Global Macro Forecast: Still Good, Just Not *As* Good

June 2019

Executive Summary

- Global economic growth has downshifted. Real GDP is projected to grow by 3.3% in 2019—still reasonable, but a big pullback from the close to 4% growth registered at the peak in 2017.
- Demand metrics for property also slowed in Q1 2019 but remained positive; vacancy is holding steady and rents are appreciating across most product types and geographies.
- While slowdowns are uncomfortable, they are necessary; there are also benefits.
- Although the U.S.-China trade dispute has taken a turn for the worse, there are economic incentives to get a deal done in short order.
- The U.S. yield curve is causing angst again, but the recent inversion is occurring for reasons that are quite different than ones that have signaled recessions in the past. A U.S. recession is not imminent.
- Assuming no major policy missteps, the global expansion will continue; property markets have proven they perform just fine when growth is “good but not great.”

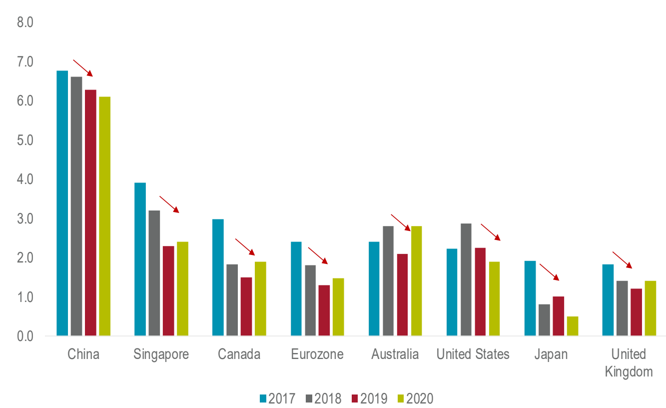
The global economy has cooled and, by extension, so too have the property markets. The combination of fading fiscal stimulus in the U.S., escalating trade tensions, tighter credit policies in China, four rate hikes by the Federal Reserve in 2018 and Brexit uncertainty has contributed to the slowdown. Trade is slowing this year, as is investment and global consumption. Real global GDP is projected to grow by 3.3% in 2019—a still reasonably solid rate but slower than the 3.6% growth in 2018. It feels much slower than the near-4% growth registered in 2017.

None of these developments are overly alarming or even fully unexpected. Slowdowns happen and many of these risks to the outlook have been on the horizon for some time. The U.S.-China trade dispute is a concern, but even on that front most would agree there are clear economic incentives for a speedy resolution. Importantly, the underlying economic fundamentals that drive demand for property remain healthy. Most notably, job growth remains steady. The global economy is tracking to create close to 29 million net new jobs this year. That will translate into 79,000 new jobs per day and another 250 million square feet (msf) of office absorption in markets around the world. We can double that figure on the industrial-logistics side. It is unlikely that businesses would be expanding at this rate if the global economy weren’t still in reasonably good shape.

So yes, the global economy has slowed—and yes, it’s still good, just not *as* good.

Synchronized Slowdown

REAL GDP GROWTH, Y/Y % CHANGE



Source: IMF, Cushman & Wakefield Research

Global Macro Forecast

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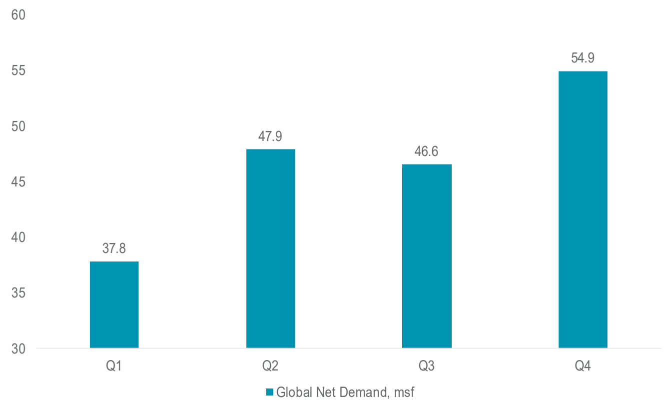
Leasing Fundamentals Holding Up Well

The globe's property markets got off to a slow start this year, which isn't unusual. Given seasonality—cold winter weather in some parts of the world which delays delivery of some projects and slows tenant ability to take occupancy—along with financial planning cycles, and the Chinese New Year, the first quarter of any year tends to be the weakest in terms of demand for space. Markets around the globe absorbed 43 msf of office space in the first three months of 2019, down 17% from a year ago but more than in a typical first quarter in this cycle.

