Colliers

Global Capital Markets: **Insights & Outlook**

Global Capital Flows

SEPTEMBER 2023

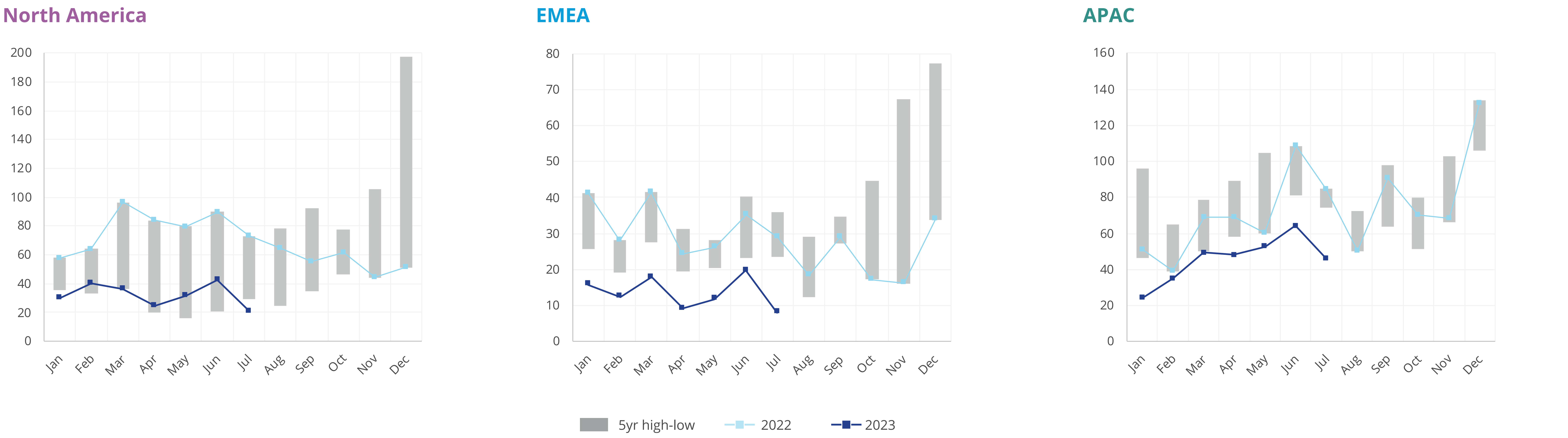
Monthly regional investment flows: mixed messages?

Although markets are now beyond the halfway mark in 2023, the outlook for the second half of the year remains opaque. During Q2, there were clear signs of market activity improving relative to the five year high-low range, with North America leading the recovery. Figures for July, however, point to a downturn in activity. August figures are also expected to be low. The big question is whether this reflects the result of a summer recess in North America and Europe, prior to markets picking up in late Q3 and Q4, or if it represents more fragility across markets, with further challenges to overcome.

The current and future paths of both inflation and interest rates remain critical factors influencing market sentiment. With multiple interest rate decisions to be made across the globe in September, we are unlikely to see the impact of these decisions filter through to investment activity until Q4.

Will policy makers 'stick or twist' on raising interest rates? The factors driving this decision vary markedly by region, and are likely to create a staggered return to positive investment momentum as we head into 2024.

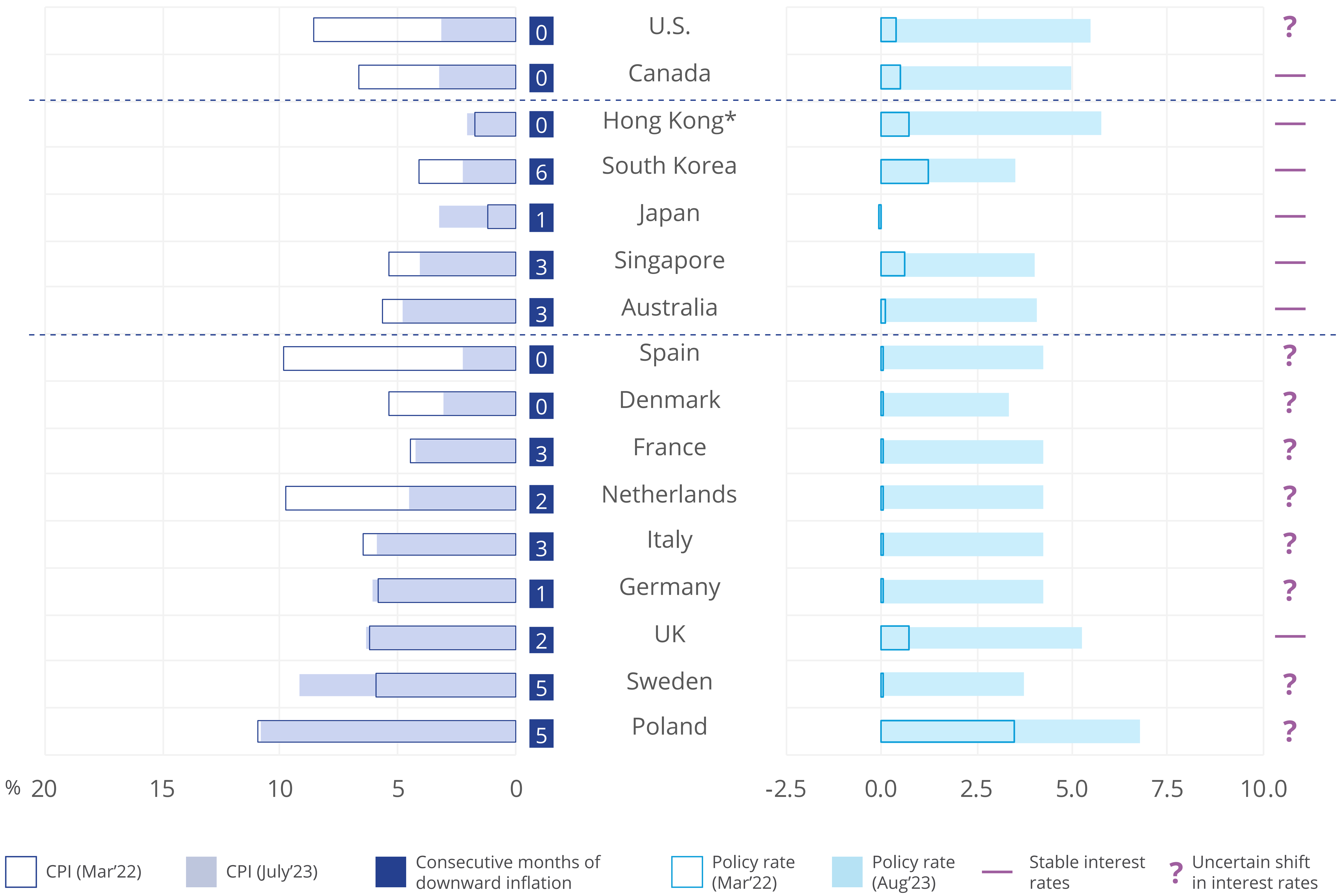
Figure 1. **Monthly regional investment flows, up to July 2023, US$ bn, all sectors including development land/sites**



