Empira Group Research: Economy & Real Estate

Quarterly View 2024 / Q3

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Dear Reader,

Welcome to the third edition of our Research Quarterly View for 2024. In this issue, we present the latest developments and trends in the economy and real estate markets. Our focus is on the dynamic changes in the DACH region as well as global developments that significantly impact our industry.

The economic environment remains challenging, particularly in the DACH region. Despite the German government's increased growth forecast of +0.3% for the current year, the outlook remains subdued. Despite the rise in consumer spending by private households the government cannot fully offset the decline in gros fixed capital formation. Similarly, in Austria, no growth is expected following last year's recession. In contrast, Switzerland shows resilience with positive growth forecasts driven by rising exports and private consumption.

The real estate markets seem to have hit rock bottom. Data is now indicating an initial market revival, especially in investments in residential portfolios. Despite a decline in building permits in Germany and a continuing tense market situation, investor confidence is growing. In other major European cities, the real estate market is following a similar pattern, with Madrid experiencing a remarkable real estate boom.

After a period of key interest rate increases, the ECB has begun to lower the interest rate level, potentially marking the start of a longer path towards further rate cuts. At the same time, the US market shows remarkable resilience despite high credit rates and inflation. The stock and cryptocurrency markets are seeing strong gains, highlighting the unique dynamics of these asset classes.

The current developments show that markets are in a constant state of change. The ability to respond flexibly to these changes and make the right decisions is crucial for success. With this edition of our Research Quarterly View, we aim to provide you with well-founded insights and analyses to help you better understand and capitalize on the opportunities and risks in this dynamic environment.

Regards,

Lahcen Knapp
Founder and Chairman, Empira Group

1. Overview

While the economic climate remains challenging in the DACH region in particular, the real estate markets appear to have bottomed out. The latest data are showing the first signs of a market recovery.

Economic climate

A phase of high inflation rates and sharp interest rate hikes was followed by a period of economic stagnation and falling inflation rates in many western economies. The focus of economic policy is therefore shifting away from combating inflation and towards reviving the economy.

DACH region

The economic outlook in Germany remains gloomy. In its spring projection, the federal government slightly raised its growth forecast for the current year to +0.3% (previously +0.2%). However, this growth is primarily attributable to a rise in private household and government final consumption expenditure (+0.9% and +0.7% respectively). Meanwhile, gross fixed capital formation continues to decline (-0.8%), which affects investments in both machinery and equipment (-0.3%) and construction (-1.8%). This is significant because these investments form the basis for future growth potential, and so the declines also suppress economic growth in subsequent years. This is reflected in the lowering of the growth forecast for 2025 (most recently +1.3%). The outlook for neighboring Austria is even bleaker. Following a pronounced recession last year (-0.8%), no growth is expected for this year either. One reason for this is the 2% decline in goods production and 2.4% reduction in government final consumption expenditure. The decline for construction (-4.2%) will be significantly steeper than for investment in machinery and equipment (-0.9%). However, trade (+0.4%) and private consumption (+1.1%) are making positive contributions to growth. A rise in the unemployment rate to 6.9% is expected (2023: 6.4%).

Economic development	2023	2024p	2025p
Economic growth Germany	-0.3 %	+0.3 %	+1.0 %
Economic growth Austria	-0.8 %	0.0 %	+1.5 %
Economic growth Switzerland	+1.3 %	+1.2 %	+1.7 %
Inflation Germany	5.9 %	2.4 %	1.9 %
Unemployment rate Germany	5.7 %	5.8 %	5.6 %

Figure 1: „Economic Development in the DACH Region, source: Own representation based on data from the German Federal Government – Key Points of the Spring Projection 2024, DESTATIS, WIFO Economic Forecast 2/2024, SECO Economic Trends Summer 2024“

In contrast, dynamic growth is forecast for Switzerland in 2024 and 2025, driven mainly by growing exports (+3.6%) and private consumption (+1.3%). Unlike in Germany and Austria, slight growth is also expected for construction investments (+0.1%).

Inflation is becoming less and less important an issue in the DACH region. The inflation rate in Germany is now between 2% and 3% and is therefore almost back within the target range; in Switzerland it was already well below the 2% mark in May, at 1.4%. The constant upward pressure on the Swiss franc means that deflation cannot be ruled out in the future. Only Austria still has a significantly elevated inflation rate (May: 3.4%), and an inflation rate of over 3% is predicted for full-year 2024 here.

