TOP 10 PREDICTIONS 2019

> Romania has defied gravity in recent years and managed to see above-potential economic output, which also prompted the real estate industry to see some of the best results in the post-crisis period. The re-emergence of risks (both internal and external) and the slowdown trend started last year underscore the necessity to balance short-term risks, while also keeping in mind the huge untapped long-term potential that Romania displays.
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1 MACRO OUTLOOK DECENT, BUT RISKS SKEWED TO THE DOWNSIDE

Romania's growth topped 4% last year, slowing from 7% in 2017, as consumers turned a bit more cautious amid tighter monetary policy and fiscal uncertainties, while the higher inflation chipped away at disposable income gains. A gloomier outlook for the global economy and geopolitical tensions popping up on the radar make 2019 a bit more challenging, meaning that an increasingly cautious approach for the next couple of years is warranted. Our baseline scenario assumes a c.4% GDP growth rate for Romania in 2019 (one of the better in the EU), still led primarily by consumption, but risks are skewed to the downside as Romania fares worse than its CEE peers in terms of internal vulnerabilities. For real estate, this momentum is bound to keep activity at decent levels, for now.

2 INVESTMENTS CAN DO MORE THAN TREAD WATER, BUT OUTLOOK IS CLOUDY

Turnover in the real estate market was more or less flat last year compared to 2017, at almost EUR950mn and a bit below our call for EUR1bn, but still decent. For 2019, we are moderately optimistic. The economy is set to continue expanding around its potential growth rate, which is double the EU's average. This is thanks to a robust private sector, with diversified inputs from both manufacturing and services (including IT). Normally, this, alongside a juicy yield gap between Romanian products and those in other CEE countries, would be enough, especially given that office pipeline suggests over half a billion euros. Still, the bigger risks (both economic- and political noise-related) are a source of concern. So is the fact that a new tax slapped on bank assets might tighten lending conditions significantly.

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3 INCREASED PRESSURES FROM A TIGHT LABOUR MARKET

With unemployment having ended 2018 at record lows, below 4%, and central bank estimates suggesting growing supply-demand skills mismatches in the labour market, various real estate segments are likely to have a tougher time in 2019. For office landlords, this means fighting more for tenants as they will have a harder time to find employees, while industrial market players (mostly in central and western Romania) will have to rely increasingly more on "imported" workforce from other parts of Romania or even other countries. As a positive, this context will bring upward pressures on wages, which means further upside for retailers. That said, a too tight labour market is a sign of a future correction.

4 BUCHAREST OFFICE MARKET: BUILD IT AND THEY WILL COME?

This year is set to more than double on the deliveries of modern office spaces in Bucharest. Meanwhile, our baseline scenario assumes new demand for modern office spaces in Bucharest to remain robust in 2019 (around the cycle average), but given the tight labour market, it will likely trend lower versus recent years, which marked cyclical peaks. We expect vacancy to climb to multi-year highs of at least 13% by year end (most of this to be caused by relocations from older buildings to new ones, as buildings due in 2019 already have a pre-lease ratio of well over 60%). Still, Bucharest is a heterogenous market, so certain buildings or areas might actually clinch bigger rents despite the overall context shifting to a tenant market. IT&C and BPO&SSC are likely to remain at the forefront of new demand.

5 INDUSTRIAL AND LOGISTICS MARKET SET TO DELIVER BIG AGAIN

The warehouse segment is coming after, arguably, it's best couple of years ever if we look at deliveries, with manufacturing activities also faring nicely. The modern warehouse spaces stock expanded c.40% in 2017-2018, to over 4.2 million sqm nationwide, but activity is likely to cool a bit in 2019. Outside Bucharest, towns in central and western Romania will remain very interesting, but economic hubs like Ploiesti, Iasi or Constanta should also fare well. As Romania has been in the spotlight on a regional level, we could see notable entries in 2019 (maybe even some of the biggest global names); furthermore, developers traditionally active on other segments in Romania (office, residential or retail) are eying the market.

6 AS GOOD AS IT GETS FOR RETAIL

After recording the strongest private consumption growth in the major EU states in recent years, Romania is on the map. With low vacancy rates and consistent interest from retailers (present or looking to enter), developers have been scrambling to increase the retail stock significantly, with the 2019-2020 pipeline (nearing half a million sqm) more than double the deliveries in 2017-2018. Still, this does not look like the pre-crisis period as deliveries are well smaller and consumption seems more sustainable (less reliance on loans). Also, for the first time in many years, rents managed to move higher in 2018 on a more generalized basis, but with a heavy delivery calendar, it will be difficult to replicate this in 2019.

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7 FOGGY OUTLOOK FOR RESIDENTIAL

The residential market was already slowing down in 2018 as the central bank's tightening cycle (starting late 2017) kicked in. A further blow will come from the new debt limits for loans promoted by the central bank starting this year; together with the gloomier economic outlook, fiscal uncertainties and strong construction appetite for new units, a storm is brewing. Even though consumers have more money amid rising disposable income and the cultural inclination to own a home, a wait-and-see mood might prevail given the foggy context. Furthermore, the tighter lending conditions might also shut off some customers from loans. As such, unchanged prices in 2019 might actually look like a feat; a price dip (maybe in the 5% region) looks more likely.

8 LAND MARKET TO COOL A BIT AFTER SOME EXCELLENT YEARS

Last year was similar to 2017 in terms of market activity for the land market, but amid some higher prices (and a few big deals), market turnover increased by 15-20%, to a new post-crisis high. Several major deals remain in various negotiation phases, but given the slower projected path for the economy as well as potential troubles in the residential market, new demand might be a bit lower in 2019 than in the previous years. That said, we expect this year to deliver solid results as good land plots in big cities will still see sufficient demand; other trends (like retailers focusing on smaller towns; office developers looking at big regional hubs) will remain valid. Prices look set to remain more or less the same, with increases only on a case-by-case basis, for very good plots.

9 REGIONAL CITIES REMAIN IN THE SPOTLIGHT; ROOM TO GROW ON ALL REAL ESTATE SEGMENTS

The favourable perception that some regional cities enjoy continues, with the most dynamic counties (Cluj, Timis and Iasi) adding more jobs last year than Bucharest, even though their total workforce represents just two thirds of the capital's. This is just another sign of the fast convergence taking place, with growing attention from employers also for second-tier/smaller regional cities. This overperformance relative to Bucharest is likely to remain in place over the longer term, but some cities risk hitting glass ceilings as local authorities might not be best prepared for the booming economy. Local infrastructure constrains and tight labour markets are among the growing issues, but the good news is that these are not insurmountable challenges.

10 POLITICAL SCENE HEATING UP (AND BOILING OVER?)

With the Romanian socialist-led government increasingly at odds with EU institutions, investors will likely be closely looking at upcoming elections for any hints on what the future may hold, especially in light of the erratic fiscal changes promoted by the ruling coalition. The European Parliament elections in May and the November/December presidential elections may be just the warm-up round for the all-important late 2020 general elections. In this context, we do not expect any material progress regarding vital structural reforms; on the contrary, backwards steps seem more likely, with new populist measures potentially on the agenda. Elections for the EU Parliament will also serve as a "referendum" on the vitality of Eurosceptics and Europhiles throughout all of Europe.

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