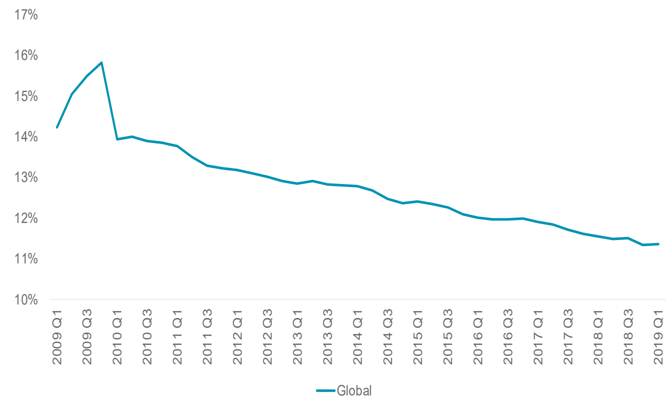
First Quarter Always the Weakest

AVERAGE OFFICE ABSORPTION BY QUARTER SINCE 2010



Source: Cushman & Wakefield Research

Global Office Vacancy Tight



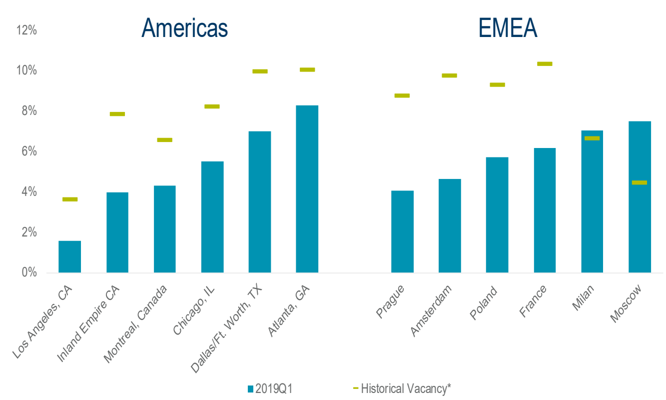
Source: Cushman & Wakefield Research

Of the 190 global markets tracked by Cushman & Wakefield, nearly three quarters (74%) reported they were still absorbing office space as of Q1 2019. Demand for office space was strong enough to keep pace with new construction, keeping global vacancy firm at 11.3%. This is the lowest that global vacancy has been at any point in the current cycle. The tightness of the overall global market is reflected in rents which have risen 3.1% year-over-year, an acceleration from the 2.5% increase registered in Q1 2018. All in all, the global office sector remains healthy and continues to grow.

Likewise, global demand for the industrial logistics sector also throttled back in Q1 2019. Markets absorbed 102 msf of industrial-logistics space, down 31% from the same quarter a year ago. Nevertheless, industrial occupancy rates remain either at or near record highs in most tier 1 and tier 2 cities around the world. The key engines that drive demand for industrial-logistics space remain firmly intact. Namely, eCommerce continues to thrive and consumers continue to spend; the bulk of this consumer demand is captured by the industrial sector in the form of storage and distribution. In the U.S., internet sales were up another 12% in Q1 2019 versus a year ago. eCommerce currently accounts for 10.2% of total retail sales. Consumer spending also remains solid around the world: retail sales were up around 3% globally from a year ago and even higher in certain markets (e.g., closer to 7% in China and India).

Industrial-Logistics Vacancy Is Tight

VACANCY ACROSS SELECT GLOBAL CITIES



Source: Cushman & Wakefield Research. *Historical Vacancy for Americas & EMEA represents the 20-Year Average 1998-2018.

