

World Overview

Growth: Global prospects are split across regions, with the 'Trans-Atlantic' nations showing weakness and the Asian pacific (APAC) countries still motoring. Fourth quarter GDP was weak in the US 0.2% (q/q), stronger than expected in the UK at 0.6% (q/q) and booming in China 11.4% (y/y). APAC countries have been traditionally export led but are seeing some pick up in domestic activity; the contribution of consumption to Chinese growth increased and Australian statistics all show strong activity. In contrast the US saw job losses in December, as did Canada and in the Euro zone job creation has paused. Trans-Atlantic household confidence has weakened, which is feeding into diminishing retail activity: UK retail sales fell by 0.4% (Dec m/m), US spending fell 0.4% (Dec m/m) and Euro zone fell by 0.1% (Dec m/m).

Inflation: Unsurprisingly inflation is more worrying in the APAC countries, with China introducing price controls. Australia inflation was 3% (Q407) driving by strong growth and capacity constraints, leading to interest rates hitting an 11 year high. Japanese inflation surprised on the upside growing at its fastest pace in 10 years at 0.7% (Dec y/y). Inflation at 2.1% (Dec y/y) in the UK, 2.4% (Dec y/y) Canada and 2.4% (Dec y/y) USA appears under control, but in the Euro Zone it is at a record high of 3.2% (Jan).

Policy: The US response has been rapid and large, with two January rate cuts totally 125 bps to put rates at 3%. Another push to growth is the large fiscal package just approved by Congress worth around 1% of GDP. In the near term the impacts will be on the markets and confidence, only later will they feed into the real economy. China's price controls have been implemented to stem inflation and Australian rates are now at 7%. Elsewhere there have been rate cuts in Canada 25bps (Jan) and the UK 25bps (Feb), with BoJ and ECB are still facing limited policy options.

Region by Region (changes in bold)

	Growth	Inflation Rate	Short Int Rate
USA	Weakening	Easing	Falling
Euro zone	Weakening	Steady	Stable
UK	Weakening	Steady	Falling
Japan	Weakening	Steady	Stable
Canada	Weakening	Steady	Stable
China	Strong	Rising	Rising
Australia	Strong	Rising	Rising

Are recessions bad for real estate?

Today's papers are full of gloom over the impending US recession. Will the other regions of the world follow the US into recession and will they fare better or worse? More to the point, what will be the impact on real estate returns?

What do we mean by a recession anyway? Many say a recession is two consecutive quarters of contracting growth. The authoritative US National Bureau of Economic Research (NBER) defines a recession as a significant decline in economic activity, lasting more than a few months, which begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. From a real estate perspective it is the feed through from GDP weakness to unemployment that is most important.

Table 1 shows the two most recent recession periods, 1990-93 and 2000-03, in terms of length, persistence and depth of recession. In the 1990s consecutive quarters of GDP contraction were evenly spread across the globe, but while the US bounced back other nations suffered further quarters of contraction – in the UK it was 5 consecutive quarters. Further, the UK suffered the

biggest peak to trough loss of GDP. In GDP terms the early 2000s recession was mild and largely confined to the US. In the early 1990s interest rates were used to squeeze inflation from the system but low inflation in 2000 allowed interest rate cuts to support struggling economies.

The recession impact on employment is generally longer (table 2) and greater than the GDP impact. Office occupation and absorption are closely related to the health of the labour market, one mechanism by which real estate markets are affected. Increasing levels of unemployment are also associated with lower earnings and less spending, combined with debt default. All of these factors are closely aligned to the performance of retail assets.

Not only is the contraction important but also the length of time to return to the same number of employed people. In the UK the peak of employment was in 1990Q4 and it wasn't until 1998Q3 that employment reached the same level. In the US, job losses began a quarter earlier than in the UK but returned to post recession levels more rapidly with the numbers employed returning in 1992Q3. This highlights the flexibility of the US labour market. Interestingly, only the US saw contracting GDP in the 2000-03 years but there were mild job losses across all countries in this period. It doesn't take a recession to create unemployment, merely slow growth.

Table 1: Economic growth - recessions compared

GDP	USA	UK	EU	China	Australia
1990-93					
Consecutive quarters	2	5	2	0	2
Total quarters	2	6	4	0	5
% peak to trough	-1.3	-2.5	-0.1	-	-1.8
2000-03					
Consecutive quarters	0	0	0	0	0
Total quarters	3	0	0	0	1
% peak to trough	-0.1	-	-	-	-0.8

Source: Grosvenor, Global Insight

Table 2: Employment - recessions compared

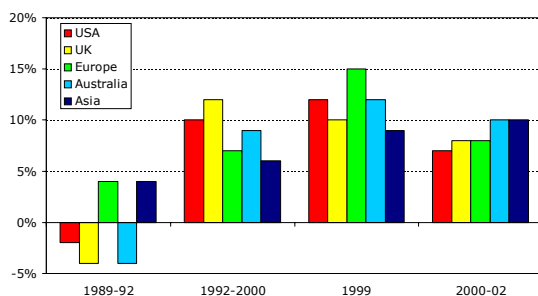
Employment	USA	UK	EU	China	Australia
1990-93					
Consecutive quarters	6	11	3	0	6
Total quarters	6	11	9	1	8
% peak to trough	-1.2	-6.1	-3.9	-1.0	-3.0
2000-03					
Consecutive quarters	4	0	2	10	0
Total quarters	7	2	6	12	2
% peak to trough	-1.2	-0.1	-1.1	-11.0	-0.8

Source: Grosvenor, Global Insight

What are the linkages with real estate performance? Chart 1 shows annual average percent returns in four time periods: early '90s recession, mid 90s growth phase, 1999 and 2000s recession. The UK and Australia suffered the greatest losses in the early '90s, with both experiencing 3 years of falling returns. The US suffered losses in only 2 years and Europe saw only a marginal loss in one year, but slowed significantly. The real estate pain of the early '90s is strongly related to the recession experience of the UK, USA and Australia. The performance was also influenced by the supply conditions in each market. This was especially the case in the UK, which entered the recession with significant over supply.

The recession of 2000-2003 had very little impact on percent per annum returns compared to those experienced from 1992-2000, although there was a significant slowdown between 1999 and 2000. The severity of the recession was not as great in this period and not characterised by consecutive declines in GDP, which led to benign outcomes. Australian and Asian returns grew strongly from 2000-02, but were recovering from the 1997 financial crisis.

Chart 1: Real estate returns



Source: Grosvenor, IPD, NCREIF, PCA,

Where are we now? Probably worse than the 2000s but not as bad as the early 1990s. Inflation is not entirely subdued but is tame enough for some interest rate cuts. Moreover in the 1990s, and even the 2000s, there was only the US to rely on: now India and China are credible motors of the global economy. So, real estate will not get away scot-free, but may escape with only 1 year of negative returns. The UK looks badly placed due to high supply levels and an over dependence on financial services, the focus of current problems.