situation is not expected to improve until 2025, as reflected in a forecast growth rate of +1.8%.

Things look more positive for the Swiss economy. Switzerland ended 2023 with economic growth of 1.3% and, unlike its German-speaking neighbors, remains on course for growth. Here too, however, economic growth is on a downward trajectory, falling year on year (2022: +2.5%) and with only modest growth of 1.1% expected for 2024. However, the Swiss economy appears to be in a structurally better position to cope with the current global conditions than that of Germany or Austria.

DACH economic growth	2023	2024p	2025p
Economic growth – Germany	-0.3%	+0.1%	+1.4%
Economic growth – Austria	-0.8%	+0.2%	+1.8%
Economic growth – Switzerland	+1.3%	+1.1%	+1.7%
Inflation – Germany	5.9%	2.3%	1.8%
Unemployment rate – Germany	5.7%	5.9%	5.6%

Source: German government – Annual Economic Report 2024, Destatis, Austrian Institute of Economic Research (WIFO) economic outlook (1/2024), SECO economic trends (spring 2024), Joint Economic Forecast (spring 2024).

Inflation is becoming a less significant issue. Although the inflation rate for full-year 2023 was 5.9%, missing the 2% threshold set out in the Maastricht Treaty and only slightly lower than in 2022, this is because it is an average for the year: whereas rates were over 8% at the start of the year, they fell significantly from September onwards. In January 2024, the consumer price index was up by less than 3% for the first time since June 2021, meaning that normality is being restored. This is because lower demand amid the recession is curbing price increases. Similar patterns were seen in previous crisis years: inflation figures of 0.3% and 0.5% were recorded in 2009 and 2020, respectively. For full-year 2024, an inflation rate of 2.3% is anticipated.

In Austria, the inflation rate for full-year 2023 was 7.8%, which was considerably higher than the German rate. Rates are also falling in Austria, but the trend is less advanced: inflation remained above 4% in the first two months of 2024. For full-year 2024, an inflation rate of 3.5% is predicted.

The situation in Switzerland is completely different, with inflation of just 2.1% in 2023 and rates already below the critical 2% mark in the first two months of 2024. A rate of 1.6% is expected for full-year 2024.

We can conclude that inflation has become far less of a critical issue over recent months and will disappear further from focus provided the current trend continues.

US

In general, US economic data is more positive than in the DACH region of Europe. Economic output rose by 2.5%, coupled with an increase in real incomes of over 4%. Inflation fell to a yearly average of 3.7% in 2023, while unemployment is at a historically low level. Compared with Europe, and Germany in particular, the world's leading economic power is in a very good position.

US economic data	2023	2024p	2025p
Economic growth	+2.5%	+2.1%	+1.5%
Inflation	3.7%	2.1%	2.0%
Unemployment rate	3.6%	4.0%	4.0%
Disposable income	+4.2%	+1.5%	+1.4%

Source: The Conference Board Economic Forecast for the US Economy (March 2024).

Economic forecasts for 2024 have recently been raised again, and the US economy is expected to continue to deliver positive momentum. For example, whereas economic growth of 1.2% was still being forecast in January, 2.1% is now predicted.

