

Real Estate House View

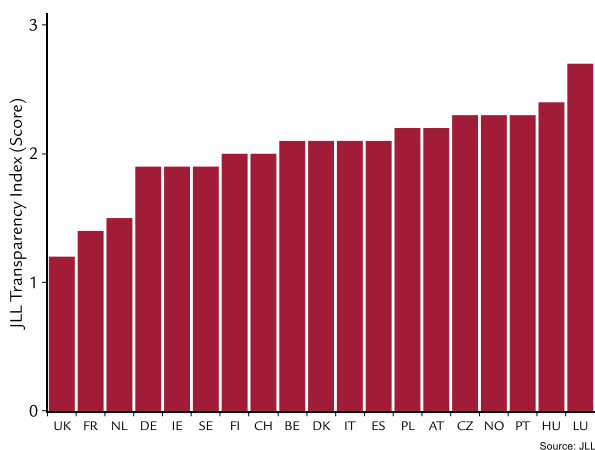
Hungary, Poland, Czech Republic

First half-year 2019

Key takeaways

- The macroeconomic momentum in Central and Eastern Europe remains above average in the European context, but has only been partially transferred to the real estate markets.
- The situation in the office markets continues to become more challenging. Following a recovery in recent years, construction activity in Prague and Budapest has picked up significantly, reducing the prospects for rental growth. Warsaw is still suffering from an oversupply of office space.
- Retail is benefiting from the ongoing positive economic outlook and continues to provide prospects for moderate rental growth as domestic and international retail chains expand in major cities and leading shopping centres.
- Starting from the currently low level, e-commerce will become increasingly important in the CEE countries over the next few years.
- The logistics sector will continue to gain in importance in line with the expansion of e-commerce, but given the high availability of land it promises little prospect of rental growth.
- The contraction in initial yields should come to an end by 2019 at the latest and move into a phase of consolidation with a slight upward trend.

Chart in focus



The real estate markets in CEE have adopted many patterns seen in the West European markets since economic liberalisation. One example is the JLL Transparency Index, which puts the markets in Poland, the Czech Republic and Hungary on a par with many West European countries. However, some concerns remain in terms of market monitoring, such as take-up (which also includes some contract renewals), prime rental levels which contain a lot of incentives or, in principle, the market activity taking place in pre-1990 buildings, which is typically not part of market analysis. It thus remains essential to review the data critically.

Although industrial activity slowed markedly in major European economies, this was less pronounced in Central & Eastern Europe (CEE) during the third quarter. Declining unemployment rates pave the way for stronger wage growth, which poses the risk of further overheating and inflation. In the Czech Republic, the central bank is steadily tightening monetary policy. Since mid-2017, its key monetary policy rate has been raised from 0% to 1.75%. Weakening global trade dynamics are clouding the outlook for exporting sectors in the region. Exports amount to 99% of nominal GDP in the case of Hungary. At 97% and 54% respectively, the same metric is still remarkably high for the Czech Republic and Poland.

Office markets getting bumpier

As a result of relatively restrained construction activity and strong demand, the major CEE office markets (except Warsaw) have recovered noticeably since 2015 and recorded rental growth. Nevertheless, another slowdown of the letting markets is on the horizon. In Prague and Budapest, construction activity has already picked up in response to the brightening of the markets and will create a lot of available space in coming years. Warsaw is expected to continue seeing a substantial number of completions of projects despite high vacancy rates. There are signs that building activity may slow in the medium term, but the lessons learned have been rare among developers so far. Against this background, the enormous take-up volumes and levels of absorption, which brokers report on a regular basis, are unable to balance supply and demand. Driven by the supply side, we are increasingly sceptical about the rental outlook for these markets. In Warsaw, stable rents are to be anticipated over the next 2 to 3 years. In Budapest and Prague, modest but slowing growth seems feasible.

E-commerce is growing

The retail sector in the CEE countries relies on good macroeconomic foundations: high employment levels and rising wages that fuel consumption and retail spending. In a European context, these countries have the strongest growth rates in retail spending, and although the momentum is expected to weaken slightly (especially in Hungary) this should hold up. Store-based retail may benefit from low penetration by e-

commerce, but the situation is changing: the online share of all retail sales reached 8.8% in the Czech Republic in 2017 against 5.3% in Poland and only 3.8% in Hungary. According to PMA, strong growth rates should push online retail's share up to 14.5% in the Czech Republic in the next five years, while a doubling is predicted for both the other countries. Aside from these shifts, the strong retail climate is attracting international brands to these markets (especially the capitals – and thus also the major shopping centres). However, the expansion of domestic retailers and restaurant chains must also be taken into account. Thus there is further potential for rental growth in high street areas and large shopping centres, with Prague having the best prospects.

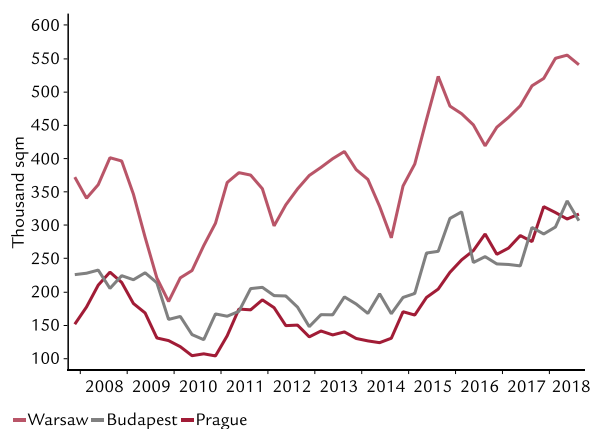
Logistics still depends on manufacturing

With the strong growth of e-commerce, the logistics industry in the CEE countries will also experience a further boost – especially those properties that serve the distribution of goods to private customers. Owing to the strongly industrial character of the region, the logistics sector has already grown substantially in recent years. In terms of take-up, the metropolitan areas belong to the leading regions in Europe. However, this momentum is only reflected to a limited extent in rental performance, as there is sufficient land available to be developed in many regions. We therefore expect only very limited prospects for rental growth in the immediate future.

Yields starting to move sideways

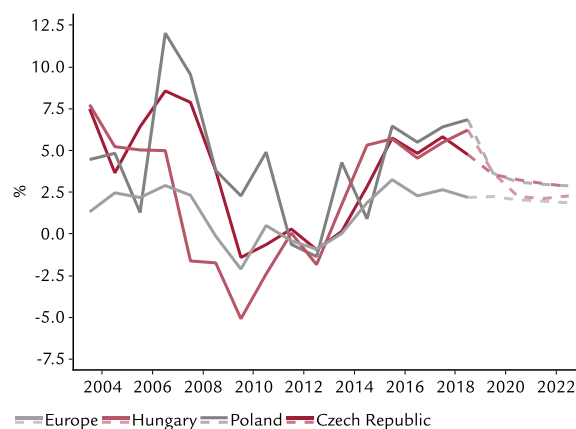
Investment demand remained high in the CEE countries in the first quarters of 2018, though (with the exception of Poland) a supply shortfall kept transaction volumes below the year-ago level in the first half of the year. Retail assets and portfolios remain very important for the region and particularly for Poland. In both the Czech Republic and Poland, prime yields are bottoming out. Hungary still offers higher yields, and their compression continued in the first quarters of 2018. For 2019, however, we do not expect further contraction in yields in any of the countries. This applies mainly to the office sector, as the prospects emerging for the letting markets are less favourable.

Chart 1: Office take-up in CEE's main office markets (rolling annual figures)



Source: PMA

Chart 2: Retail spending (real) in CEE countries compared to EU



Source: Oxford Economics

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