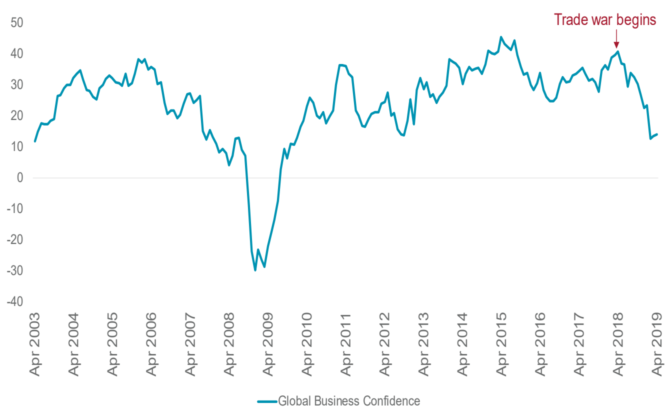
Despite the economic headwinds, consumer demand and spending have remained relatively resilient. These are key ingredients for the continued health of global property markets going forward.

U.S.-China Trade War Heats Up

Trade tensions are flaring up again. Towards the end of April this year, the U.S. and China appeared to be nearing a truce on trade. Then, things suddenly took a turn for the worse. On May 10, 2019 issues over the negotiations prompted the U.S. to increase tariffs from 10% to 25% on $200 billion worth of Chinese imported goods; it also threatened to slap additional tariffs on all trade with China. China responded with threats of its own, increasing tariff rates on roughly $60 billion worth of U.S. goods—to go into effect on June 1st.

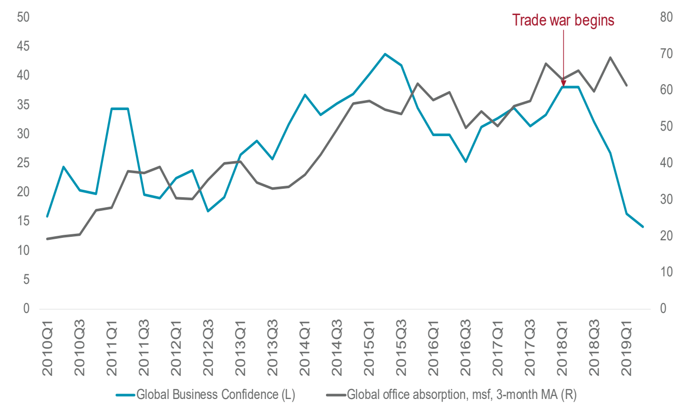
Thus far, the global economy has navigated the ongoing trade skirmish reasonably well. But rough waters are beginning to form. Business leaders are clearly unnerved by the trade war. Each time negotiations take a step backwards, business sentiment plunges. According to a weekly survey conducted by Moody's Analytics, global business confidence plummeted in March of this year to its lowest level since the period right before the financial crisis of 2008 and 2009. Confidence is particularly dismal in export-oriented economies: Germany, Canada, Singapore and South Korea have all seen business sentiment plunge in recent months.

Global Confidence Down Sharply



Source: Moody's Analytics, Cushman & Wakefield Research

Property Fundamentals Resilent, So Far



Source: Moody's Analytics, Cushman & Wakefield Research

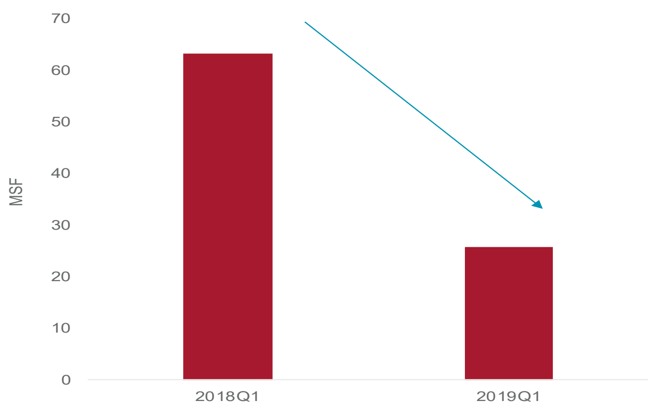
Global equity markets are equally rattled. It is no coincidence that when President Trump tweeted his intention to raise tariffs on China on May 5, 2019, global equity markets tumbled. As of May 28, the largest declines occurred in the DOW (-4%), the Shanghai (-5%) and Hang Seng (-9%). If the sell-off continues, this will inevitably impact the property markets through confidence and wealth effect channels. Every $1 decline in stock wealth typically causes consumer spending to decline by an estimated three-to-six cents. The negative impact is not instantaneous though. Any stock market decline would need to be sustained, and if it were, consumer spending would eventually decline as households see their "paper-wealth" evaporate. Combined with reduced appetite by businesses to invest, labor markets would inevitably be impacted and thus demand for commercial real estate (CRE) would be negatively impacted.

