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Macroeconomic and Real Estate Financing Outlook

Key economic and market insights from discussions among top industry experts

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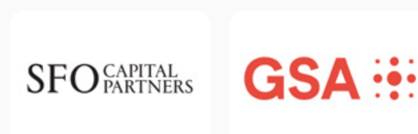

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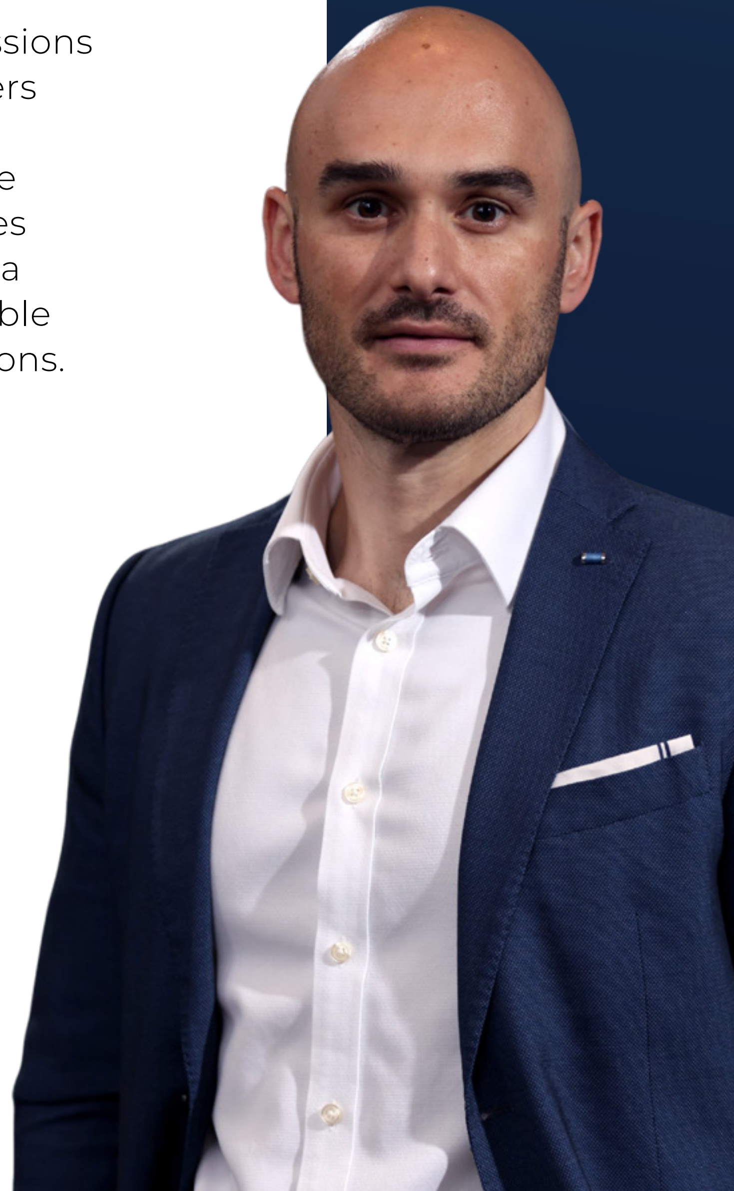
European real estate has faced significant challenges stemming from geopolitical instability, unprecedented inflation, surging interest rates, and the lingering effects of the global pandemic.

These factors have created a critical moment of adjustment for the industry, as it adapts to the evolving macroeconomic landscape of the twenty-first century. Pandemic-driven trends, coupled with rapid technological advances, have reshaped all sectors of the market to varying degrees.

During two days of roundtable discussions at Europe GRI 2024, key market leaders thoroughly examined the current macroeconomic environment and the resulting opportunities and challenges across the industry. This report offers a detailed, exclusive look at the invaluable insights shared during these discussions.

Enjoy reading!

GUSTAVO FAVARON
CEO & Managing Partner, ***GRI Club***



INTRODUCTION

For more than 25 years, GRI Club's exclusive networking events have been providing unique opportunities for the industry's decision makers to exchange valuable insights and experiences, igniting deal flow and potentialising the real estate market.

GRI Club reports present the key takeaways from these events, including the most valuable insights, the most ardent discussions, and the most intriguing strategies.

This report offers an in-depth assessment of conversations on the macroeconomic outlook that took place among the 60+ roundtable discussions at **Europe GRI 2024**, the biggest event in GRI Club history, with almost 800 of the biggest players in the industry, including investors, lenders, and operators active in the European markets.

