4Q2024 Global Economic Outlook

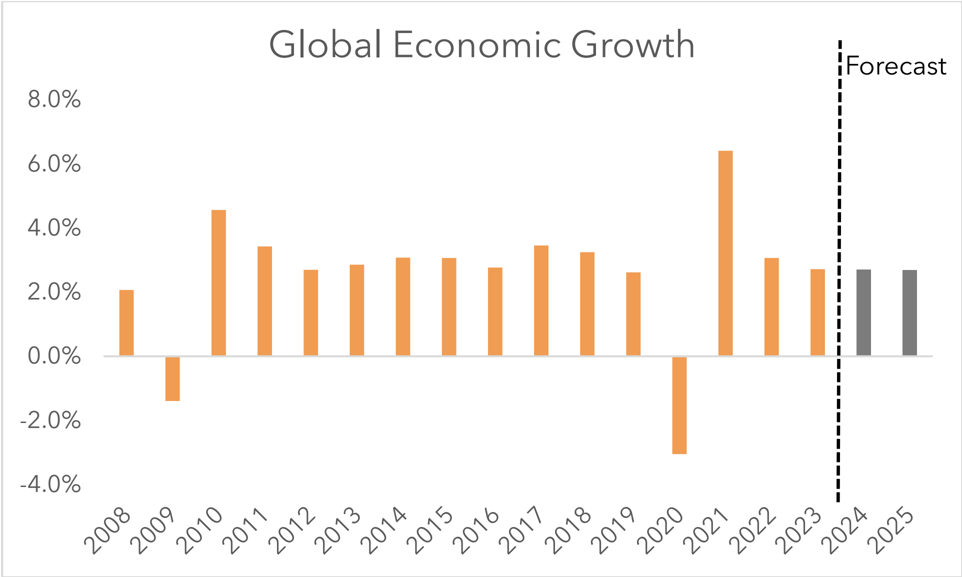
Highlights

- Economic growth remains resilient
- Economy pushing past obstacles
- Pandemic-era inflation defeated
- Interest rates are already declining
- Positive CRE outlook seems durable

As the fourth quarter kicks off, the global economy has unfolded largely as we have expected. Economic growth remained resilient, but not spectacular, much as it did in 2023. Inflation around the world has decelerated as the impact of the pandemic fades. And with this disinflation, virtually all major central banks around the world have begun to cut interest rates. Resilient growth, slower inflation, and declining interest rates sound like the perfect recipe for more attractive commercial real estate (CRE) performance. But should we expect the global economy to continue to cooperate as we head toward 2025 and what will that mean for the CRE market?

GDP Outlook

We would get tired of saying the global economy is resilient, but it remains an apt and important descriptor. To be sure, the economy has hit some bumps in the road. Growth slowed notably in Europe, China continues to grapple with the consequences of a housing bubble and tepid consumer demand, and Canada struggled under the weight of higher interest rates. But despite those challenges, global growth held fairly steady this year. The US economy is slowing, but not collapsing. Emerging economies continue to outperform developed economies. And even the UK experienced a notable rebound in GDP growth. The global economy has pulled off the proverbial soft landing and now heads into a transition phase. During the last two and half years, most major central banks focused on relatively high inflation and the risks it posed to their respective economies, but the winds are shifting as inflation has slowed. The broad outlook for central bank policy looks dovish over the balance of this year and into 2025 as central banks shift their attention to toward the labor market and the growth required to support it.



Sources: Oxford Economics, National Sources, BGO Economics and Research

Consequently the outlook for growth remains largely positive. While the US is slowing, virtually all other major developed economies look set to accelerate in the coming quarters. Emerging economies offer a bit more of a mixed picture, but should provide a healthy boost overall. That

should keep global growth on an even keel through the end of 2025, roughly in the 2.5% to 2.0% range.