Source: Colliers, MSCI Real Capital Analytics

Inflation/interest rate development and outlook: are we there yet?

Figure 2. CPI/base rate alignment



*June 2023 CPI Data
Source: Colliers, OxfordEconomics, Macrobond

The path of inflation and subsequent shifts in interest rates over the past 12-18 months has varied markedly by region, see figure 2. This variation in interest rates is expected to continue as underlying fundamentals differ globally.

In North America, the sense that rates had peaked and would therefore (potentially) be wound back in early 2024 has been put on hold. After 12 months of consecutive inflation declines to June 2023, reaching c.3%, interest rates appeared to have done their job. Rates held at 5.25% in July, although inflation (CPI) moved up marginally by 20 basis points (bps). The hawkish tones of the Federal Reserve suggest future rate rises may not yet be over, but a decision to keep rates on hold in September would allay fears that rates have not yet peaked. Canada confirmed their decision to keep their rates on hold at the beginning of September.

APAC is next up on the CPI/interest rate cycle. It is the most diverse market in terms of factors at play, with rates in Japan holding at 0.1% for many years. Inflation in other key regions remains manageable, and all markets have CPI at below 5%, suggesting future rate rises are no longer necessary. In Australia, rates have been on hold as inflation has been wound back from April 2023 highs, with clearer signals that rates are at their peak.

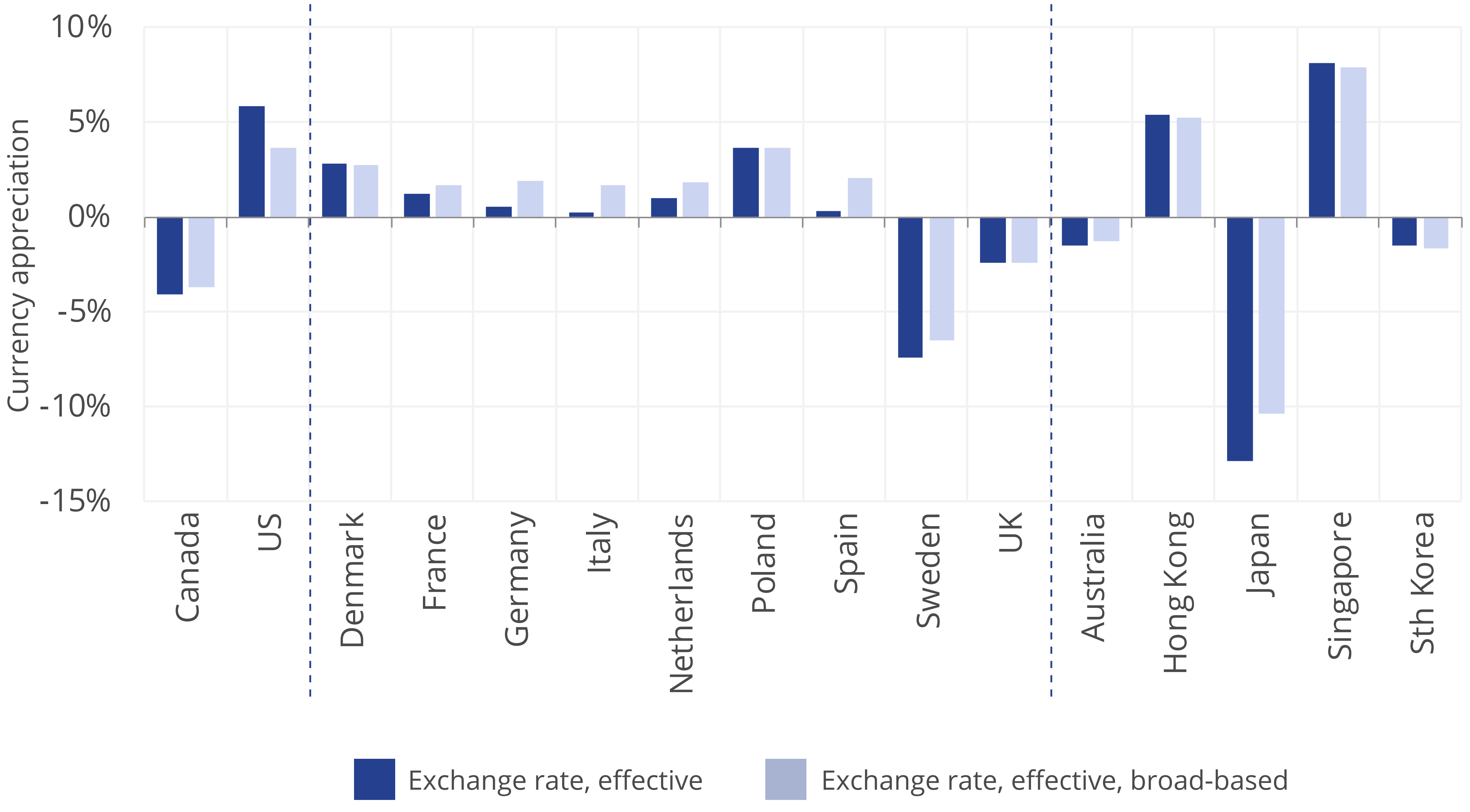
EMEA sits at the back of the pack with much lower investment volumes relative to the five year high-low range. Inflation has remained persistently high, though it is on a gradual downward path, with CPI in the UK at 6.2% in July, and 5.3% for the Eurozone. Until August, the view was that UK rates had most likely peaked at 5.25%, but the Eurozone would face a further rate hike in September. However, the European economic outlook has deteriorated with Purchasing Managers Indices dropping to well below the 50 mark. Despite this, the ECB pushed forward with another rate rise in September, but it will take months to see whether this action drives down CPI. It has some way to go before closing in on target levels of 2%.