MACROECONOMIC GROWTH OUTLOOK

» Cautious Optimism Continues

The defining sentiment for the macroeconomic outlook continues to be cautious optimism. While interest rates are expected to continue their recent downward trend, there is concern that a sharp drop could signal broader economic distress. The pace of recovery following these rate cuts remains uncertain, and the economic rebound will depend on various factors, including sectoral shifts and overall market conditions.

A certain level of volatility is anticipated in bond yields as policy rates decrease. While bond yields may initially fall, they are likely to rise again as economic recovery begins to take hold. Inflation, which had been a significant concern, is now viewed with less alarm, as levels above 2% appear increasingly unlikely.

» Recovery or Recession?

At the start of 2024, there was uncertainty about when central banks would begin cutting interest rates. However, confidence in the rate outlook has since grown as central banks, notably the European Central Bank (ECB) and the Federal Reserve, have initiated rate cuts. The Bank of Japan remains an exception to this trend, as it continues to lag behind in adjusting its monetary policy.

The prospect of a “soft landing” for the economy is still on the table, with the Federal Reserve and European forecasts both falling in line with the theme of cautious optimism. Such an outcome would avoid a sharp downturn and allow for a more gradual economic adjustment.

The combination of lower interest rates and easing inflation is expected to alleviate financial pressures on both households and businesses, providing an environment conducive to increased spending. Historically, recessions have occurred when cash-rich entities delay spending, but the ongoing rate reduction should encourage increased economic activity.

While the outlook is generally positive, a degree of caution is warranted. Risks remain, and while inflation and monetary policies are moving in favourable directions, the global economy faces potential headwinds. A balanced approach, recognising both the opportunities and challenges ahead, will be critical in navigating the next phase of economic recovery.

» Monetary Policy Forecasts

Disinflation trends in both the US and Europe are creating room for central banks to continue easing monetary policies. This flexibility is expected to drive further rate cuts as part of ongoing efforts to support economic growth.

Looking ahead, the Federal Reserve is expected to reduce rates from 5.5% to 3.5% by the end of the year, a move that should boost economic sentiment and confidence. The Fed is subsequently expected to cut interest rates by around 200 basis points over the next 12 months, with officials including Powell and Waller indicating a clear shift towards easing, though the exact timing remains data-driven.

Similarly, the ECB is forecast to lower rates to 3.5%, with the potential for further reductions if economic conditions fall short of expectations. The ECB approach to rate cuts has been cautious but the bank is anticipated to continue lowering rates. While it aims to ease monetary policy, Chief Economist Philip Lane has emphasised the need to avoid cutting rates too rapidly. The focus is on a sustainable reduction in rates that balances long-term stability with short-term economic support.

These moves should alleviate some pressure on bond yields and help stimulate economic activity in both regions.

According to the latest ECB bank lending survey, credit standards remain cautious, but banks anticipate rising demand for housing and consumer loans to be seen in the third quarter. This signals potential recovery in lending, especially for housing, as lower rates may prompt more borrowing activity in the months ahead.

Image: GRI Club

Market forecasts for interest rates are highly sensitive to incoming data, and project financing can be significantly affected by the timing of rate movements. Fluctuations in market pricing make it crucial for businesses to remain agile in their financial planning.

Real interest rates are also expected to stay elevated. This is driven by a combination of inflationary pressures, supply chain diversification, labour market constraints, and the need for investments in green and digital transitions. These factors are likely to keep real rates above historical norms in the coming years.

Public debt is rising across many advanced economies, including the US and several European nations. These increases in debt levels could act as a headwind, limiting future economic growth and placing additional pressure on governments to implement fiscal reforms.

Corporate debt markets are also attracting significant interest, although much of this depends on sector performance. If interest rates drop as expected, refinancing pressures could ease, similar to the period following the 2008-2009 financial crisis. This would provide relief to companies facing near-term debt obligations, particularly in stressed sectors.

» Global Economic Future

In terms of economic growth, forecasts for 2024 suggest a stable, if modest, recovery. Quarter-over-quarter growth is projected at 0.5% for the US and 0.4% for the Eurozone. While these figures do not indicate a robust expansion, they reflect a stable recovery without the threat of a major economic collapse, once again reinforcing the cautious optimism about the path forward.

The future growth of the global economy is expected to be driven by three key factors: disinflation, monetary policy easing, and structural investment needs. These structural investments are particularly important in sectors such as infrastructure, climate change mitigation, and technological development.

The demand for such investments is immense, with the European Commission's (EC) Draghi Report on competitiveness offering valuable insights into the necessity for structural reforms and strategic capital deployment.