Global trade flows are also being affected. Since the U.S.-China bilateral trade relationship is the largest in the world—trade between the two countries total approximately $700 billion worth of goods per annum—the dispute is having a ripple effect on trade flows in nearly every country. World export volumes have gone flat this year, a significant come down from the near-5% growth averaged the last two years. In 2018, despite the trade threats, the exchange of goods between the U.S. and China continued to grow, partly to get ahead of the implementation of the tariffs. In fact, trade between the two countries increased by 4.6% last year. Thus far in 2019, as the tariffs take hold, the U.S. and China are buying far less from each other. U.S. imports of Chinese goods in March 2019 were down 18.5% from a year ago and Chinese imports of U.S. goods were down 16% over the same timeframe.

There has been no clear evidence that the property market fundamentals have been adversely impacted by the trade wars—at least not yet. Admittedly, it is difficult to measure the impact. U.S. industrial-logistics absorption was down sharply in Q1 2019, 59% lower than Q1 2018. It is possible that the trade dispute is causing disruptions to supply chains which are causing demand for industrial space to slow. Another possibility is companies may have overstocked prior to the implementation of tariffs in 2018. Seasonality, a general slowing in the global economy and lagging supply may also have been the main culprits. There are also anecdotal reports in the U.S. that construction costs for steel, aluminum, cabinetry, flooring, etc., are being driven up as China is "taken out" as a supplier. But the hard data does not support these observations. The producer price index for steel and aluminum show that so far in 2019 prices are down from a year ago. In mainland China, office absorption declined to a 4-year low in Q1 2019. But remember that the first quarter also coincides with the Chinese New Year which usually depresses first-quarter activity. Although it is challenging to parse out the impact, it is not difficult to conclude that the longer the trade war drags out the more disruptive it will be.

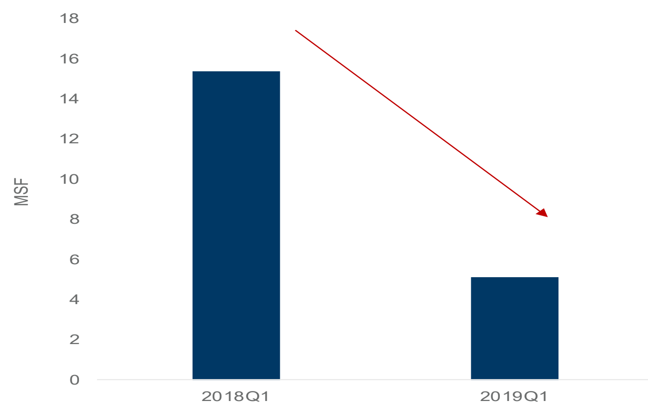
Early Signs of Trade War Impact?

U.S. Industrial Sector Net Absorption



Source: Cushman & Wakefield Research

China's Office Sector Net Absorption



Source: Cushman & Wakefield Research

Our baseline assumption is that a U.S.-China trade agreement will be reached in the second half of 2019. Some of the thornier issues—ones related to intellectual property and technology transfers—may be kicked down the road, but at least a symbolic agreement or temporary halt is more likely than not. The benefits of a graceful resolution versus the alternative creates a strong economic incentive to get a deal done. A trade agreement would quickly restore consumer and business sentiment in both the U.S. and China and would likely lift global equity markets. These would boost economic activity—spending and investment—and most sectors, including CRE, would benefit.

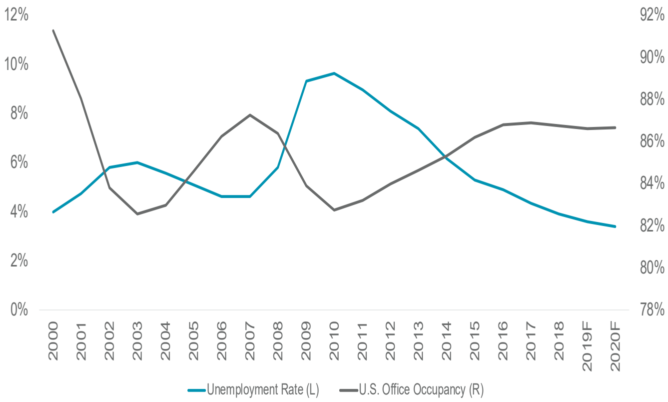
An Uneven World

Unlike the last two years during which economic activity was accelerating in almost every region of the world, growth has become less synchronized. The property markets too, have decoupled, creating a mix of hot and cold trends, and everything in between.