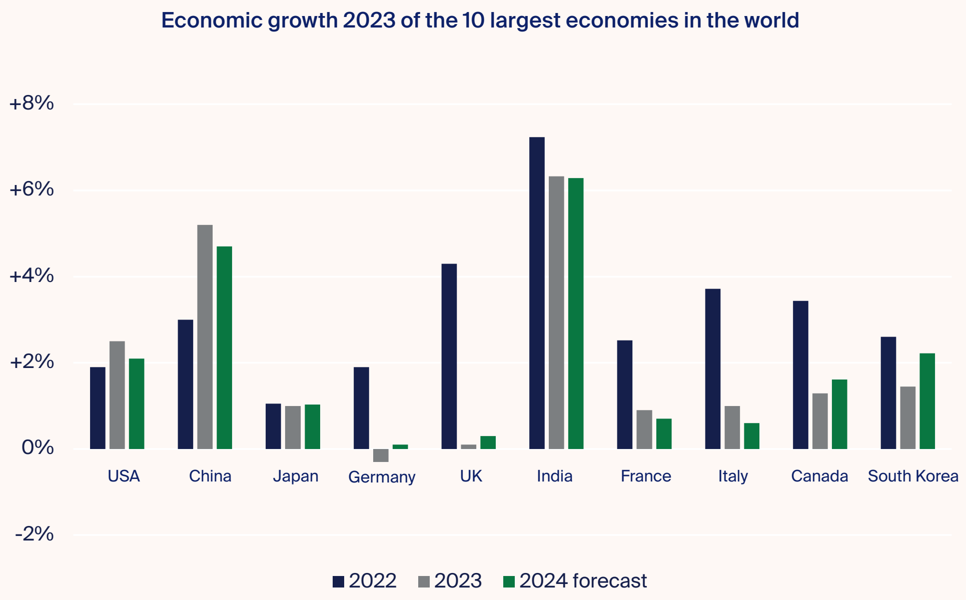
Real incomes will also continue to grow, enabling domestic consumption to make a positive contribution to the economy. Further parameters, such as price stability and the labor market, are in line with expectations and there are no signs of overheating.

The upcoming US presidential elections represent a cyclical factor. Generally, the government in power seeks to present voters with positive economic data, for example by launching economic programs, to improve its chances of re-election.

Global development

Other major European economies are also seeing slowing momentum. Countries such as France (+0.9%), Italy (+1.0%), the Netherlands (+0.1%), Poland (+0.1%), and the UK (+0.1%) recorded low economic growth in 2023. Spain was the only major European economy to post solid growth (+2.5%). Outside Europe, growth was particularly strong in China (+5.2%), although this was partly attributable to catch-up effects after the country's significantly longer-lasting pandemic restrictions.

The geopolitical situation remains fraught. The wars in Ukraine and the Middle East remain a source of economic instability. Supply chain disruptions, reduced availability of raw materials and goods, and sanctions are restricting the growth prospects for the global economy.
As such, European economies also look set to stagnate in 2024, with growth forecasts remaining predominantly low (F: +0.7%; I: +0.6%; NL: +0.8%, UK: +0.3%). In Poland and Spain, however, dynamic growth is forecast (+2.7% and +1.8%, respectively).



Source: IMF, German government, The Conference Board.

Real estate markets

The real estate markets regularly follow economic trends, sometimes with a time lag and with differing intensity depending on the region and usage type.

DACH region

Building permits in Germany	Residential buildings		Residential units	
	2023/Q4	2022/Q4	2023/Q4	2022/Q4
Total	67,931	110,659	214,088	304,323
Of which 3 or more residential units	12,931	18,510	142,570	190,408

Source: German Federal Statistical Office (Destatis).

Housebuilding fell sharply in 2023. Whereas 304,323 units were granted permits in 2022, this figure dropped to just 214,088 in 2023, representing a year-on-year decline of 30% or 39% in terms of buildings. The political goal of building 400,000 new homes each year looks unrealistic in the current environment.

Housebuilding continues to be dominated by multifamily dwellings, and therefore by professional investors. Around two-thirds of homes that were granted permits are in buildings with at least three residential units (representing 19% of the 67,931 residential buildings to receive permits).

Forecast housing completions in thousands of units	2023	2024	2025	2026
Germany	270	225	195	175
Austria	56	49	47	46
Switzerland	42	42	43	44
Europe	1,763	1,548	1,512	1,531
France	381	329	296	297

Source: ifo Schnelldienst – selected findings from the EUROCONSTRUCT winter conference 2023.

Housebuilding forecasts for Germany and Austria remain low for the period to 2026.

The reduction in building permits, exacerbated by canceled or postponed projects, means that completion figures are also declining. Provisional figures for Germany are for 270,000 units in 2023, with a forecast reduction to 175,000 units by 2026. If this proves correct, annual completions will then be 41% below their level in 2022 (or 57% below the German government's target). This low supply also comes at a time of high demand. In 2023 alone, 1.94 million people moved to Germany from other countries – the third-highest figure since the turn of the millennium (behind 2022 and 2015).