Structural investment needs are critical on a global scale, as many economies face pressing challenges related to modernising infrastructure and advancing sustainability efforts. Understanding the scope of these needs is crucial for shaping future economic policies and investment strategies.

» Key Risks

Delayed effects from past monetary tightening, coupled with the possibility of a non-linear slowdown in the US, have the potential to present significant challenges. If growth projections are overly optimistic, companies may respond by cutting costs and freezing hiring, which could trigger a negative cycle in both consumer sentiment and investment activity.

Consumer behaviour plays a key role in this feedback loop. When companies stop hiring, households become more cautious, leading to reduced discretionary spending on items like real estate, cars, luxury goods, and vacations. This decline in consumer spending can further reinforce economic slowdowns, particularly in sectors reliant on consumer confidence.

Over-reliance on patterns drawn from historical data that guide economic forecasting can also present risks. While such data can often serve as useful indicators, they must be interpreted with care. For example, although a 50-basis point rise in unemployment has historically signalled recessions, this is not a guaranteed outcome in every scenario.

Geopolitical risks are another growing concern. Economic fragmentation, rising political instability, and protectionism are leading to lower stock market valuations and higher default risks for companies exposed to politically risky regions. Alarmingly, protectionist policies are gaining traction, with little political cost to those promoting them, even though the economic consequences are clear.

Image: GRI Club

» Shifting Sentiments

Business sentiment has seen a notable shift in recent months. Confidence in growth, which was initially positive, has weakened, particularly in Europe and the US, raising concerns about economic stagnation. Despite these concerns, the global picture remains mixed.

In the Eurozone, recent data from the EC indicates a slight improvement in business sentiment, although momentum remains weak. Consumer confidence, however, is on the rise, driven by a robust labour market and providing a positive sign for the region's economic outlook.

The composite Purchasing Manager Index (PMI), which combines manufacturing and services data, suggests that GDP growth will stay in positive territory, with no immediate risk of negative quarter-over-quarter growth.

Supporting this optimistic outlook is the Euro Coin, an indicator developed by the Bank of Italy that tracks Eurozone economic activity. The indicator showed an uptick in August, further reinforcing cautious optimism for the region's economic prospects as it signals a correlation with GDP growth.

In the US, there is a dichotomy between manufacturing, which is contracting, and services, which are still growing, though losing momentum. Meanwhile in China, although exports continue to perform strongly, the domestic economy faces challenges due to the ongoing issues in the property sector, leading to cautious household spending.

Image: GRI Club

» Sectoral Performance

In the US, headline and core inflation are gradually decreasing, aided by a softening labour market and slower wage growth. In the Eurozone, inflation for industrial goods (excluding energy) remains low, though inflation in the services sector is still elevated. However, recent data indicates some improvement, which may help ease inflationary pressures in the region.

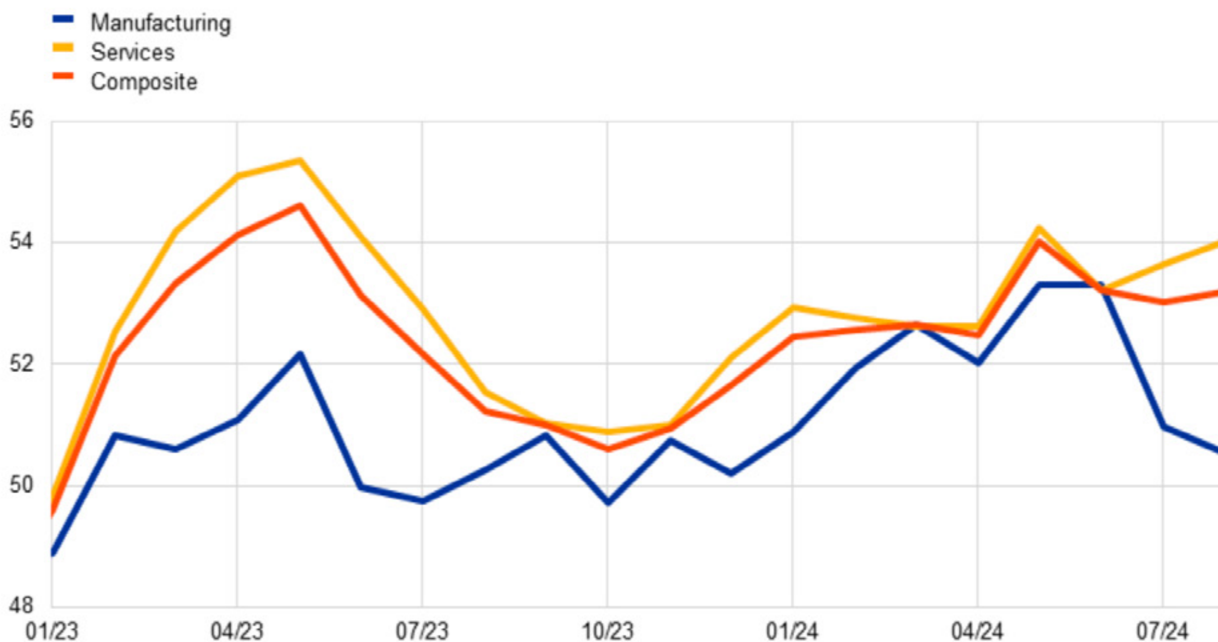
Both the US and Eurozone are seeing contractions in manufacturing while services remain in growth territory. Despite this, momentum in both sectors has stalled, as reflected by PMI data, which hovers around 50, signalling stable activity without strong growth. This stagnation highlights the challenges in maintaining economic momentum.