Foreign Exchange (FX) volatility contributing to lower cross border flows

Changes in interest rates has also played havoc with foreign exchange rates over the past 12 months, see figure 3. Cross border investment activity has diminished markedly in 2023, dropping to 18% of volumes, having represented 39% in 2021 and 25% in 2022, see figure 4.

Three of the top four sources of capital (Singapore, U.S. and Hong Kong) have witnessed the highest level of FX appreciation over a global basket of currencies. APAC capital has expanded its influence as a global capital source, reflected by the prominence of Singapore, Hong Kong and Japan in the global top 10. Singapore tops the charts as the biggest global spender so far in 2023, followed by the U.S., see figure 5. These markets significantly outsize the next biggest spender, Canada. Both the U.S. and Singapore have spent most of their cross border capital on real estate within their own regions. Interestingly, the U.S. has spent less on other global regions than any other top 10 capital source market, see figure 5.

Figure 3. **FX change by country, since Q1 2022**

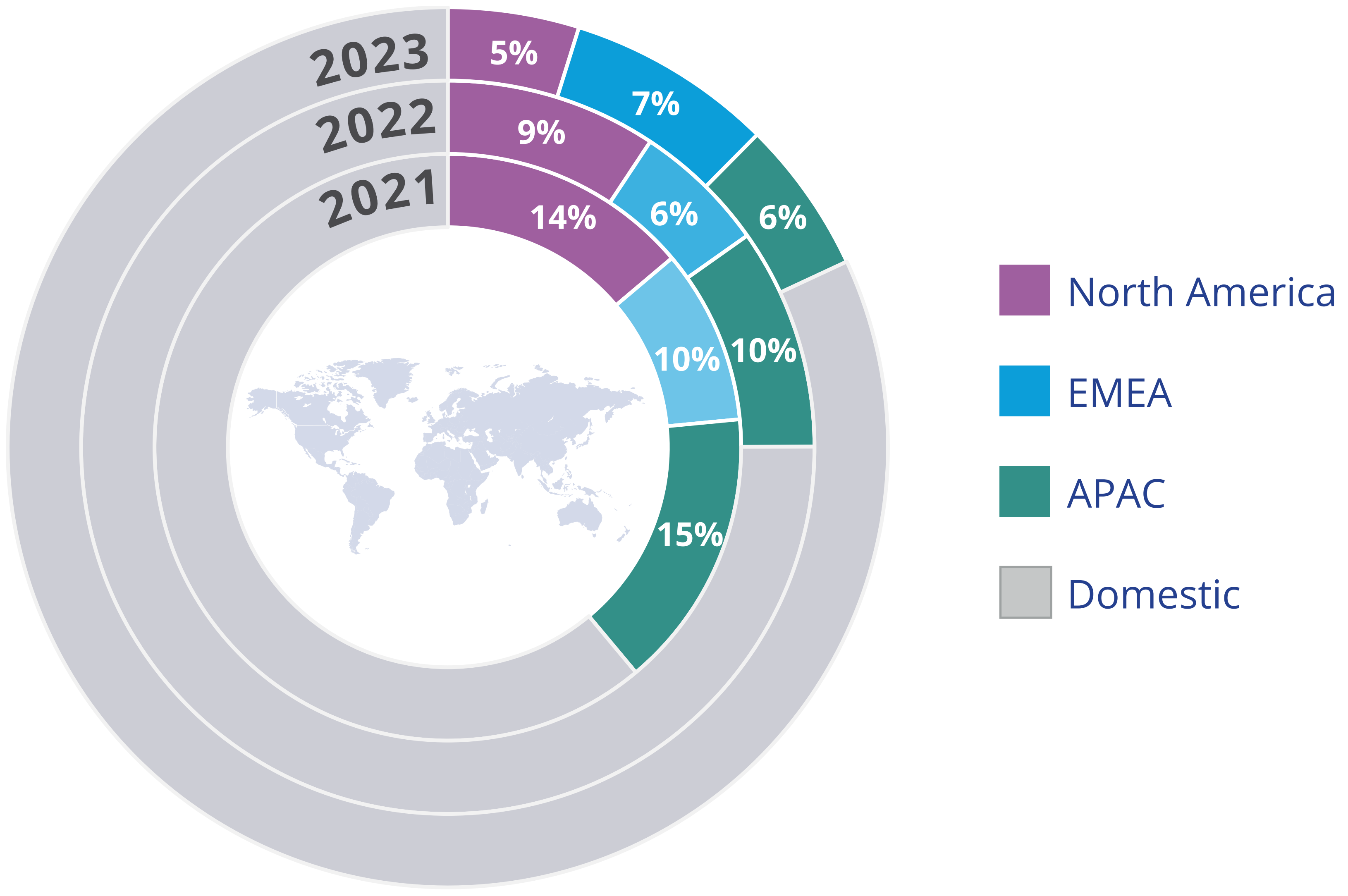


Exchange rate, effective *- The effective exchange rate is an index that describes the strength of a currency relative to a basket of reserve currencies.*

Exchange rate, effective, broad-based *- The effective exchange rate is an index that describes the strength of a currency relative to a larger basket currencies (broad base).*

Source: Colliers, OxfordEconomics, Macrobond, Factset

Figure 4. **Global cross border investment activity, by source region**



Source: Colliers, MSCI Real Capital Analytics

Cross border capital flows down, but APAC rising in prominence

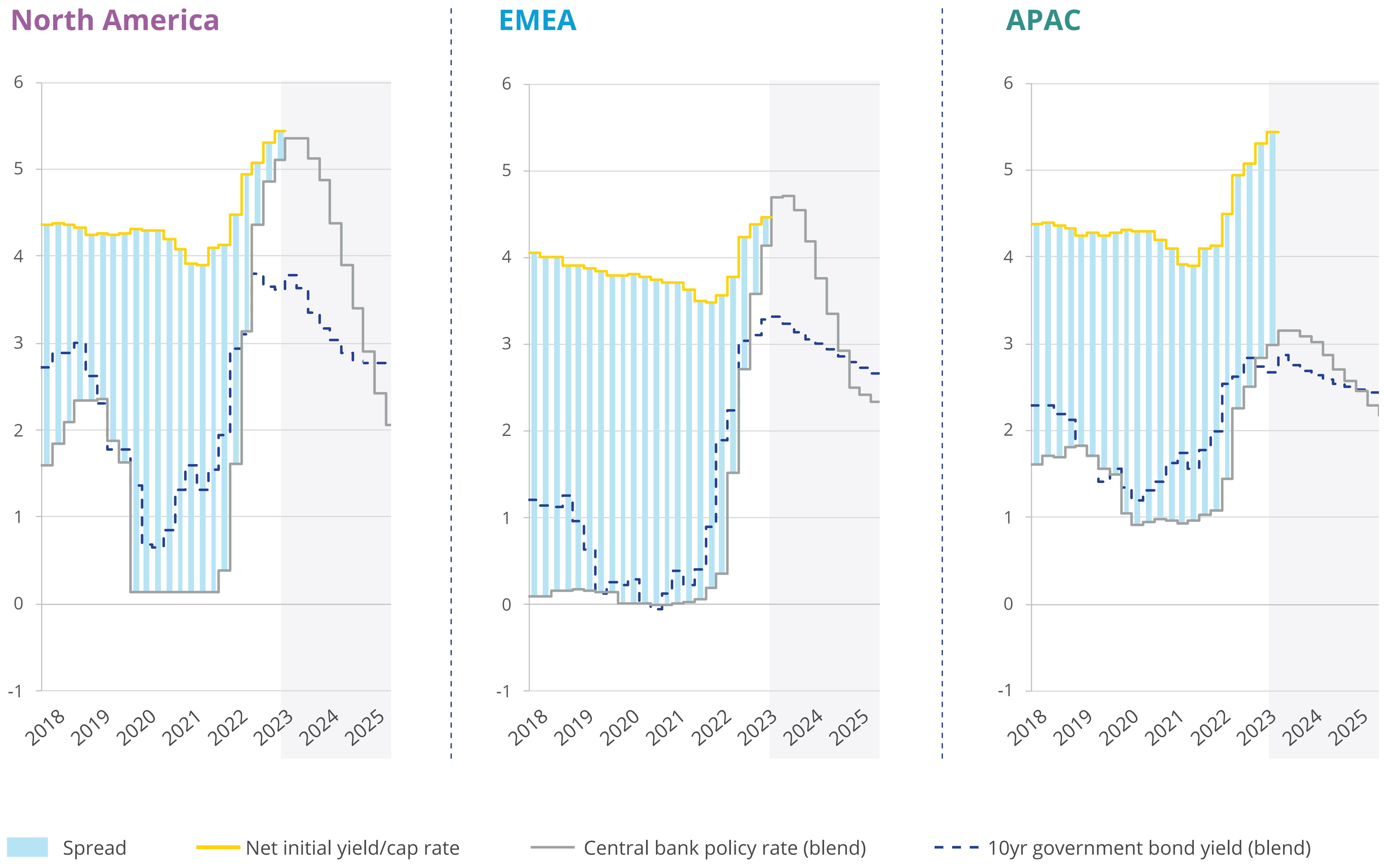
Figure 5. Top 10 global cross border capital sources: H1 2023 US$ mn