Completions are also down in Austria, where a fall from 56,000 units in 2023 to 46,400 in 2026 is expected. However, this 25% decrease is still less sharp than that in Germany.

A fall is also expected for Europe as a whole over the same period, albeit less pronounced at 17%. Figures are comparatively strong in Switzerland (+1.1%), Ireland (+21.3%), Portugal (+12.6%), Spain (+12.2%), Slovakia (+9.3%), and Norway (+7.6%).

The high cost of land, materials, wages, and borrowing is likely to be an obstacle to more house building. In many cases, factors such as long approval processes and increasingly stringent construction standards are also playing a role.

The volume of investment in residential portfolios with 30 or more residential units fell further in the first quarter. Just EUR 771 million was invested in this asset class in the first three months of 2024, which is down a further 33% year on year and 85% below the long-term average. By way of comparison, a total of around EUR 4 billion was invested in the first quarter of 2022.

Price development	Purchase prices in EUR/m²		Rent new building in EUR/m²	
	2023	2022	2023	2022
Berlin	-2.8 %	0.0 %	+8.9 %	+9.2 %
Hamburg	-8.2 %	+3.5 %	+4.3 %	+3.8 %
Munich	-1.5 %	+2.0 %	+3.3 %	+2.4 %
Cologne	-5.8 %	+7.0 %	+3.9 %	+8.5 %
Frankfurt a. M.	-5.5 %	-1.8 %	+2.9 %	+1.2 %
Stuttgart	0.0 %	+3.3 %	+1.7 %	+1.8 %
Dusseldorf	-4.8 %	+5.8 %	+5.6 %	+2.9 %
Vienna	+0.3 %	+22.9 %	+6.7 %	+1.5 %
Zurich	-3.0 %	+8.1 %	0.0 %	+4.5 %
European comparison cities				
Brussels	0.0 %	+4.3 %	+7.1 %	+3.7 %
Prague	-8.1 %	+3.0 %	+12.9 %	+7.1 %
Copenhagen	-3.6 %	-1.9 %	+5.9 %	+0.7 %
Paris	+11.3 %	+7.8 %	+11.3 %	+12.4 %
Luxembourg	-5.6 %	+3.2 %	+3.1 %	+15.3 %
Warsaw	+0.9 %	-10.9 %	+5.4 %	+24.5 %
Madrid	+11.3 %	+7.8 %	+11.3 %	+12.4 %
Stockholm	-5.6 %	+3.2 %	+3.1 %	+15.3 %
London	+0,9 %	-10,9 %	+5,4 %	+24,5 %

Source: RIWIS, Catella residential market overview, 2023.

The average net basic rent in Germany rose 2.2% year on year in February 2024, with a degree of variance within each city. By contrast, purchase prices fell in almost all of the top seven cities: the sharpest drop came in Hamburg (-8.3 %), while prices barely changed in Stuttgart (constant) and Munich (-1.5 %). This reflects the current market environment, with similar figures recorded in other European countries.

US

The real estate market in the US is less regulated and often also more volatile. The various metro areas in the US are very heterogeneous, and levels of momentum in their property markets therefore vary considerably.

Performances range from Johnstown in Pennsylvania, where asking rents have risen 9% year on year, to Punta Gorda in Florida, the weakest location, where they are 8% below the prior year.

Three of the five metro areas with the highest levels of momentum are in the New England region, while the other two are in the Midwest.

Average change in metro area	Rents – multifamily YoY
Top five by rent growth	
Johnstown, PA	+9.1%
Ocean City, NJ	+8.8%
Danville, IL	+8.8%
Battle Creek, MI	+8.6%
Norwich, CT	+7.9%
Others	
Miami, FL	+1.8%
Dallas-Fort Worth, TX	-1.3%
US average	+0.7%

Source: Co-Star.