Labour market trends are contributing to economic uncertainty, where conditions remain tight both in Europe and the US. Companies are largely retaining their workforce, although specific industries, such as Germany's automobile sector, are beginning to show signs of strain.

Unemployment has risen slightly in the US, and job creation is slowing. This trend is directly impacting bank lending and broader economic activity, as the willingness of banks to lend often correlates with labour market strength.

Global PMI output

(diffusion indices)



Sources: S&P Global Market Intelligence and ECB staff calculations.
Note: The latest observations are for August 2024.

» European Debt Discrepancy

Debt trajectories within the Eurozone exhibit significant discrepancies, with smaller countries such as Portugal and Greece experiencing substantial reductions in their debt levels (Portugal -27%, Greece -30%). In contrast, larger economies like Germany and France have seen debt levels increase, moving in the opposite direction.

The reductions in debt for countries like Portugal and Greece can be traced back to the strict fiscal adjustments imposed during the sovereign debt crisis. These measures, while initially painful, have ultimately led to positive economic outcomes, improving investor confidence in the long run.

However, larger economies like France and Belgium, which have historically benefited from strong economic fundamentals, are now facing increased pressure to address their fiscal dynamics. These countries must develop credible debt management strategies, as underscored by the European Commission's recent review of 11 Eurozone nations that require clear plans for addressing their growing debt levels.

These fiscal dynamics play a crucial role in stabilising interest rates across the Eurozone. Effective debt management is key to putting a "floor" on interest rates, ensuring broader economic confidence and maintaining stability in the region's financial markets. Without addressing these debt challenges, interest rates could face increased volatility, complicating economic recovery efforts.

Image: GRI Club

» Trend Exposure

Structural changes in society are reshaping the global economy. Technological advancements, such as artificial intelligence, labour market shortages due to ageing populations, climate change, and political polarisation are creating new challenges for businesses. Companies that fail to adapt to these shifts risk falling behind in an increasingly competitive landscape.

Awareness of exposure is paramount, meaning that businesses and investors must carefully evaluate how they are exposed to these structural trends. Companies that are heavily reliant on debt, particularly in a high real interest rate environment, may face significant challenges, including increased borrowing costs, reduced investment opportunities, and heightened risk of default, if they fail to adapt to these transformative forces.

» War Sentiments

The ongoing Ukraine-Russia war has had a profound impact on European economic sentiment and voter confidence since 2022. It is predicted that if the war ends within the next 12 months, there will likely be a sharp, immediate improvement in economic sentiment - a "one-shot adjustment" - that could boost confidence across the region. However, this change is expected to be short-lived, with no sustained or long-term rise in sentiment beyond the initial adjustment.

The post-war rebuilding phase will present significant economic opportunities, particularly for companies involved in reconstruction efforts. The focus will shift towards identifying the businesses that will benefit from these efforts and determining the sources of funding for the rebuilding. While this phase will open up new prospects, the immediate impact will be a shift in sentiment, similar to the initial reaction seen when the war began.

The reduction in uncertainty that comes with the end of the war would positively influence macroeconomic sentiment across Europe. This improvement in confidence could support a short-term economic recovery. However, the lasting economic effects will largely depend on how rebuilding and funding are managed, with the long-term impacts tied to the effectiveness of these efforts.