US economics data	2023	2024p	2025p
Economic growth	+2.5 %	+2.0 %	+1.5 %
Inflation	3.7 %	2.4 %	2.0 %
Unemployment rate	3.6 %	4.0 %	4.0 %
Disposable income	+4.2 %	+1.2 %	+1.4 %

Figure 2: US economics data, source: Own representation based on The Conference Board Economic Forecast for the US Economy (June 2024)

US

Economic indicators in the US are ambiguous. For example, the inflation rate has ranged between 3% and 4% since June 2023, settling at a level well above the 2% target. The declining trend observed between June 2022 (9.1%) and mid-2023 has not continued. Since this level of inflation is still considerably higher than the target, the Fed is expected to continue with its restrictive monetary policy.

The growth forecast for this year has been lowered slightly since the spring (previously: +2.1%). However, the US economic area is significantly outperforming other western economies.

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

Alongside the weak growth forecasts, the European and national election results showed that the current political situation is fragile, even in major European economies like France and Italy.

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.

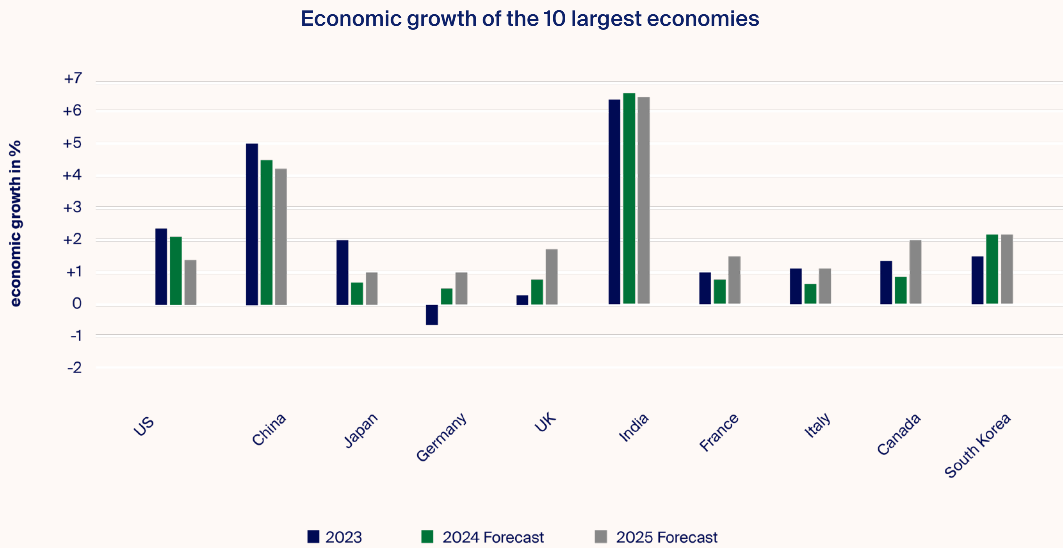

Figure 3: Economic growth of the 10 largest economies, source: Own representation based on Bundesregierung, The Conference Board, Gemeinschaftsdiagnose

2. Real Estate markets

Building permits in Germany since the start of the year	Residential buildings		Residential units	
	2024 Q1	2023 Q1	2024 Q1	2023 Q1
Total	18,937	25,606	44,137	58,972
Of which 3 or more residential units	2,533	3,510	28,638	37,188

Figure 4: Building permits in Germany since the start of the year, source: own representation based on Statistischen Bundesamts (Destatis)

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

In the first quarter, permits were granted for 44,137 residential units in 18,937 new residential buildings in Germany, representing year-on-year declines of 25% and 23% respectively. Due to insufficient housing construction last year, excess demand is likely to increase further in many housing markets. Just 225,000 completed units are expected for full-year 2024 and only 195,000 in 2025. The multifamily segment continues to be very important: although just 13% of all newly approved buildings are in this category, 65% of all new homes are in multifamily buildings.

In 2023, a total of 294,399 new housing units were built, which was more or less equal to the level in 2022 (295,275) and significantly exceeded the forecast of 270,000 units. However, the German federal government's target of building 400,000 new homes a year was once again missed by a long way, which means the high level of excess housing demand is not being adequately met. Construction of new buildings produced 262,859 housing units, and an additional 31,540 units resulted from construction measures on existing buildings.

