RESILIENCE AND SECURITY ARE THE KEY LINKS IN SUPPLY CHAINS

GETTY IMAGES

WORDS **OLIVER SALMON**

Disruption is easing post-Covid – but geopolitical tensions and more insular government policies are redefining how businesses manage their supply chains

After three years of disruption, international supply chains appear to be returning to normal. The cost of shipping freight by sea or air has largely returned to pre-Covid-19 levels; container ships aren't queuing outside major ports and businesses no longer cite "supplier delays" as one of their most pressing problems.

This does not, however, mean it is business as usual for logistics, manufacturing and other industrial sectors. The pandemic and geopolitical tensions have exposed the fragility of supply chains and placed a new emphasis on resilience. Meanwhile, cost continues to be key in a tough economic climate.

Fragmented politics and new strategic alliances

The changing approaches to supply chains aren't being driven solely by businesses; in response to geopolitical tensions and a new economic paradigm, they're underpinned by strategic government policy in many parts of the world.

The single defining feature of the past 20-plus years has been unconstrained globalisation, with ever-increasing efficiencies driving global business growth.

This has now been tempered by a new focus on security and renewed protectionism in many parts of the world. Governments are looking to drive domestic productivity while safeguarding strategically important sectors – be that energy, food and pharmaceuticals, or the minerals and technologies needed to support high-growth future businesses, such as semiconductors or electric vehicles.

The IMF refers to this situation as "geo-economic fragmentation", with the Russian invasion of Ukraine expediting a decoupling of US-China relations, potentially creating two major global spheres of political and economic influence – a situation not seen since the collapse of the Soviet Union.

Against this backdrop, "friendshoring" could be a key driver of supply chains, as industrial policy is deployed to help deliver domestic and foreign policy initiatives relating to energy security, new technology and the transition to net zero.

What does this mean for property markets?

These geopolitical shifts could have an impact on international capital flows into real estate markets. This has already started to happen in some parts of the world. Chinese investment into the US – including into commercial real estate – has fallen sharply since 2016, which according to the Rhodium Group, was largely attributable to a combination of Beijing's regulatory crackdown on capital outflows and growing investment hurdles in the US for Chinese firms.

These global headwinds will also impact demand for specific types of commercial property, particularly logistics and manufacturing, across the US, Europe and Asia Pacific.

North America

Resilience has become a buzzword for supply chain managers in North America, but cost remains the single biggest factor in location decisions.

Although job announcements linked to nearshoring have risen in recent years – with these primarily relocating from Northeast Asia – many firms are still utilising overseas manufacturing and benefiting from cheaper labour.

JC Renshaw, a Senior Supply Chain Consultant at Savills UK, says: "The reality on the ground is that it is difficult for firms to wean themselves away from strategies that for decades have focused purely on maximising profits. There may also be a first-mover disadvantage, impacting pricing and profits, which could slow this transition."

Government policy could be shifting this balance, though. For sectors deemed strategically important by US legislators, pull factors (such as subsidies for relocating companies) and push factors (such as EV subsidies) are being introduced. In the words of President Joe Biden, the US is "in competition with China and other countries to win the 21st century".

Renshaw cites the recent US Inflation Reduction Act (IRA) 2022, which provides huge incentives via tax credits to firms investing in clean energy infrastructure, manufacturing and transportation, including EVs.

This act focuses on building domestic scale, with incentives linked to US production and components sourced from countries with free trade agreements with the US. Similar incentives are provided through the CHIPS and Science Act 2022, designed to reduce US reliance on imports of semiconductors from Taiwan and South Korea.

Legislation such as the IRA is driving change in commercial real estate markets. Export restrictions, with the aim of curtailing China's access to advanced semiconductors and related technologies, will have a similar effect. Firms, including TSMC, Intel, Samsung and Texas Instruments, have announced plans to build semiconductor plants in the US. More than 20 electric vehicle projects with new battery plants and investments in existing facilities are slated for completion by 2026.