Skirting Risks

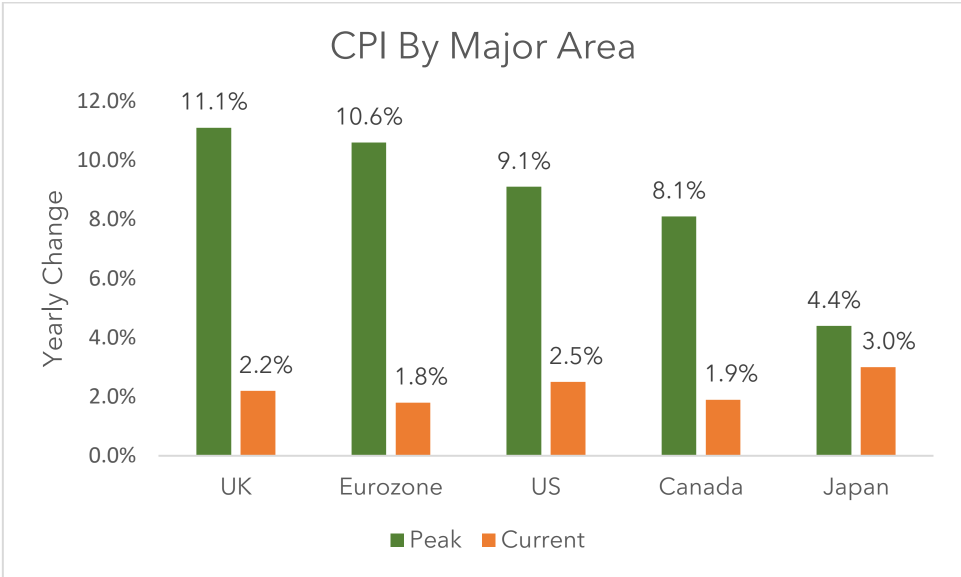
Many did not believe that the global economy could avert disaster. Thankfully, we did not fall into this trap. The most widely forecasted recession that didn't occur was the one planned for 2023, at least in the US. Or maybe it was 2024. It has been hard to keep up with incorrect forecasts moving the goalposts. Even now (in the US at least) many still call for a recession in 2025 that will bring low the global economy since the US still represents roughly 25% of global GDP and remains a key market for exports of many countries. But we remain skeptical. Not only does our proprietary modeling continue to forecast solid if not spectacular growth, but we remain skeptical of the heuristics many use to try to predict recessions. Two main indicators garner the most attention. The inverted yield curve has entered the popular consciousness as a reliable recessionary signal. But it isn't infallible and is based on the pricing opinions of investors. Second, the Sahm Rule (which tracks the recent trend in the unemployment rate relative to its cyclical low) is now emerging as a widely recognized tool. But even its creator, Claudia Sahm, has recognized that it gets misinterpreted and misapplied, especially this cycle when the unemployment rate is increasing more due to labor supply than labor demand.

More broadly, we see a few key issues with these metrics. First, they tend to work better for the US economy than other economies. Allowing for some reasonable variation, market-oriented economies generally tend to follow the same rules. Therefore, that makes us question their broad applicability. Second, measures like these run the risk of "selecting on the dependent variable" which is a phenomenon where one chooses to study only cases where the outcome one is interested in has already occurred (like a recession). Finally, recessions do not occur very frequently anymore (thankfully). That provides very few observations to try to test empirically, making predicting recessions incredibly difficult, at least far enough in advance to be useful. Risks to the economy certainly abound. We remain concerned about the geopolitical environment, which seemingly gets worse with every subsequent writing of this quarterly report, not better. The blowback against globalization continues. Some election outcomes have proven a bit unpredictable and could continue to defy expectations. Labor unrest is resurging and presents the ability to disrupt national economies. Even weather remains a noteworthy variable in the equation. And it is easy to keep making doom-and-gloom proclamations over and over until they ultimately prove correct, something we call "broken-clock economics." But the economy continues to overcome risks, numerous though they remain. And we'd rather be level-headed and objective in our analysis, even if that garners fewer headlines. In the absence of a major shock, such as a pandemic or financial crisis, global economic growth remains resilient.

Inflation And Interest Rates

As expected, inflation continued to slow around the world. This occurred at different paces in different places, owing to factors like exposure to energy markets and methodologies for accounting for housing inflation. But through the noise, the signal clearly shows that pandemic-

era inflation is beaten with inflation settling down close to central bank target rates. If anything, the world offered up a number of idiosyncratic factors that could have caused global inflation to reaccelerate – wars, shipping disruptions, housing shortages, labor unrest, deglobalization, and changing supply chains. It isn't as if the backdrop has been very cooperative, and inflation settled down. Inflation has become more benign in world that is becoming increasingly less benign. It will take a bit longer for inflation in some parts of the world to fully reach target rates. But at this juncture it will likely take a significant shock to cause a major disruption to ongoing disinflation.