In the **U.S.**, growth remains solid if not robust. Real GDP in Q1 2019 surprised many, coming in at 3.1%; this was the same quarter that featured the longest government shutdown on record. As the tax cut stimulus effects fade, however, growth rates are expected to moderate over the course of the year. Still, most forecasters continue to peg GDP growth rates in the 2-to-2.5% range for 2019. The U.S. economy also got a lift from the Federal Reserve's Federal Open Market Committee (FOMC) which took a pause in its interest rates hikes and has signaled it is unlikely to raise rates again this year. In fact, rather than a rate increase, the fed funds futures market now, as of this writing in early-June, sees a 95% implied likelihood of a rate cut to occur in 2019. The U.S. labor markets continue to perform well, averaging 164,000 net new jobs per month so far in 2019 (through May). While down from last year's 229,000 figure over the timeframe, this is still solid and anticipated. Job growth will moderate given the tightness of the market. Unemployment is currently at a 49-year low of 3.6% and initial unemployment insurance claims—a leading indicator—as a share of the working-age population has never been lower.

Low Unemployment = Stable Occupancy

UNITED STATES



Source: BLS, Cushman & Wakefield Research

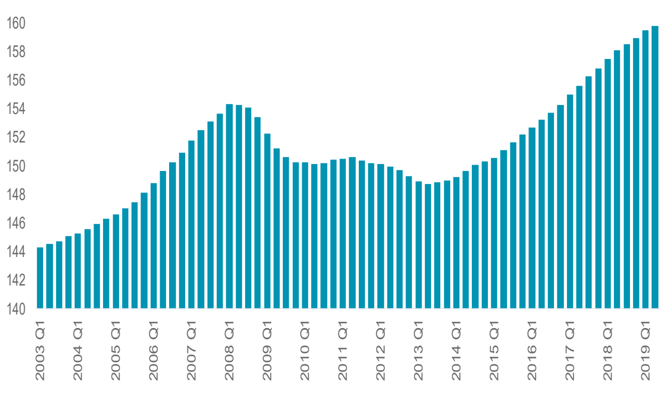
Beyond 2019, the outlook for the U.S. gets murkier. With the tax cut and government spending stimulus largely exhausted at that point and with U.S. elections in November of 2020, growth is expected to slow to around 1.5-2%. While that is slower, such economic growth should be sufficient to support continued job growth and consumption, particularly as wage growth firms above 3%. Demand for office space should keep pace with new construction, keeping occupancy firm near 87% through 2020.

Canada's economy is also holding up extremely well given what is being thrown at it. The U.S.-Mexico-Canada Agreement (USMCA) is now facing political pressures and the probability of it being ratified have come down. Still, the Canadian economy motors on. Real GDP is set to grow 1.7% in the first quarter of 2019 although a more moderate pace of 1.1% is expected for the year. Despite that, Canada's labor markets have taken off as of late. In Q1 2019 the Canadian economy created 133,000 net new jobs—the strongest pace since 2012. This was in addition to 100,000 new jobs created during the fourth quarter of 2018. Canadian property markets are also powering forward, absorbing 1.3 msf of office space in Q1 2019—a level four times stronger than a year ago. Industrial-logistics demand continues strong.

The **eurozone's** economy is more of a mixed bag. On the one hand, the hard data actually still look pretty decent. The eurozone economy did slow in Q1 2019—not surprising given that the region was plagued by the looming "no deal" Brexit scenario for most of the quarter. Still, real GDP surprised on the upside, growing an annualized rate of 1.2%—not great, but also not terrible, especially since Italy fell into a technical recession in the final quarter of 2018 and Germany just barely avoided one. GDP growth in the United Kingdom was also lackluster but the 1.5% real GDP growth rate can be considered "just fine." European consumers are carrying most of the load. Eurozone retail sales are tracking to be up almost 3% in Q1 2019 compared to a year ago, over 5% in the U.K. and up over 8% in some spots such as Ireland and Slovenia. The eurozone's labor markets also continue perform extremely well. The harmonized unemployment rate—defined as people of working age who are without work, are available for work and have taken specific steps to find work—declined from 7.8% in February to 7.7% in March. Real wage growth accelerated at its strongest rate of growth in the current cycle. The eurozone also continues to churn out new jobs at a solid pace of 2 million per year.