	COUNTRY	CROSS BORDER TOTAL	CROSS BORDER GLOBAL	CROSS BORDER REGIONAL	2023 % OF TOTAL	2018 - 2022 % OF TOTAL
1.	Singapore	21,840	15,511	6,329	▲ 24.9%	8.9%
2.	United States	15,852	14,650	1,202	▼ 18.1%	22.5%
3.	Canada	7,239	2,288	4,950	▼ 8.3%	12.2%
4.	Hong Kong	6,508	613	5,895	▲ 7.4%	4.2%
5.	Japan	5,151	3,122	2,029	▲ 5.9%	0.9%
6.	France	5,101	713	4,389	▲ 5.8%	5.0%
7.	Germany	3,794	380	3,414	▼ 4.3%	8.6%
8.	United Kingdom	3,587	666	2,921	▼ 4.1%	7.0%
9.	United Arab Emirates	3,341	1,855	1,486	▲ 3.8%	0.7%
10.	Switzerland	2,490	1,054	1,437	▼ 2.8%	3.8%

Source: Colliers, MSCI Real Capital Analytics

Global spreads: are we there yet?

Figure 6. **All sector yield/cap rate spreads, %**



Source: Colliers, OxfordEconomics, Macrobond, Factset

The sensitivity of potential shifts in interest rates is depicted clearly in the regional spreads charts, see figure 6. These illustrate the spread between all-sector yields/cap rates and central bank policy rates, highlighting significant differences between regions.

North American cap rates have stayed slightly ahead of central bank policy rates, even though the spread itself is minimal. If U.S. interest rates are kept on hold in September, as per Canada, it would support the sentiment that they have peaked. Although interest rates are not likely to be wound back until 2024, generating more positive income spreads, cap rates have adjusted enough to support a positive return to investment momentum.

For EMEA, spreads remain behind the interest rate curve and there needs to be further positive shifts in CPI fundamentals before there are clearer, established signals that rates have peaked. Markets may need to price in a further correction in yields or current bid-ask uncertainty will continue to act as a drag on investment activity short-term. Hope of positive momentum in Q4 is diminishing.

The APAC region has the most diverse range of markets and by far the biggest spread range. While spreads are wholly positive, this is driven by markets such as Japan and Singapore where yields are trading at a wide spread. Australian all-sector spreads are also positive (75bps). Growing consensus that rates may have peaked is feeding into more positive investment sentiment in the market.

Signs of deceleration in yield/cap rate and capital value re-pricing

As the all-sector yield/cap rate and capital values indices charts show, each region has re-priced at a different magnitude and speed, see figures 7 and 8.

Yield/cap rates in North America have re-priced the hardest and fastest, in-line with the strong outward movement in interest rates in the U.S. and Canada over the past 12 months. This is supporting a strong capital value correction, which enabled activity to re-boot in Q2.

In EMEA, there has also been a strong yield and capital value correction, although not to the same extent as North America. However, as the previous spreads analysis shows, whether this adjustment is sufficient remains to be seen. What is clear is that core investment activity is markedly down, with value-add investment picking up - not least supported by higher yield entry levels.

In APAC, the yield rate adjustment has been much more benign and the capital value adjustment negligible. This lack of change has some part to play in a slower return to investment flows. Underlying fundamentals in the region are generally more positive than other regions, but availability/liquidity of product is tighter.

