European Commercial – Autumn 2020

SPOTLIGHT
Savills Research

European Manufacturing Outlook

● Investment ● Warehouse Demand ● Nearshoring

Manufacturing output returns to growth

Economic Overview-
COVID-19 has created mass disruption to global supply chains during 2020. Early disruption during lockdown included shipping vessels being stranded at sea, unable to enter Chinese ports, although most of the European port authorities remained fully operational during this time. Nevertheless, this had a huge knock-on impact on product availability in Europe, as consumers stockpiled on necessity goods and held off on discretionary spend during the March/ April lockdown period, ultimately adding more pressure on the already undersupplied European logistics market.

The pace to which consumer confidence and retail sales recover will be essential. Discretionary spend is undergoing an initial positive rebound as lockdowns are gradually lifted, but the extent will be influenced by the long term impact on consumer finances and real incomes, which could involve a lull in retail sales during early 2021. More evidence on how successful the furlough schemes have been at maintaining employment levels is likely to be revealed by the middle of 2021.

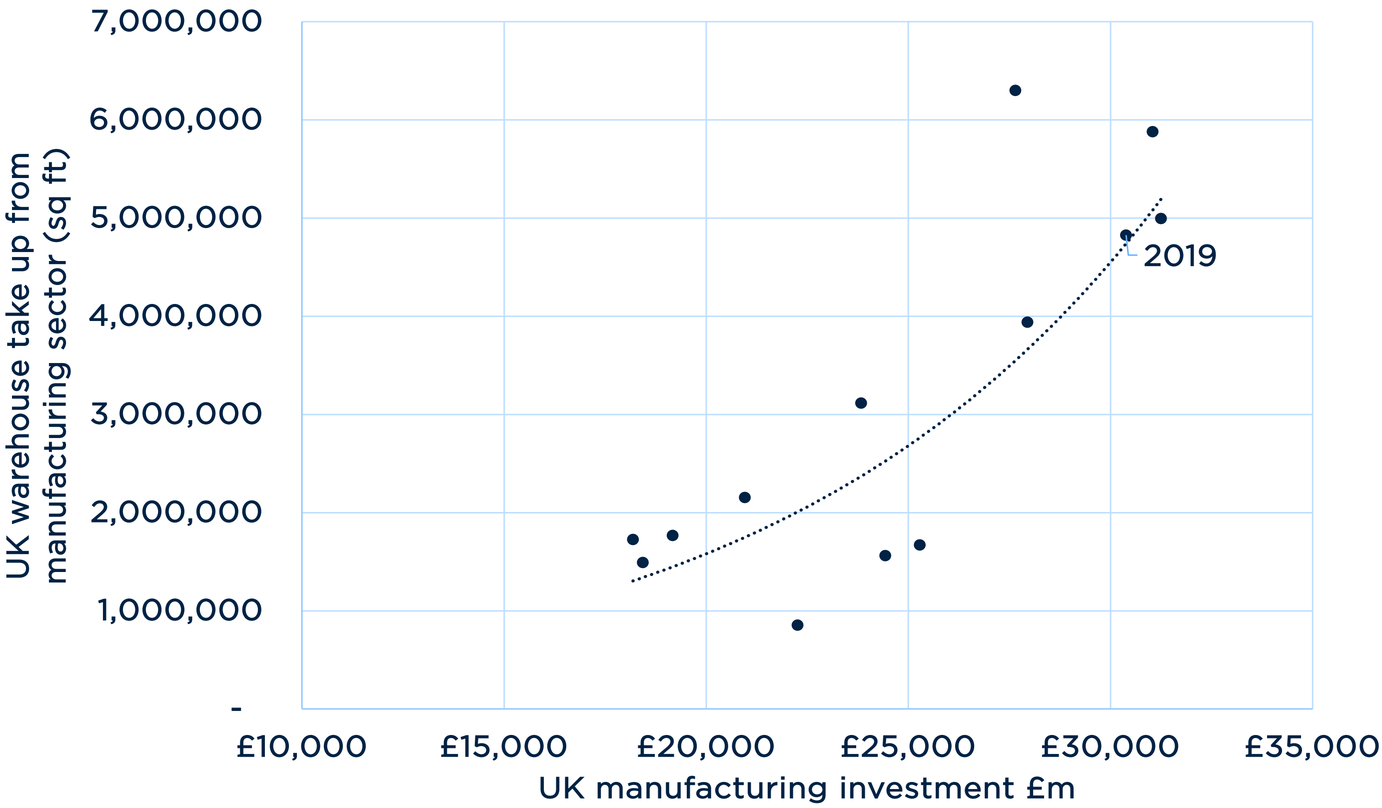
Eurozone industrial production fell by over 20% yoy during April and May 2020 and Oxford Economics subsequently forecast Eurozone manufacturing output to contract by 11% in 2020 before recovering by 8.4% in 2021. However, this is still above the 15% contraction in output recorded during the Global Financial Crisis (GFC) in 2009.