The insufficient construction activity is reflected in the business climate for residential construction. While business expectations were slightly better than in the same month of the previous year (45.1 points compared with 50.0 points), they were still considerably worse than the 2015 baseline. In April, 55% of companies in this segment reported a lack of orders as a barrier to their business activity, while 18% also suffered from canceled orders.

Total investment in housing portfolios with 30 or more units – the professional segment – once again gained considerable momentum: around EUR 2.5 billion was recorded for the second quarter, exceeding the figure for the previous year (around EUR 1.5 billion) by over two-thirds. Restraint on the residential investment market appears to be easing, which could be an indication of a market recovery.

Change in prices	Purchase prices in EUR/m²		Rents for new-build properties in EUR/m²	
	2024 Q1	2023 Q1	2024 Q1	2023 Q1
Berlin	0.0 %	-1.4 %	+7.8 %	+9.1 %
Hamburg	-8.1 %	+2.8 %	+4.8 %	+4.4 %
Munich	-1.5 %	+0.5 %	+6.5 %	+1.9 %
Cologne	-5.1 %	+3.8 %	+3.8 %	+10.6 %
Frankfurt	-2.5 %	-5.9 %	+4.0 %	+1.2 %
Stuttgart	0.0 %	+2.6 %	+1.2 %	+1.2 %
Düsseldorf	-1.4 %	-1.4 %	+4.8 %	+5.1 %
Vienna	-0.2 %	+9.0 %	+9.4 %	-0.7 %
Zurich	+0.4 %	-3.1 %	+3.9 %	+3.3 %

European peers

Brussels	+2.1 %	-2.1 %	+16.1 %	0.0 %
Amsterdam	0.0 %	-4.2 %	+2.9 %	+4.0 %
Copenhagen	-0.8 %	-9.9 %	+12.8 %	+4.4 %
Paris	-8.4 %	-2.0 %	+4.2 %	0.0 %
Madrid	+10.2 %	+15.5 %	+16.9 %	+12.9 %
Stockholm	-1.0 %	+1.4 %	+6.9 %	+8.3 %
London	-1.6 %	-1.5 %	+8.8 %	+7.8 %

Figure 5: Change in prices, source: own representation based on RIWIS, Catella – European Residential Market Overview Q1/2024

There was a further drop in purchase prices in five of the German Top 7 cities. Hamburg saw the steepest decline (-8.1%), while the drops in Munich (-1.5%) and Düsseldorf (-1.4%) were moderate. Prices remained stable in Berlin and Stuttgart.

In contrast, rental prices continued to climb, with an average increase of 2.2% across all German cities. With the exception of Stuttgart, rents increased considerably faster in all A locations, with the German capital Berlin recording the strongest growth (+7.8%).

The major European cities are following this pattern of stagnating to falling purchase prices alongside a parallel increase in rents. Only the Spanish capital Madrid is currently experiencing a real estate boom, although it is not yet clear whether this will be sustained over the long term

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.

Average change in metro area	Rents – multifamily YoY
Top five by rent growth	
Hinesville GA	+13.4 %
Barnstable Town MA	+12.9 %
Hot Springs AR	+11.2 %
Kokomo IN	+8.9 %
Johnstown PA	+8.7 %
Others	
Miami FL	+2.4 %
Dallas-Fort Worth TX	-1.4 %
US average	+1.0 %

Figure 6: Average change in metro area, source: own representation based on Co-Star

Performances range from Hinesville in Georgia, where asking rents have risen 13% year on year, to Punta Gorda in Florida, the weakest location for the third consecutive quarter, where they are 11% below the prior year.

Two of the five metro areas with the highest levels of momentum are in the New England region, two are in the Sun Belt and one is in the Midwest.

The US real estate market is continuing to experience pressure from high loan rates and high inflation, since affordability for potential buyers has worsened significantly: borrowers continue to face interest charges of around 7%. For this reason, sales of new properties and existing properties have fallen by 1.9% and 4.7% respectively.

3. Capital market and finance

Following a phase of raised key interest rates, the ECB started to lower rates in the second quarter of 2024. It is not yet possible to predict with confidence whether this marks the start of a longer period of interest rate reductions, or whether rates are likely to plateau at a higher level over the long term.