Europe Keeps Cranking Out Jobs

EUROZONE EMPLOYMENT

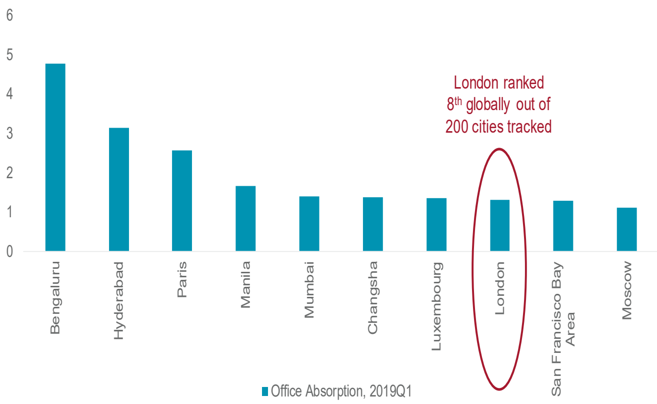


Source: Oxford Economics, Cushman & Wakefield Research

On the other hand, the soft data point to an economy that is weak and about to get weaker. Eurozone business and consumer confidence are both down sharply. It's even worse in the U.K.: consumer sentiment in Britain hit a 5-year low in March. As of April, the eurozone's Manufacturing PMI indexes have also dropped below 50 in most EU countries indicating weakness and likely reflecting the trade woes. It is also notable that 10-year government bond yields have turned negative in Germany and Switzerland and are generally lower across all of Europe—a development which often signals economic weakness. Downside Brexit scenarios seem never-ending and are unlikely to go away anytime soon. Theresa May's long heralded decision to step down has finally been made signaling a race amongst Conservative Members of Parliament (MPs) to take up the mantle. It is unclear whether this makes a hard Brexit more or less likely. More than half the MPs have stated they will push a no deal agenda and leave on October 31—the next deadline. Given the growing list of downside risks, the European Central Bank announced in March of this year that it will inject more stimulus into the economy after ceasing quantitative easing (QE) in December of 2018.

Powering Through Brexit

TOP 10 OFFICE ABSORPTION LEADERS IN Q1 2019



Source: Cushman & Wakefield Research

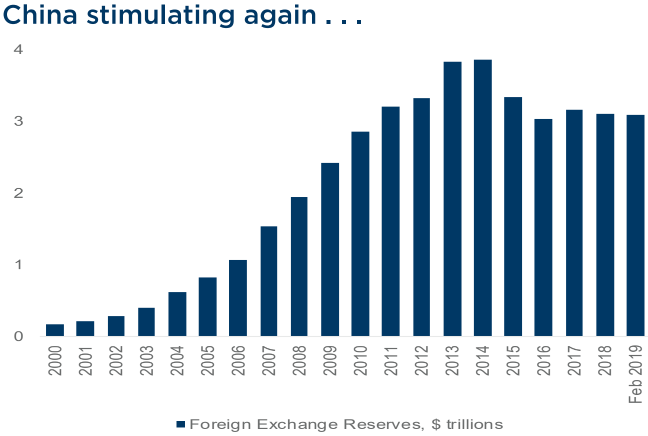
Despite all these headwinds, Europe's property market fundamentals continue to demonstrate resiliency. The eurozone absorbed 12.8 msf of office space during Q1 2019 and vacancy tightened another 30 basis points (bps) from the prior period to 6.8%. Amid the uncertainty of the Brexit implementation, Europe still has the most occupied office sector in the world. It is notable—and perhaps telling—that businesses continue to gobble up office space in London. In Q1 2019, Central London absorbed 1.3 msf of office space—besting every single office market in the U.S. for the quarter and ranking 8th in the world.