Image: teksomolika / Freepik

EUROPEAN REAL ESTATE FINANCING

» European Overview

Household investment in real estate across the Eurozone has been declining, primarily due to rising borrowing costs. However, recent trends indicate potential recovery, as real disposable income and interest rates begin to decrease. This shift may encourage a gradual uptick in household investments in property.

Loan conditions have started to ease, marking a shift from the previous tightening environment. More banks are now reporting increased demand for loans, particularly for house purchases, as interest rates fall. This easing is a positive signal for the housing market, but cautious optimism remains the key term, as broader economic conditions still play a critical role in sustaining recovery.

Despite some encouraging signs, the Eurozone housing sector remains weak overall. Survey data shows only a small percentage of improvement, and with the construction sectors of key countries such as France and Germany still contracting, pressure could be set to increase. The UK, however, shows more positive momentum, reflecting a mixed regional picture.

» Market Dysfunction

The European real estate market is currently experiencing significant dysfunction, with many asset classes and locations facing challenges. Investors are showing a marked hesitancy to commit, leading to limited credible bids and a slowdown in both sales and acquisitions. This uncertainty is creating a difficult environment, particularly in sectors that were previously strong.

However, the debt market has shown signs of stabilisation, especially for high-quality assets located in key regions in Western Europe. These well-positioned assets are attracting more attention from lenders, with multiple term sheets being offered. However, for less attractive assets, particularly those in weaker sectors or locations, the struggle to secure financing persists.

Image: GRI Club / Midjourney

» Sector-Specific Challenges

Previously robust sectors such as logistics and living are now facing new pressures. Logistics, despite its strong performance in recent years, is seeing a slowdown in rental growth. Similarly, the living sector is grappling with affordability concerns.

Distress is particularly notable in London's office market, where pricing has hit historic lows, creating challenges for investors. The expectation of further price declines, particularly in secondary office markets, is driving cautious investor sentiment.

Many believe that the market is still in flux, and that significant opportunities may arise as prices adjust further. However, the fragmented and unpredictable nature of the current environment requires investors to remain flexible and patient in their strategies.

Despite the overall market challenges, there are rare "generational pricing" opportunities in certain markets. These opportunities, such as logistics deals in Sweden or distressed offices in London, offer investors the chance to acquire assets at prices not seen in years. However, these deals are limited and require a tactical, opportunistic approach to find.

» Capital Constraints

A significant shift in capital allocation is occurring among institutional investors, including sovereign wealth funds, which are reducing their exposure to real estate in favour of alternative asset classes such as private credit. This shift is contributing to a capital crunch, making it increasingly difficult for real estate funds to raise new capital and complete transactions.

Transaction volumes in European real estate declined by as much as 60% in some asset classes, with many assets undergoing valuation write-downs. As a result, sellers - particularly those in distressed sectors like retail - have been more motivated to offload assets. Retail, in markets like Italy, is facing particular difficulties, with declining demand and limited financing options, although there are some signs of recovery.

European real estate is also facing increased competition from markets in the US and Asia, which are offering more attractive growth prospects. Large institutional investors, in particular, are finding it difficult to justify allocations to Europe when other regions present higher returns and more stable growth trajectories. This competition is putting additional pressure on European markets to attract and retain capital.

» Tactical Opportunities

In this challenging market, investors are moving away from broad sectoral strategies and instead seeking out niche, idiosyncratic opportunities. These tactical investments are often more localised, requiring careful asset selection and a disciplined approach. Investors are focusing on specific assets or regions where they see potential for outperformance despite broader market conditions.

Despite the challenges, there remains a strong focus on leveraging higher-quality assets, particularly in core markets and asset classes. Investors are becoming more cautious with speculative investments, favouring deals that promise stable returns. While capital deployment has slowed overall, those who can identify well-positioned assets with strong fundamentals are finding opportunities to generate returns through strategic leveraging.

» Refinancing Challenges

With many low-interest loans coming due, refinancing has become a significant issue, as current rates are considerably higher than before. Investors are grappling with the reality that refinancing at these elevated rates is eroding asset values, leading to substantial equity losses.

Interest rates, while expected to ease, are not projected to return to previous lows anytime soon. This has created an environment where financing has become more expensive and difficult to secure. The result is a strain on many sectors, including real estate, where borrowing costs are reshaping market dynamics.

In response, private credit markets have become increasingly important, stepping in to provide financing where traditional banks have pulled back. However, this comes at a steep cost to equity holders. With refinancing options limited, property owners are often forced to accept deals that significantly diminish the value of their holdings. This shift has introduced liquidity to the market, but at the expense of long-term equity preservation.

Image: GRI Club / Midjourney

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Find out more about GRI Club Europe.

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