Sources: National Sources, BGO Economics and Research

At this juncture, almost all major central banks are easing monetary policy. The lone exception remains the Bank of Japan (BOJ) which has been raising rates to offset relatively high inflation. But beyond the BOJ, the questions for the US Federal Reserve (the Fed), the Bank of Canada (BOC), Bank of England (BOE), the European Central Bank (ECB), and even the People's Bank of China (PBOC) will be how quickly and how aggressively interest rates will get cut. We continue to see rates coming down at different paces. Areas more exposed to energy, such as Europe, gave their central banks (the ECB and the BOE) the ability to cut earlier. But even more recalcitrant central banks, like the Fed, eventually got to the point where risks to the labor market and broader economic growth trumped any lingering concerns about inflation.

With policy rates coming down, long-bond rates also responded in anticipation of rate cuts. While the market doesn't perfectly price in the future path of short-term rates, they provide a guide for the path of forward short-term rates. As yield curves flatten and normalize, we should see far less pressure across the yield curve, which should improve not just the cost of capital across the term structure of interest rates but should also increase liquidity in the debt markets.

CRE And The Economy

The Great Resynchronization, which we have previously discussed, seems finally upon us. With central banks around the world raising rates over the last two and half years, CRE capital markets struggled the most they have in decades. But economic growth, and consequently space markets and income returns, held up relatively well. That's not to say that higher rates didn't impact economies around the world at all. They did, to varying degrees, with some major economies contracting temporarily. But with major central banks shifting into monetary loosening, that should certainly bolster economic growth and consequently the space markets which remain procyclical. But more importantly, the CRE capital markets should fare much better over the next few years than the previous few years.

That should set the stage for both parts of the CRE market to be moving in the same direction. This will not occur immediately, nor will it unfold at the same pace in markets around the world. But it offers tremendous opportunity for attractive real estate returns. A similar resynchronization occurred only once before and that was more of a US phenomenon than a global phenomenon. But if that history provides any sort of benchmark, the global CRE investment market could see its best performance in at least decades. This very well could be the best global performance ever. We are tempering our comments a bit because global CRE data remains suspect, especially the historical data. But around the world the investment environment is clearly turning much more favorable, and the opportunity set is greatly increasing.

Closing Thoughts

At this juncture, it would likely take something highly idiosyncratic to disrupt the global economy. Over the last half century, a true global recession only occurred due to such events – global oil embargoes, global financial crisis, Covid pandemic. As we mentioned, many risks are present today, but one would have to rise to a substantial level to derail the global economy. Moreover, monetary policy is shifting from a headwind to a tailwind, taking the key risk from the last few years off the table. Central banks could cut rates at a slower pace than we currently anticipate, which would lead the economic expansion to unfold more slowly than we currently forecast. That would, in turn, cause the recovery in the global CRE market and its great resynchronization to unfold more slowly than we forecast. But ultimately, any shock that would prove that disruptive to the global economy would cause a lot of damage. Under such a scenario, CRE could look relatively more attractive after two and half years of negative appreciation. At this point, downside risks still exist, but their impact on CRE looks rather limited.

About BGO

BentallGreenOak ("BGO" or "BentallGreenOak") includes BentallGreenOak (Canada) Limited Partnership, BentallGreenOak (U.S.) Limited Partnership ("BGO U.S."), their worldwide subsidiaries, and the real estate and commercial mortgage investment groups of certain of their affiliates, all of which comprise a team of real estate professionals spanning multiple legal entities.

This document is for informational purposes only and does not constitute an offer to sell or solicitation of an offer to buy units in any BentallGreenOak fund (a "BGO Fund", "Fund", or, collectively, "BGO Funds" or "Funds"). Prospective investors must not construe the contents of this document as legal, tax, financial, accounting, investment or other advice, and each prospective investor is urged to consult with its own advisers with respect to legal, tax, financial, accounting, investment and other consequences of investing in a BGO Fund, the suitability of a BGO Fund for such investor and other relevant matters concerning an investment in a BGO Fund. A decision as to an investment in any Fund must be made solely by the investor and in consultation with its own advisers.

Statements in this document that are not historical facts are based on current expectations, estimates, projections, opinions and beliefs and are subject to change. Such statements are subject to known and unknown risks, uncertainties and other factors. Moreover, this document contains statements, estimates and projections as well as certain forward-looking statements, which can be identified by the use of forward-looking terminology such as "may", "will", "would", "should", "expect", "project", "intend", "target" or "believe" or the negatives thereof or other variations thereon or comparable terminology (together, the "Projections"). Economic outcomes may differ materially from those reflected in or contemplated by such forward-looking statements, and undue reliance should not be placed thereon. The market analysis presented in this document represents the subjective views of BGO.

Ryan Severino, CFA
Managing Director, Chief Economist & Head of Research
BGO
ryan.severino@bgo.com

BGO