Investors need to be prudent to weather the poor economy

By Stephen Ackroyd, European analyst, BNP Paribas Real Estate

The Euro sovereign debt crisis continues to adjust prospects for the UK economy almost on a daily basis. Although the UK stands outside the Eurozone, it is not immune from problems given that Europe is major export destination for goods and services. Capital Economics, always a bearish forecaster, expects that the fallout from the Euro sovereign debt crisis will result in the UK’s annual GDP of 0.8% for 2011 slowing to 0% in 2012, with a strong likelihood of recession. In Europe we expect a prolonged period of weak GDP and flat employment growth, presenting challenges in the short term for the occupational market.

What this translates to is very uncertain times for investment. Nevertheless decisions still have to be made about where to put money. In previous downturns, property investment has followed the economy downward and yet what is striking is the volume of investment still occurring across Europe with Quarter 3 experiencing an increase to €19 billion euros in the big 5.

![Investment volume is increasing again](chart.png)
This year’s total investment volume in the big 5 is unlikely to match 2010’s figure of £81 billion. And Europe as a whole will see lower investment volumes. But it is clear that Europe’s travails are leading to continued emphasis on defensive and quality products across all asset classes including property.

The attention focused on property is not surprising considering the context of the gap with European bond yields. Property is an attractive proposition given the great uncertainty about the stability of European government finances. We think that the gap between European commercial property and bond yields will remain relatively high due to the low interest rate environment the Euro crisis implies.

This is not to say all property is of equal interest everywhere. For the office market the key northern markets of Paris and big German six are on a different trajectory to the southern European cities. As are the Nordic countries and the UK or more specifically, the London office market that is more strongly driven by overseas buyers than the other cities in Europe.

Much is often said about UK exceptionalism with regards to Europe. And in the current property market there is an element of truth to this suggestion. The real point of exception is in retail investment. Historically a much stronger component of investment for the UK than in Europe, it is in relative decline compared to Germany and France. German retail has buyers across all retail segments and shows the strongest investment growth in Europe; whilst in France it is receiving more interest than before. For investors in Germany and France, retail presents a more secure income source, underpinned by lower personal debt levels. This is not the case for UK where retail investment is falling and heading down to levels last seen at the end of 2008. Purchasers are still buying, but are much more selective in a market characterised by falling household consumption and deleveraging.

What the situation with UK retail ultimately reflects though, is the polarisation that is occurring between the best and secondary property in Europe. And with the Euro crisis still unrolling, that looks set to be a Europe wide trend for the immediate future.

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Press contacts: Kate Titchmarsh, +44 (0) 7595673610, [kate@revolution-pr.co.uk](mailto:kate@revolution-pr.co.uk)