Purchase prices are expected to further stagnate in the US real estate market in 2024 (range: +0.7% to +2.8%). In general, rents are set to slightly increase (+1.1%), while a slight decline is forecast for the multifamily segment in particular (1.1%).

Slight growth is predicted for unit sales (new builds: +5.3%, existing building stock: +15.2%).

Capital market and finance

To counter the high inflation rates, many western central banks began hiking key interest rates in mid-2022, with the fed funds rate now standing at 5.5% and the ECB rate at 4.5%. Alongside other economic data, inflation is the main measure that will determine the next steps to be taken, including an expected reduction in interest rates.

Key interest rates

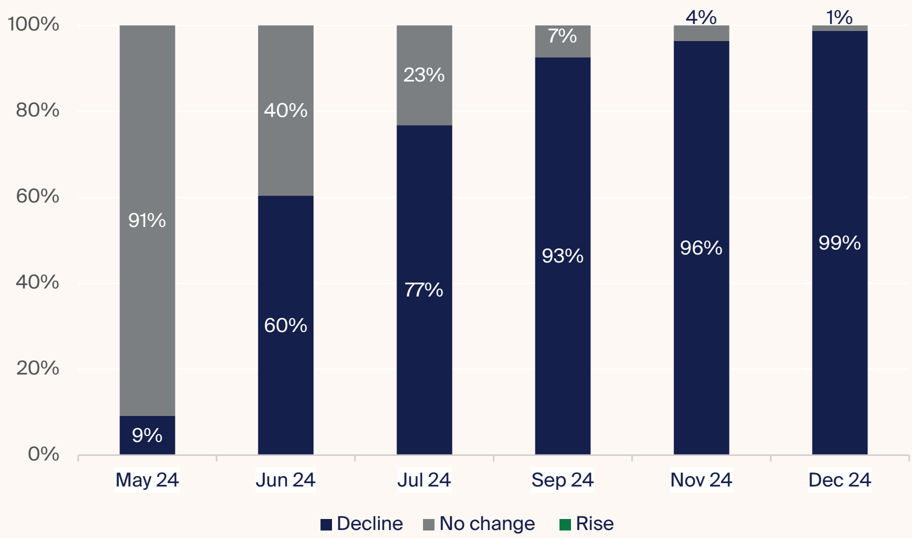
The Fed and ECB once again opted to hold key interest rates steady in the first quarter of 2024. New economic forecasts and the corresponding interest rate strategy were released at the Federal Open Market Committee (FOMC) meeting in March. A median key interest rate of 4.6% is still expected for 2024, but this forecast was raised slightly for 2025 and 2026, to 3.9% and 3.1%, respectively (previously 3.6% and 2.9%). The long-term target is 2.6%.

Most members of the FOMC recommend an interest rate that is 75 basis points below the current level. The most likely scenario for this year is therefore three reductions of 25 basis points each.

Financial market data suggests that leaving the current rate unchanged is the most likely scenario for the meeting in May (likelihood of 91%). By contrast, the likelihood of a rate reduction is over 50% for meetings from June onwards, and over 90% for meetings from September onwards.

The Swiss National Bank lowered its key rate by 25 basis points to 1.5% at the end of March, due to lower inflation and the appreciation of the Swiss franc against global trading currencies such as the US dollar and euro.

Probability distribution of the FED Board meeting's decision on the change in the key interest rate in 2024



Source: Data Driven Investor (March 20, 2024).

Other asset classes

While yields on government bonds have plateaued, equities and cryptocurrencies have recently gained considerably in value. The DAX and Dow Jones rose by 18% and 20% year on year, respectively. Bitcoin is showing itself to be a case apart, with gains of over 150%.