Key interest rates

In June, the ECB lowered its key rate by 25 basis points to 4.25% in response to considerably reduced price growth in the euro area. However, the central bank also reaffirmed its commitment to a restrictive monetary policy, citing the fact that inflation remains too high: inflation forecasts for the euro area as a whole in 2024 were raised again from the March predictions (overall: 2.5%, core inflation: 2.8%). The ECB also intends to further reduce bond holdings.

In contrast, the Fed did not adjust its key rate at its board meetings in May and June. The interest rate forecast was raised again: for full-year 2024, a median interest rate of 5.1% is predicted (previously: 4.6%). The forecast has also been raised for the next few years (2025: 4.1%, 2026: 3.1%). The long-term target is 2.8%. The Fed's commitment to a high-interest-rate policy reduces the scope for other western central banks to lower interest rates.

The new forecast data show significantly less willingness to make significant changes to interest rates than in March. Of the 19 members of the Fed Board, eight recommended two interest rate cuts this year, each of 25 basis points, seven preferred just one cut, and four voted for no change to the current rate.

However, most money and interest rate markets have priced in a more than 60% likelihood that the Fed will cut rates for each of its remaining Board meetings

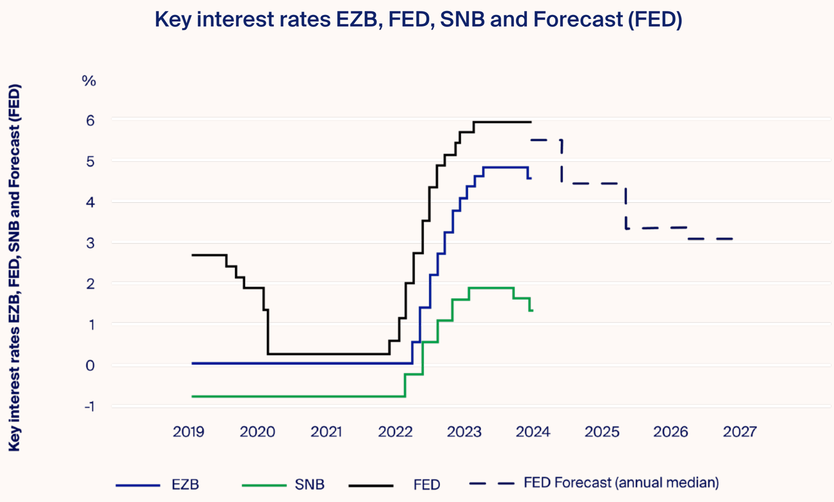

Figure 7: Key interest rates, source: own representation based on EZB, FED, SNB

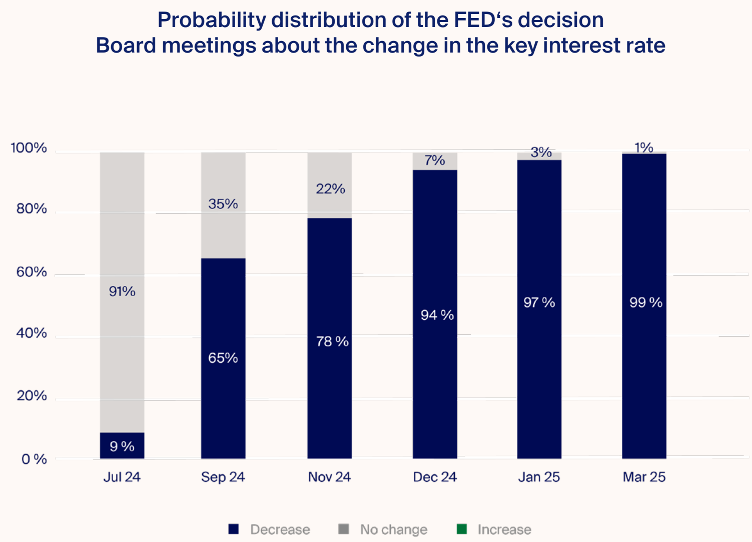

Figure 8: Probability distribution of the FED's decision Board meetings about the change in the key interest rate, source: own representation based on Data Driven Investor (02.07.2024)

between September and the year-end and for the first two meetings of 2025.

In June, the SNB lowered its key rate for the second time this year: a cut of a further 25 basis points to 1.25%. The SNB took this step in response to a stable inflation rate and excessive upward pressure on the Swiss franc against global currencies such as the US dollar and the euro.