When forecasting Europe's economic trajectory, the temptation is to overshoot to the downside. Europe still has much to work through including damaged business and consumer confidence, elevated sovereign debt spreads and fiscal challenges in Italy, as well as a wide range of Brexit scenarios that are still in play. However, Europe has been powering through similar headwinds for years now. Real GDP will grow by 1.3% in 2019, according to the IMF, and will pick up in 2020 as the central bank's stimulus kicks in.

In **Asia Pacific**, economic growth has also slowed. This partly linked to China's effort to rein in credit last year—the effects of which carried into 2019—and to the trade dispute which has caused external demand to soften. That said, the current rate of growth in Asia Pacific would be considered dynamite growth for any other region. Real GDP in Asia Pacific is forecast to grow in the neighborhood of 4.5% in 2019—nearly 200 basis points (bps) faster than any other region. Moreover, despite the downshift from 5% growth in 2017, the region continues to lead the world in office space absorption. In the first quarter of 2019, eight of the top 20 markets in the world in terms of net demand for office space were in Asia Pacific, with particular strength in India. Bengaluru and Hyderabad led the world in office space absorption in Q1 2019.

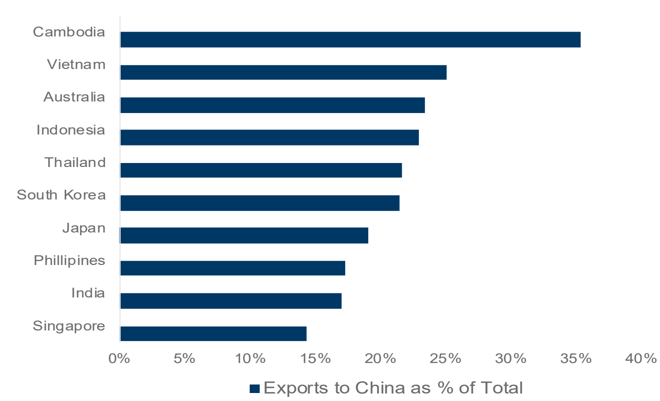
As China goes, so goes the rest of Asia Pacific. China accounts for nearly 50% of Asia Pacific's GDP and most countries in the region have significant trade links with mainland China. In Japan, for example, nearly 20% of all exports are to China. South Korea, Australia, Vietnam—several other Asia Pacific nations—also send well over 20% of their exports to China.

China stimulating again . . .



Source: Oxford Economics, CIA World Factbook

. . . will boost trade in APAC



Source: Oxford Economics, Cushman & Wakefield Research

China also plays a central role in the region's supply chains; it is the final stop in assembly on numerous products such as mobile phones, steel and auto production. In response to the trade dispute, China has launched a number of pro-growth stimulus measures. The People's Bank of China lowered reserve requirement ratios on banks to boost lending, and the government cut taxes while increasing spending on infrastructure and other projects. Remember that China implemented similar pro-growth measures in early 2016 which proved very effective: China's GDP growth quickly re-accelerated and growth in its imports of goods and services from neighbors in Asia Pacific increased approximately 3% in 2016 to 8% the following year. Given that China's GDP growth surprised on the upside in Q1 2019—registering 6.4%—it would appear that once again these stimulus measures are working their magic.

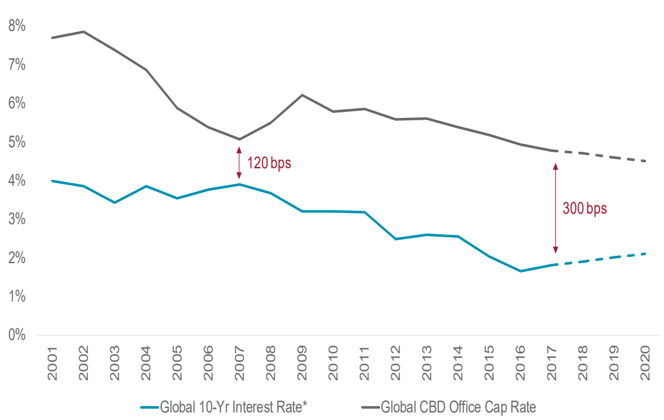
Benefits of the Global Slowdown

Slowing growth is not unusual, nor is it necessarily undesirable. Several major economies have experienced a slowdown at various points in the current cycle—those of Canada, China, Germany, Japan and the U.K.—and none of them have fallen into a recession. In fact, most of these slower periods of growth were followed by robust rebounds. For example, from mid-2014 through late 2015, oil oversupply and fears of an impending economic slowdown in China battered world commodity prices and parts of the globe (Brazil, Russia) fell into recession. Other commodity exporting countries—such as Canada—were luckier. In Canada real GDP growth slowed to just 0.7% in 2015 before gaining steam as the world economy stabilized. Its economy grew by 3.0% in 2017 before moderating yet again.

