EUROPEAN REAL ESTATE'S 'PARADISE PERIOD' IS ENDING

PASCAL LAMY

The "paradise period" of Europe's current real estate investment cycle is probably over, the former Director-General of the World Trade Organization and President Emeritus of the Jacques Delors Institute, Pascal Lamy, said in an interview with EPRA Magazine in early June.

Negative or record low interest rates have caused huge flows of capital into real estate as investors seek higher-yielding assets. As pricing has risen, investors are focusing on the economic backdrop behind property rental incomes.

Lamy, who will be a keynote speaker at EPRA's Annual Conference in Paris in September, forecasts that, all things being equal, European economies are on course for a lacklustre 1.5% average growth rate for the next five to 10 years. Europe's central banks have exhausted their options in fostering growth and few governments have budgetary leeway to provide a catalyst to their economies, he concluded.

"The overall picture (for European real estate) will not be as good in the future as it has been for the past five years," Lamy said in the interview at the Delors Institute's office in the French capital. "In an economy which is growing slowly and is at the end of this specific 'paradise period,' you go back to a normal world."

Noting that real estate is a diverse industry that is prone to price bubbles, Lamy said actions by central banks to reflate the economy have created "extraordinary financial leverage that is probably not sustainable." The normalisation of monetary policy and deleveraging may be painful, affecting real estate values with wide-reaching consequences and varying degrees of magnitude for lenders, companies and households.

"The central banks have done what they could with the ammunition that they have....This is not painless: you have to get out of this negative interest rate situation. The consequences of this monetary bombardment still have to be coped with - you need to absorb this huge amount of excess liquidity. We still have too much debt."

This has thrust economic fundamentals - consumer spending, corporate investment and hiring - centre stage in driving future rental and property values, as well as construction and development, he said.

"At the end of the day, you need people to spend or to hire. The revenue has to be there for that," he observed.

Europe is poised to lag behind the growth rates of developing economies like China as well as developed economies, notably the US, where average GDP growth may be as much as 3%. Only Japan is likely to fare worse in terms of growth among the major developed economies, he said, adding that Europe's growth prospects are due to homegrown factors.

"Demographics are the most important factor because Europe has a shrinking and ageing population," he said, adding that this can change through increased immigration, which in turn presents "political challenges."

The European Commission estimated in a report published last year that the European Union's working age inhabitants (15-65 years of age) will fall to 59.6% of its total population in 2035 from 66% in 2013. It also projected that by 2035 at least one in four will be 65 years of age or older, compared with 18.4% three years ago. In Germany, the ageing population is particularly pronounced: retirees made up 21% of the country's population in 2013 and their numbers will rise to almost 31% in 2035, according to Commission projections.

While Germany is one of the few countries with scope in its public finances to boost growth, its policy-makers are reluctant to do so because of the demographic challenges facing the country. This has created a long-term saver mind-set in government circles, Lamy said. The decision to open Germany's doors to more than one million immigrants will inevitably shift public policy, leading to some 80 billion euros of investment to house, educate and train the new arrivals in Germany, "but this will take time," he added.

Other brakes to European growth are insufficient innovation and a failure to maximise the growth potential through economies of scale, notably in the services sector. Again, both of these can change through increased integration of the Single European Market and if research institutes get better at turning their scientific breakthroughs into products or services that they can bring to the market.

Lamy observed that there has been a slowing in globalisation after 20 years of "high speed," particularly when looking at how the global supply chain has extended into multi locations for producing goods and services. This slowdown is due partly to reduced investment by companies in Europe as a result of the euro crisis, he said.

"Globalisation will keep going because its engine is technology, which shrinks distances and fosters an international division of labour, with the increased efficiencies that go with that," he said. "This won't stop, because technology doesn't move backwards. It will keep impacting economic and social systems -- probably harder and harder. It's reform brought through trade, competition and technological change."

Pascal Lamy
Jacques Delors Institute

Pascal Lamy served as General Director of the World Trade Organization (WTO) for eight years until 2013, having been European Trade Commissioner until 2004. His return to Brussels came after five years as CEO of Credit Lyonnais, prior to which he was Chief of Staff for the President of the European Commission, Jacques Delors from 1985 to 1994. He is currently President Emeritus of the Jacques Delors Institute.

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