Figure 7. All sector prime yields/cap rates

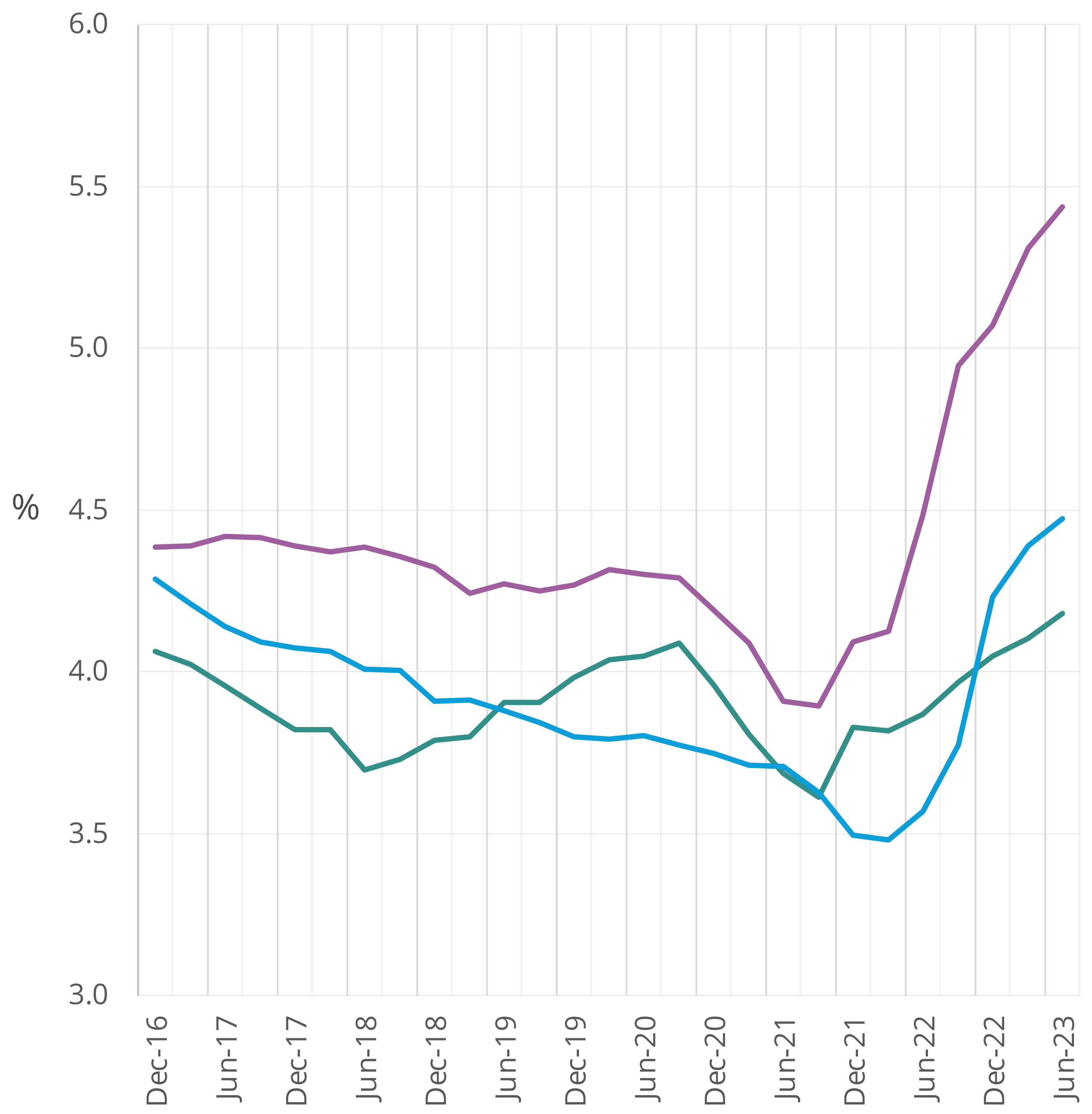
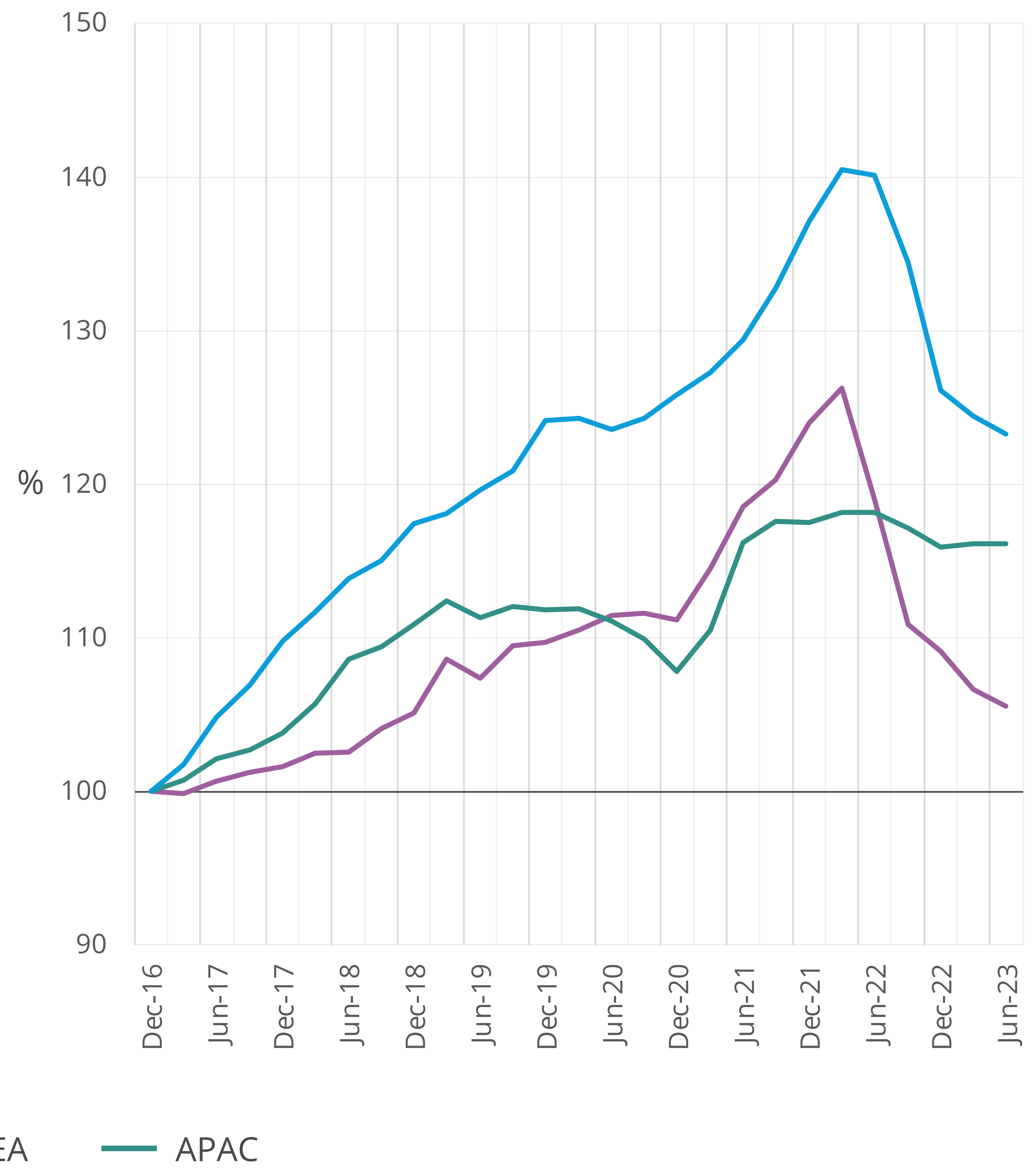