July's Eurozone Manufacturing PMI reading has since rebounded to 51.1, indicating that the sector has returned to positive monthly output growth for the first time since January 2019, as lockdown measures are lifted.

Manufacturing investment and forecasting occupier demand
Despite the well-documented growth of the ecommerce sector, the manufacturing sector currently accounts for c14% of UK industrial take up. Combining the manufacturing and automotive sectors, this amounts to a quarter of occupational demand.

Savills tracks private manufacturing investment as a lead indicator of warehouse demand from the manufacturing sector. The relationship in the UK shows a strong correlation between the level of manufacturing investment and warehouse take up from the manufacturing sector (correlation coefficient 0.88, Chart 1).

Chart 1: UK manufacturing investment and manufacturing take up (sq ft)



Source: Savills, ONS

Forecasting warehouse demand

For every €1bn of private manufacturing investment, this creates 18,000 sq m of new warehouse demand from the manufacturing sector.

Rather than a like-for-like relationship between a manufacturer receiving private funding and demand for space, it is important to note that private manufacturing investment creates a ripple effect for new demand from associated trading partners involved in the manufacturing supply chain. Our methodology examines how much space is required in the associated supply chain, rather than how much space is required for the initial manufacturing process. In other words, how much warehouse space is required to service the manufacturing process that is being undertaken.

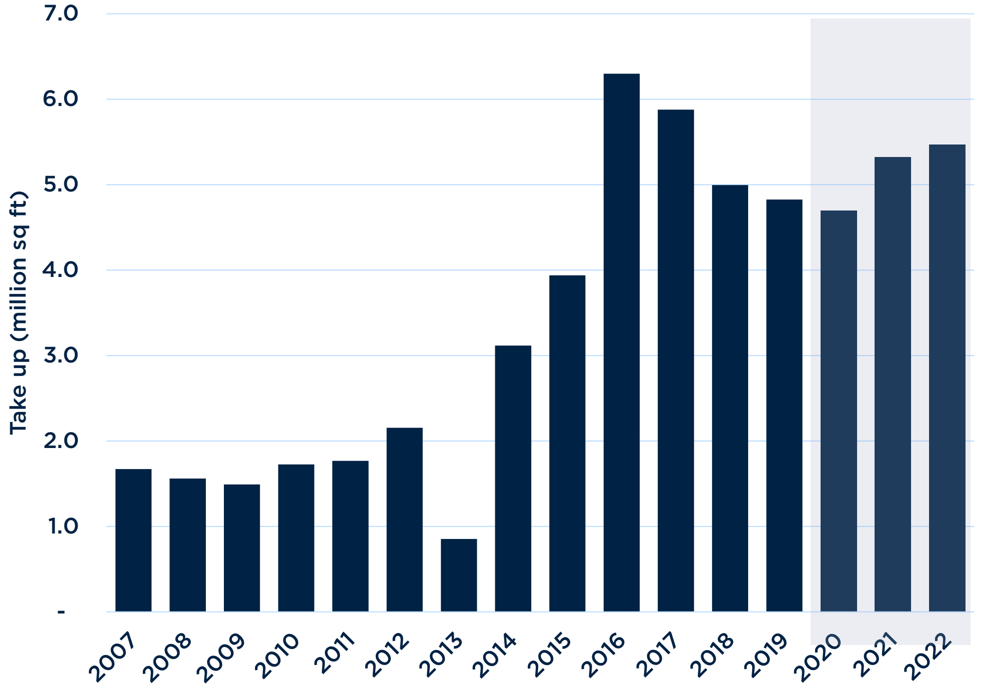
Over the past five years, the UK has attracted £148bn of private manufacturing investment, creating demand for 26m sq ft (2.4m sq m) of warehouse space from the sector. This indicates that for every £1bn of private manufacturing investment, this creates new demand for 175,000 sq ft of warehouse space.

Analysing Gross Fixed Capital Formation (GFCF) as a lead indicator of private manufacturing investment, we are able to forecast future warehouse demand. Capital Economics forecast a 12% fall in GFCF during 2020, followed by a rebound of 13% in 2021, and growth of 3% in 2022, indicating additional warehouse demand of 15.5m sq ft (1.4m sq m) by end 2022 (Chart 2).

