Real Estate House View

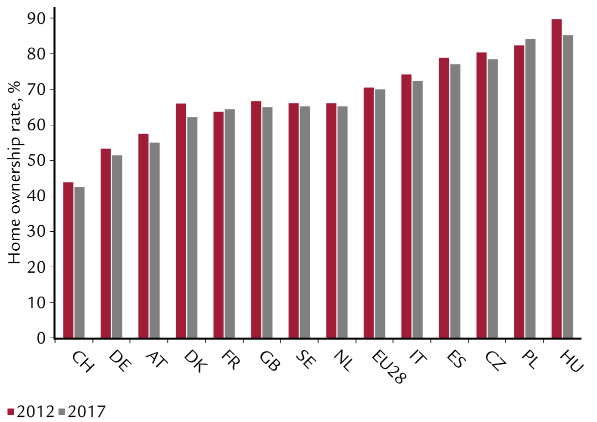
Hungary, Poland, Czech Republic

First half-year 2020

Key takeaways

- In the wake of the economic slowdown in western Europe, the prospects for economic growth in the CEE countries are deteriorating, at least in the short term, but remain well above the overall European average in the medium and long run.
- The office markets are currently in good shape thanks to strong demand and comparatively moderate completion figures. The well-known high level of construction activity that is presently being observed limits the momentum for the future and leads to the assumption of constrained rental growth.
- Requirements for logistics space are backed by the rising need of e-commerce. At the same time, construction activity is high and limits the prospects for rents rising.
- Increasing household incomes are driving the retail sector with the result that both the strong-growing e-commerce as well as the store-based retail are benefiting. Rents should thus continue to rise.
- The CEE markets offer above-average yields, which contracted again in 2019, especially in the office and logistics sector. We expect further yield compression for selected regions and sectors, but predominantly a sideways movement.

Chart in focus



Source: Eurostat

In central and eastern European countries, the privatisation of large housing stocks in the 1990s led to a high rate of home ownership. The market for institutional investments is thus limited. In most European countries, however, the ownership rate is declining, and this is clearly evident in Hungary and the Czech Republic. No rule without exception: in Poland, the ownership rate has actually grown in recent years. Nevertheless, the rental market and with that the opportunities for institutional investors are on the rise, especially in large cities.

At the end of 2019, the manufacturing purchasing managers index (PMI) for the Czech Republic was the weakest of all available PMIs in Europe. Quarterly real GDP growth in this country slowed by around half compared with 2018. The risk of a temporary recession caused by tailwinds from global trade remains elevated in all three economies as sentiment indicators continue to deteriorate across the region. As domestic price pressure continues to intensify with wage growth being a major driver, the growth/inflation mix is deteriorating further. Additionally, unfavourable demographics weigh on the region's long-term growth potential.

Office markets still in upswing

The major CEE office markets recorded strong letting activities in the first quarters of 2019, which were partly impacted by large-scale lettings, e.g. in Warsaw by the financial sector. In terms of occupier groups, the weight of multinational corporates becomes apparent, and in addition flexible office providers demand a considerable amount of space. Relocations are still an important driver of demand, fuelled by sufficient supply in new-built properties. Positive net absorption and moderate levels of completions ensure a steady decline in vacancies in Warsaw and Budapest, whereas Prague is lagging behind: a restrained take-up and a substantial amount of new supply pushed vacancy up again in 2019. For all capital cities, on the other hand, an increase in prime rents of around 5% is reported for the first nine months of 2019. However, rent levels and rental growth in these markets should be considered with caution in the light of high incentives given to tenants. We are cautious to believe market prospects are that bright: economic growth is expected to decelerate in the CEE countries in 2020 and demand for office space might be dampened. Furthermore, the escalating level of construction activity leaves us watchful for the future. Thus, our assumption remains unchanged that rents in Budapest and Prague are likely to increase only slightly but remain stable in Warsaw.

Retail remains robust

Retailers, both store-based and online, have benefited from the dynamics of economic growth and retail spending, which in particular are driven by the rising incomes of the urban population. This may slow somewhat with the expected economic slowdown but remains above the European average. New brands still enter the markets and boost demand, putting rents under upward pressure. A moderate increase in rents of around 2% can be assumed in the main shopping locations and large shopping centres over the next years, which should set these markets apart from many other European markets which show restrained growth prospects.

Logistics as a key player

In CEE countries, especially Poland and the Czech Republic, strong logistics markets have emerged. The demand from e-commerce arises on the one hand from domestic expansion and on the other by supplying markets in Western and Northern Europe (delivery and return processing). In addition, there are many customers from the manufacturing sector, although this sector is likely to be impacted by the weakness of western Europe's industry. As a result, demand for logistics space remained high in 2019, but this was countered by strong, in many cases speculative construction activity. As a result, rents have moved little and the prospects for rental growth are limited.

Strong investment markets

Investors keep central Europe in the spotlight. Following a moderate beginning in 2019, the investment market gained considerable momentum, closing the first half of the year at a transaction volume of around EUR 5 bn, almost on par with the same period of the previous year. In addition to the typically strong Austrian players, investors from South Korea invested more than EUR 1 bn in the first half of 2019. Office properties experienced strong demand, while the retail sector, which is usually of above-average importance in CEE, lost significant market share. A year-end result of over EUR 10 bn should be recorded. Prime yields remained under pressure during 2019, especially in the logistics and office sectors. In the retail sector this only applied to Budapest, whose sentiment among investors has improved overall in recent times. There is still some room for a further decline in yields, but altogether we believe in a sideways movement of current levels in the medium term.

Chart 1: Office rental growth

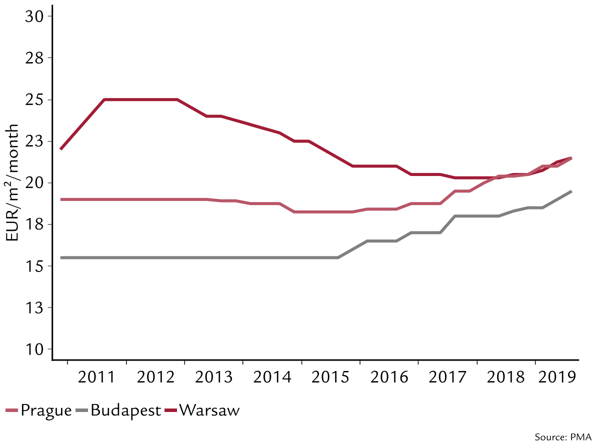
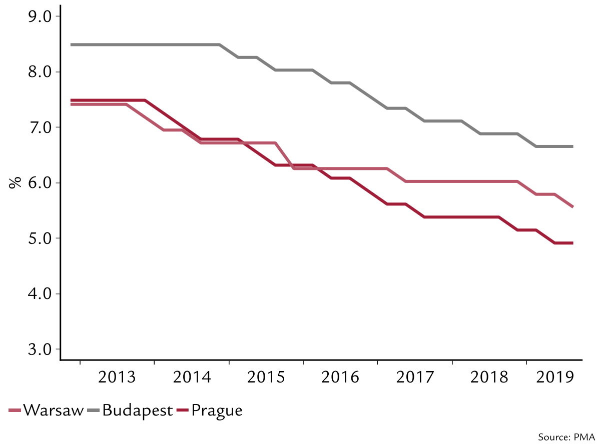


Chart 2: Prime logistics yields



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