Figure 8. All sector capital values indices [2016=100]



Source: Colliers

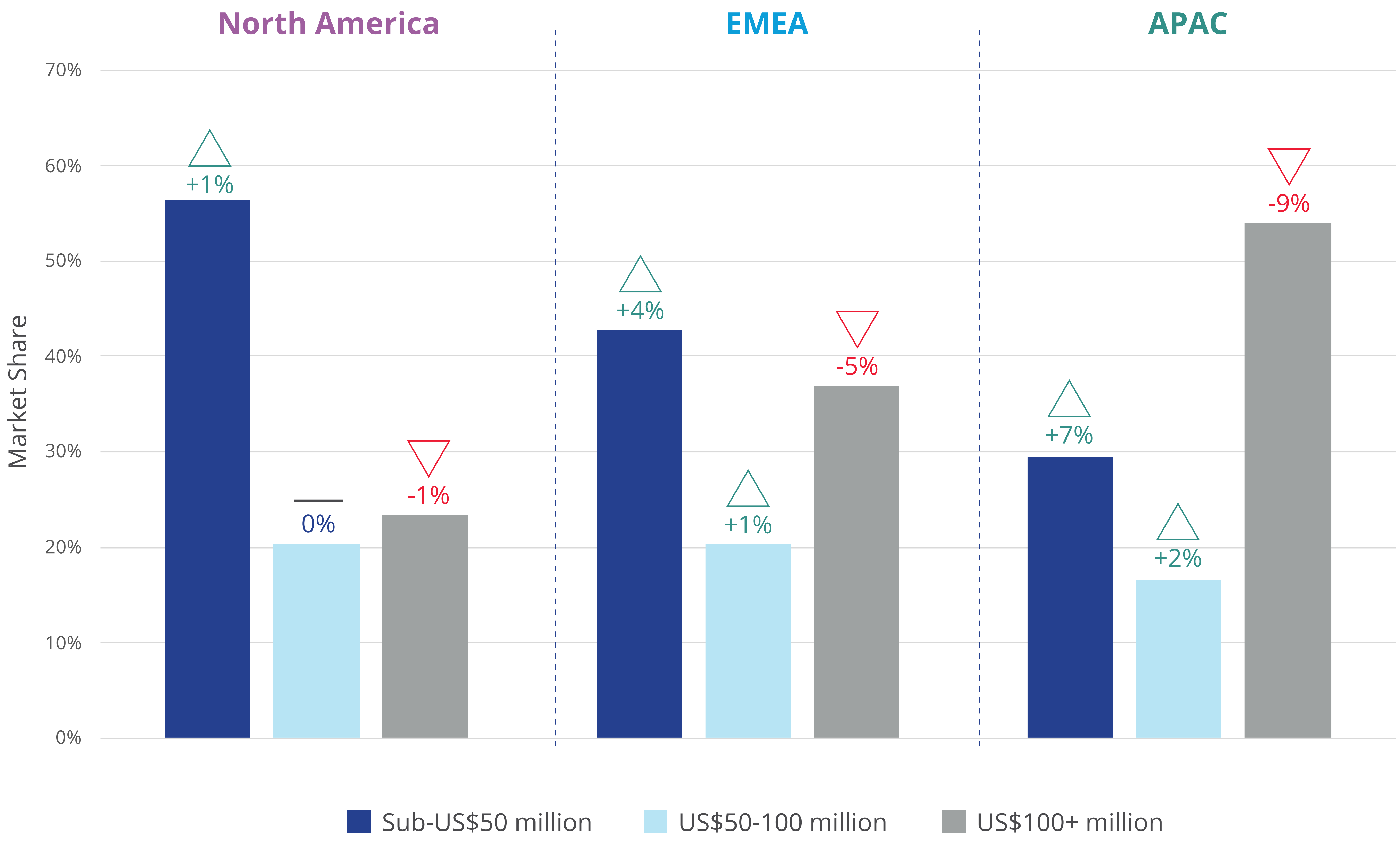
Regional deal size composition: sub-US$50 million deals driving activity

One of the key enablers of a pick-up in activity is the depth/liquidity of the market, particularly when it comes to deal size. Big, direct deals are scarce in the current environment, with activity focused on the sub-US$50 million range. It is telling that deals in this size range are increasing across all three regions so far in 2023. Equally, deals of over US$100 million are clearly on the decline.

Historically, the North American market has operated with greater liquidity from a deal-size perspective, with sub-$50 million transactions comprising 55% of the market. The U.S. has been the biggest recipient of cross border capital to date in 2023, see figure 10, and had shown the most positive momentum in investment activity up until the end of Q2.

There are positive signs in EMEA and APAC, where sub-US$50 million deals have comprised a lower proportion of activity historically. These regions have seen the highest rates of growth in activity for this deal size and the highest rates of decline in deals over US$100 million. However, this is contributing to slower deal-flow recovery, as these regions continue to adjust.