We have adopted similar methodology to forecast European manufacturing take up- for every €1bn of manufacturing investment, this creates 18,000 sq m of new warehouse demand. During 2019, EU28 GFCF reached €3.2 trillion and Capital Economics forecast this to decrease by 15% in 2020, followed by a 17% rebound in 2021, before normalising at 2% growth in 2022. Applying this growth rate to manufacturing investment volumes, this indicates an additional 11.6 million sq m of warehouse demand from the manufacturing sector across Europe by the end of 2022 (Chart 3).

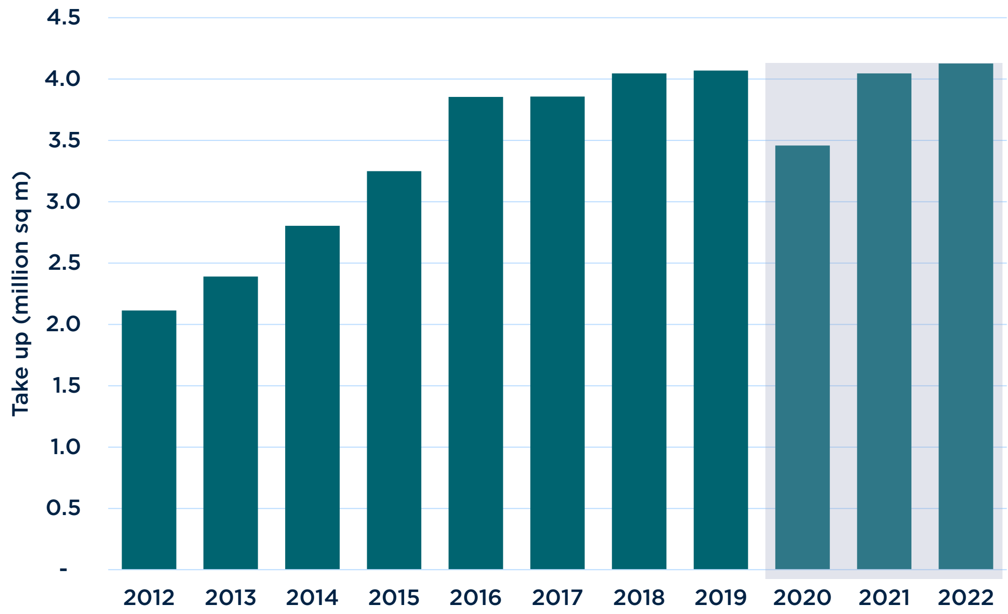
If, in the short term, companies adopt nearshoring policies to insulate themselves from future supply chain disruption, it is likely that European manufacturing will increase which in turn will create a ripple effect for warehouse demand. If the forecasts from Capital Economics are just 20% higher then an additional 13.9 million sq m of traditional warehouse space will be required across Europe by 2022.

Chart 2: UK warehouse take up from manufacturing sector (sq ft)



Source, Savills Research, Capital Economics

Chart 3: European warehouse take up from manufacturing sector (sq m)



Source, Savills Research, Capital Economics

N.B. Savills manufacturing take up forecast makes the following assumptions;
-European manufacturing investment accounts for the same proportion of GFCF as in the UK (8.6%)
- The European manufacturing sector accounts for the same proportion of logistics take up as in the UK (14%). Although this varies by country, we have observed comparable or higher proportions of take up across Central and Eastern Europe- Czech Republic (35%), Poland (14%), which would suggest that our forecasts are weighed to the downside.

What next for European manufacturing?

Global demand, trade growth, automation and nearshoring will impact occupational demand from the manufacturing sector.

Global Demand

One such boost for Europe's manufacturing sector has been the fall in oil prices. As a net importer of oil and gas, lower input costs will aid Europe's manufacturers through the COVID-19 recovery. Brent Crude Oil fell from $69 per barrel at end 2019 to its nadir of $21 per barrel during lockdown before recovering to c$45 per barrel. However, European exporters' economic resilience will depend more heavily on the speed of recovery of global demand.

The stagnation in global trade growth (c60% of global GDP ever since 2008) will leave some of Europe's manufacturers more cautious when investing. Growing China-US trade tensions and slowing Chinese economic growth dragged on demand levels during 2019, as Euro Area manufacturing output contracted by 1%.

Transportation

In the UK, one of the fastest growing subsectors for private manufacturing investment has been engineering and vehicles, rising by 70% over the last 10 years, and now accounts for 46% of total manufacturing investment in the UK. Although many of the car manufacturing plants were shut down and reopened in late April/ May 2020, the German government has provided temporary VAT cuts and a €6,000 purchase incentive scheme for electric vehicles in order to stimulate consumer demand. Although European Union new car sales are set to decline by 25% in 2020 as discretionary spending is reigned in, electric vehicle sales are expected to remain more resilient in the medium term, according to the European Automobile Manufacturers Association (ACEA).