Development of diverse asset classes	2023/Q2	2023/Q3	2023/Q4	2024/Q1
DAX	15,629	15,387	16,752	18,492
DowJones	33,274	33,508	37,697	39,807
Interest rate federal bond (10-year)	2.34 %	2.59 %	2.53 %	2.29 %
Interest rate US government bond	3.65 %	4.14 %	4.43 %	4.12 %
Bitcoin	26,201	25,475	38,149	66,023

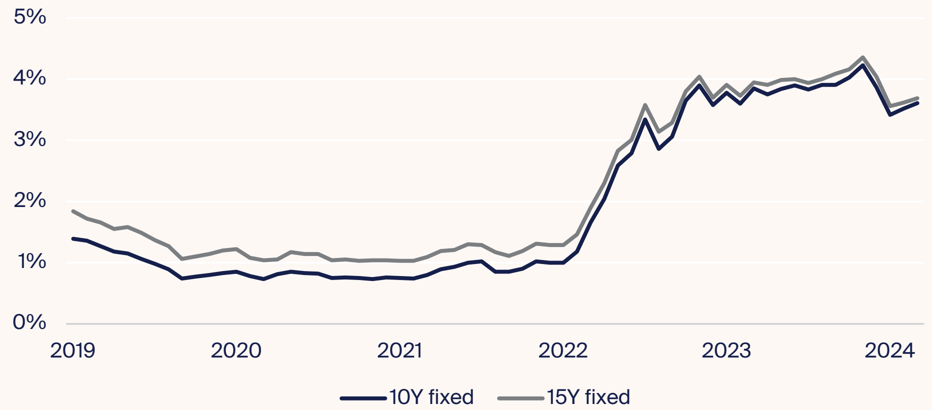
Source: finanzen.net, jew. Schlusskurs 31.03., 31.06., 31.09., 31.12., Banque centrale du Luxembourg.

Property financing

The property lending volume slumped with the sharp rise in interest rates. For private households, liquidity problems are consequently a particularly significant factor, resulting in planned purchases and new-build projects being postponed. Lending has collapsed dramatically from its peak in March 2022, when around EUR 32 billion in housebuilding loans were granted to private households, and has only been around EUR 15 billion per month since the end of 2022. This is equivalent to the level in 2013, despite considerable price increases in that period.

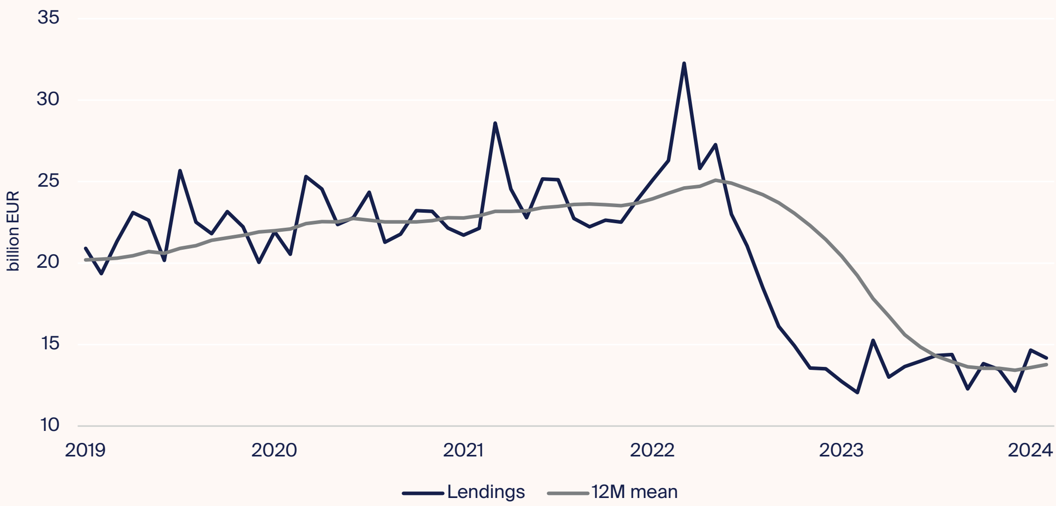
The new level of interest rates is also playing a role in refinancing. Loans that formerly had low interest arrangements are skyrocketing in price for homeowners, which could result in distressed sales or loan defaults. However, this scenario has not materialized across the market. There could be occasional buying opportunities for opportunistic investors.

Construction interest rates (supply contracts)



Source: Interhyp.

Mortgage lending to private households



Source: Deutsche Bundesbank.

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