Figure 9. Regional deal size composition [past year vs 5 year average]



Source: Colliers, MSCI Real Capital Analytics

Global capital destinations: larger, liquid markets attracting capital

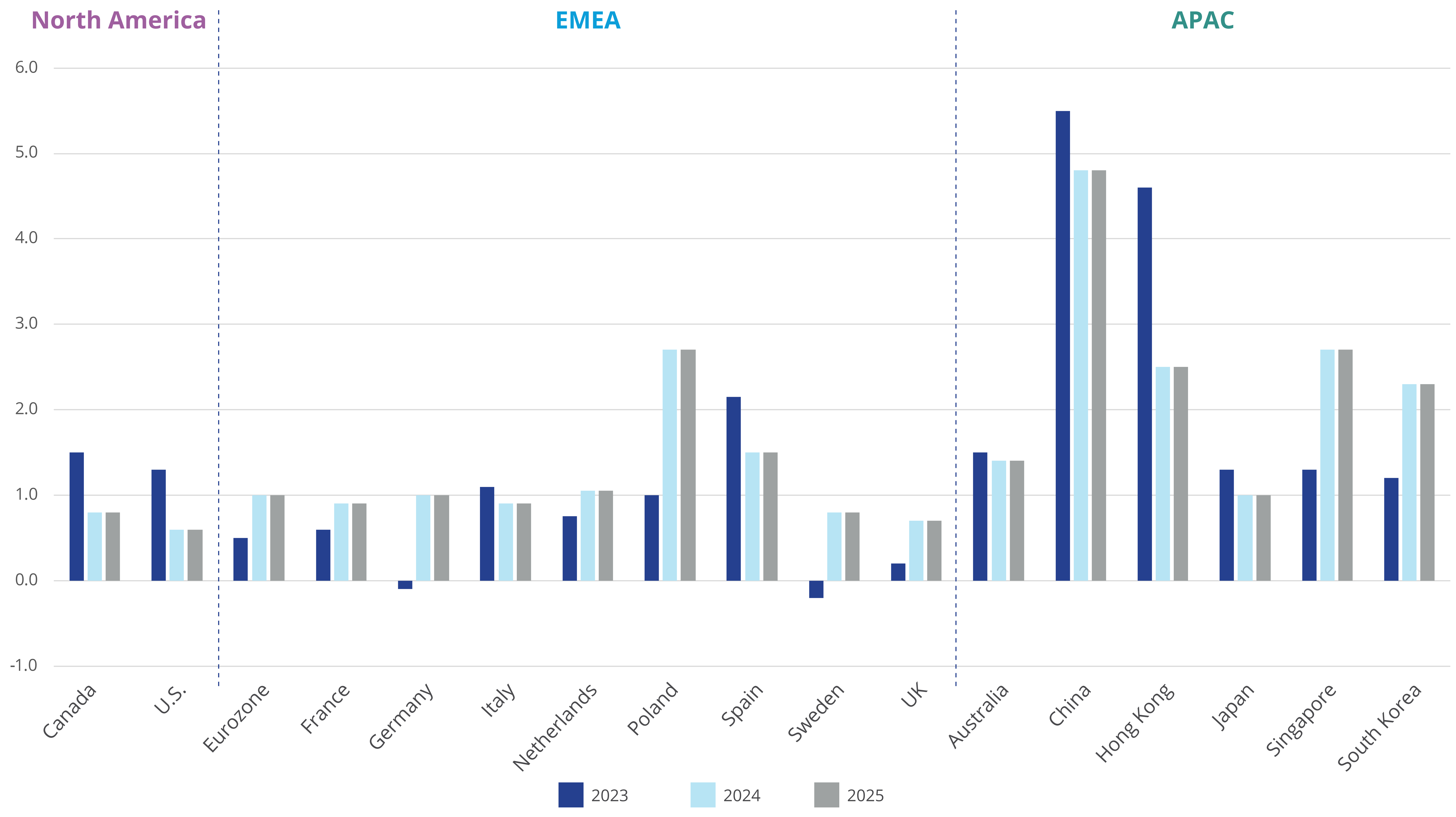
Figure 10. **Top 10 global cross border capital destinations: H1 2023 US$ mn**

	COUNTRY	CROSS BORDER TOTAL	CROSS BORDER GLOBAL	CROSS BORDER REGIONAL	2023 % OF TOTAL	2018 - 2022 % OF TOTAL
1.	United States	21,902	16,927	4,975	▲ 33.9%	26.1%
2.	United Kingdom	11,158	8,545	2,613	▲ 17.3%	13.3%
3.	Japan	7,139	3,879	3,260	▲ 11.1%	8.5%
4.	Canada	6,677	5,340	1,336	▲ 10.7%	7.9%
5.	Germany	5,459	2,088	3,370	▲ 8.5%	6.5%
6.	Spain	4,736	1,402	3,334	▲ 7.3%	5.6%
7.	France	4,684	886	3,797	▲ 7.3%	5.6%
8.	China	3,783	302	3,481	▲ 5.9%	4.5%
9.	Australia	2,624	725	1,899	▲ 4.1%	3.1%
10.	Singapore	2,469	0	2,469	▲ 3.8%	2.9%

Source: Colliers, MSCI Real Capital Analytics

Economic outlook remains positive, but at lower rates of growth

Figure 11. Real GDP growth % (2023-2025 forecast)



Source: Colliers, OxfordEconomics, Macrobond, Factset

While interest rates have been creating difficulties in terms of yield/cap rate and value adjustments, they are also leading to lower GDP output and forecasts to 2025, see figure 11.

Consensus forecasts show most North American and European locations will be reaching a benign 1% annual economic growth rate through 2025. Germany and Sweden have recessionary tendencies in Europe, although Poland and Spain boast more positive growth rates.

The economic picture for APAC is much more robust. While growth in the more mature Japanese and Australian economies is on par with Europe and North America, the remaining economies in the APAC region are set to achieve 2%+ rates of growth over 2024 and 2025.

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