Automation of manufacturing jobs in higher labour cost markets will help to maintain manufacturers' profit margins and will spread risk against future labour market disruption. Euro Area manufacturing employment is forecast to fall by over 1.2 million workers over the next ten years although the speed of automation in this sector will of course depend on the resilience of private manufacturing investment.

Savills Nearshoring Index

Post COVID-19, a number of manufacturers are seeking to bring their supply chains closer to home. According to the Institute for Supply Management's (ISM) July survey, 20% of firms are planning or have already begun to reshore or nearshore some operations, whilst 27% will reduce headcount.

One of the challenges for Europe's manufacturers looking to nearshore is the shortage of available logistics space (Chart 4). Developers have become more risk averse and the numbers of speculative announcements is likely to be tapered throughout 2020-21. This could further intensify existing demand as retailers stockpile and online retailers expand, adding upward pressure to rents.

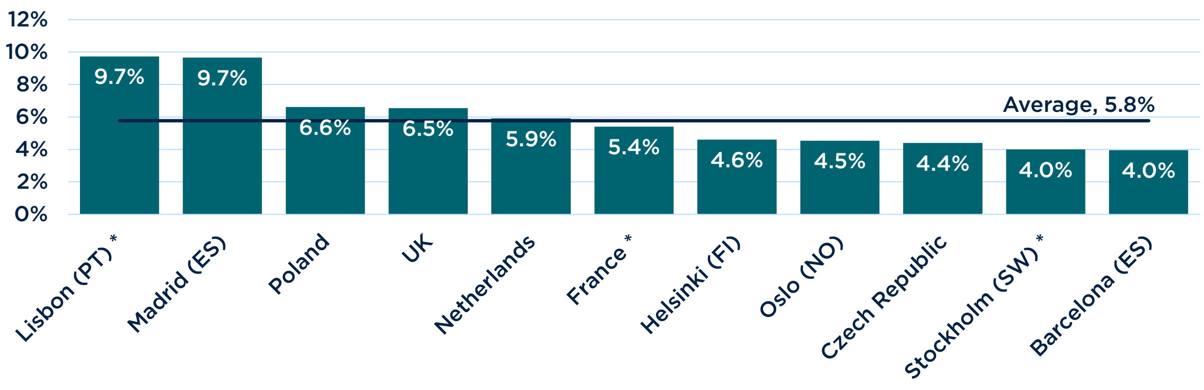
For manufacturers, labour isn't the only critical cost. Energy costs are a major component. Quality infrastructure, a favourable trade and regulatory environment and an existing manufacturing export base is also important. Savills have combined these factors to compare the manufacturing nearshoring potential of countries in proximity to the major consumer markets in an era of supply chain diversification.

The countries that offer greatest nearshoring potential in Europe are concentrated in Eastern Europe, thanks to lower input costs and direct road and rail links to the major Western European consumer markets. Ukraine is first for Europe (2nd overall), thanks to very low wage costs by European standards. Already a major agricultural exporter, there is nearshoring potential in manufacturing supported by an open trade environment. Serbia (4th), another low-cost market, benefits from a strategic location that offers the easiest overland travel between Europe and Asia Minor and beyond.

The Czech Republic follows (5th), supported by excellent infrastructure, favourable input costs and an established manufacturing economy for export. A major automobile manufacturer, electronics manufacturer Foxconn also has a base in the country. In 2019 the Czech Republic exported goods equivalent to 74% of the country's GDP and there is scope to further develop as a regional nearshoring destination, particularly given the presence of existing major global manufacturers.

Savills forecast an additional 11.6m sq m of warehouse space will be required by end 2022 to meet demand from Europe's manufacturing sector.

Chart 4: European Logistics Vacancy Rates, Q2 2020(%)



Source: Savills Research, (*) = indicative vacancy rate

Savills Commercial Research

We provide bespoke services for landowners, developers, occupiers and investors across the lifecycle of residential, commercial or mixed-use projects. We add value by providing our clients with research-backed advice and consultancy through our market-leading global research team.

Investment

Marcus De Minckwitz
Regional Investment Advisory
+44 (0) 207 409 8755
MdeMinckwitz@savills.com

Industrial

Richard Sullivan
Head of Industrial and Logistics
+44 (0) 207 409 8125
rsullivan@savills.com

Research

Mike Barnes
European Commercial
+44 (0) 207 075 2864
mike.barnes@savills.com

Kevin Mofid
UK Logistics
+44 (0) 203 618 3612
kmofid@savills.com