While yields on government bonds have plateaued, equities and cryptocurrencies have recently gained considerably in value. The DAX and S&P500 rose by 14% and 22% year on year respectively. Bitcoin is proving to be a special case, with gains of over 100%.

Performance of various asset classes	2023 Q3	2023 Q4	2024 Q1	2024 Q2
DAX	15,367	16,752	18,492	18,235
S&P500	4,288	4,770	5,254	5,460
Interest rate – German government bond (10-year)	2.59 %	2.53 %	2.32 %	2.50%
Interest rate – US government bond (10-year)	4.14 %	4.43 %	4.15 %	4.51 %
Bitcoin	25,475	38,253	66,023	58,481

Figure 9: Performance of various asset classes, source: finanzen.net, jew. Schlusskurs 31.03., 31.06., 31.09., 31.12., Banque Centrale du Luxembourg

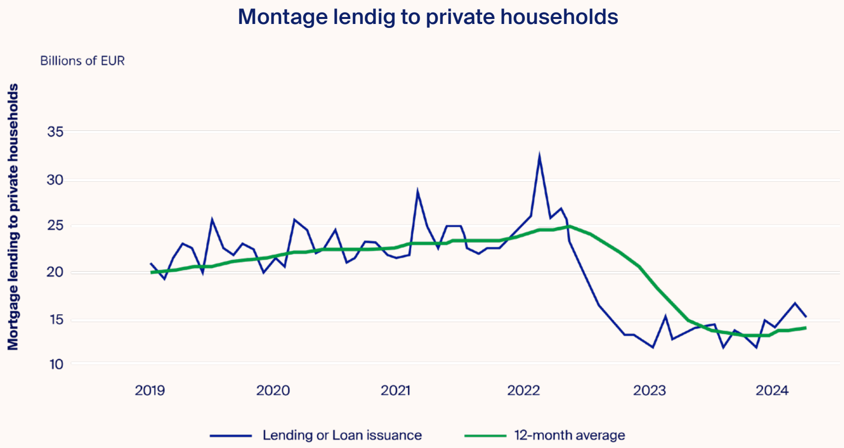

Figure 10: Montage lendig to private households, source: own representation based on Deutsche Bundesbank

Property financing

The marked decline in lending – as a result of the sharp rise in interest rates in 2022 and 2023 – for housebuilding by private households has recovered slightly since the start of the year. The level in May 2024 (EUR 15.4 billion) was well above the value for May 2023 (EUR 13.7 billion). However, it remains significantly below its peak in March 2022 (EUR 32.3 billion), although the change in the price level has not yet been factored in.

The central bank's lowering of interest rates and general expectations of a falling interest rate environment have not yet been reflected in declining loan rates for private households. The level of interest on a real estate loan with a 15-year fixed rate is 3.8%, which is slightly higher than the rate at the start of the year (approx. 3.5%). This is attributable to the general increase in market risk on the real estate market, among other factors.

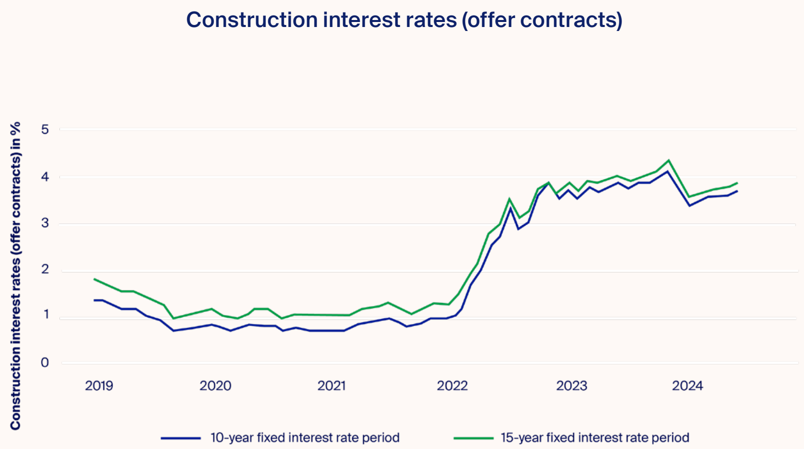

Figure 11: Construction interest rates (offer contracts), source: own representation based on Interhyp

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