Even the phrase "global slowdown" is a bit overdone since it mainly refers to the fact that global real GDP growth likely peaked in 2017 and is now moderating. Regardless of trade tensions, Brexit or other developments, some type of slowdown is inevitably going to occur. It could also be argued that these types of occasional pullbacks and mini-corrections are key ingredients in sustaining the expansion and ensuring certain sectors of the economy don't overheat. This was part of the FOMC's rationale when it opted to raise interest rates four times in 2018: to get ahead of asset markets—i.e., stocks, real estate, bonds—that were at the cusp of overheating.

While the bulk of economic analysis has focused on the slowdown itself, very little analysis has been on the benefits of a slowdown—and there are many. For example, slowing global growth has helped keep oil and gas prices more affordable. The price of Brent crude was $75 per barrel in mid-2018 and was poised to go higher. Since the recent slowdown, Brent crude has declined to $64 per barrel as of May. Lower gas prices are creating a significant tailwind for many global businesses, consumers and countries that are net importers of crude oil or its by-products. The slower global growth has also taken much of the pressure off inflation and, therefore, long-term interest rates. 10-year government bond yields are 50 bps lower on average than they were just one year ago. While 10-year bond rates in the eurozone and the U.K. are down about 40 bps (on average) between May 2018 and May 2019 (i.e., to date), in the U.S. and Canada they are down 60-70 bps over the same period. In certain countries, such as Australia and South Korea, long-term yields have compressed by 120 and 80 bps, respectively. German 10-year bund rates have declined by more than 65 bps; Germany and several other countries, continue to see negative yields on their sovereign debt. The fall in interest rates has concomitantly taken pressure off cap rates as well as created more attractive debt options for investors.

Benefits of Slowdown: Low Interest Rates



Source: Real Capital Analytics, Cushman & Wakefield Research. *To represent "global", we average 10-yr government bond yields of the U.S., Eurozone, Australia, China, Japan, Singapore

The U.S. yield curve is once again causing angst, but the worries there too, are likely overdone. The spread between the U.S. 10-year and the 3-month Treasury yield was inverted for most of May and the first half of June. This of course makes investors uncomfortable because an inverted yield curve has proven to be a reliable predictor of past recessions. In fact, since 1970, the yield curve has inverted seven times and every time this has been followed by a recession, at various lags. This track record in predicting recessions is second to none, which is why it is attracting so much attention in the financial markets.

However, the recent curve inversion is occurring for reasons that are quite different than ones that have signaled recessions in the past. Typically, recessions occur because of the Fed's efforts to address an economy that is overheating or showing signs that it may soon do so. With core inflation still well below 2% and trending lower, there is very little evidence indicating the U.S. economy is overheating, or is at the cusp of doing so. More likely, the recent inversion is due to other factors, such as a flight to quality in financial markets (e.g., U.S. bonds) due to the trade dispute and slowing global growth. It is unlikely that the current inversion is signaling an imminent recession. Moreover, the current state of the yield curve does provide opportunities for investors to reengineer their debt, switching out of shorter-term debt and locking in more longer-term debt at lower rates.

As we look ahead to the second half of the year and to 2020, certainly there are downside risks which we will continue to monitor. But there is also compelling evidence that the economic fundamentals are not the source of any risks to the outlook. Indeed, assuming policy missteps do not derail momentum, the IMF projects global growth will improve in the second half of 2019 and return to 3.6% in 2020. Few analysts, if any, are calling for a global downturn to occur anytime soon. The economic expansion, which in the U.S. will officially be the longest on record come this July will in all probability continue to move forward. Overall, the global backdrop is still pretty good, just not as good. And property markets have performed just fine when growth was "good but not great''—this time shouldn't be any different.

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