Renshaw says that over the longer term this could influence where logistics facilities are located. If fewer Chinese goods are imported, this could hit demand for warehousing and logistics in California.

Meanwhile, Mexico could also benefit because it is geographically close and, with Canada, part of the North American Free Trade Agreement. This could drive additional demand for logistics and transport facilities in states close to the Mexico border.

Europe

There has been huge demand for industrial warehousing in Europe in recent years, with the take-up from manufacturing-related companies at its highest ever in 2022. This demand can be seen in many European countries including the UK, which also saw record levels of demand last year.

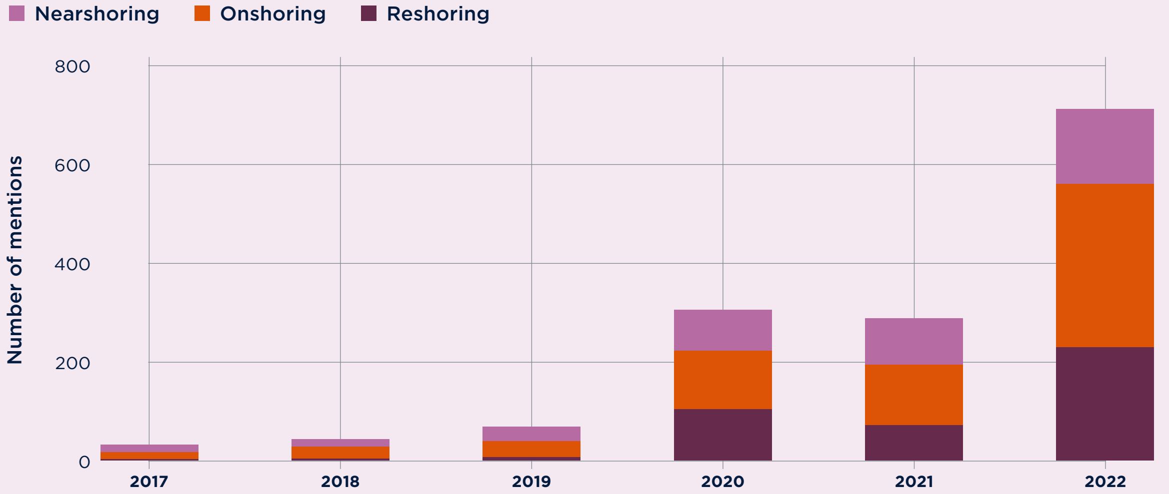
Kevin Mofid, Head of EMEA Industrial and Logistics Research at Savills UK, says that while there has been much discussion around supply chain resilience post-Covid-19, increased warehouse demand has largely been driven by the growth in online retailing.

Over the medium term, the security of supply chains amid global defragmentation may have greater impact. "Covid-19 might have put supply chains at the top of the corporate agenda but other factors are keeping it there. The Ukraine war highlights problems with energy security, while there is also a recognised need to invest in green technology and manufacturing," says Mofid.

Europe may not deploy the same "America First" protectionism introduced by the Trump administration and continued in President Joe Biden's

GETTY IMAGES

MENTIONS OF KEY TERMS IN CORPORATE PRESENTATIONS



Source: Savills Research using IMF

policies. But it is in the same game of "strategic competition" with the European Green Deal and European Chips Act – which aim to double the EU's market share of semiconductors.

Nearshoring may also create opportunities for real estate investment in Eastern European countries, particularly those strategically aligned to EU objectives and values but with cheaper labour pools.

Mofid adds: "This focus on supply chains will create a slow-burn ripple effect in demand for warehousing and manufacturing in commercial real estate markets. This is in contrast to the rapid surge in demand seen in recent years from the explosion in online retailing."

Asia Pacific

China remains the "world's factory", accounting for around 30 per cent of global manufacturing. Despite the decoupling of the US and China, and unease in the West about its relations with Russia, China still holds significant competitive advantage with its relatively mature infrastructure, high-quality workforce and deep integration into global supply chains.

Jack Harkness, Director of Regional Industrial and Logistics Services at Savills Asia Pacific, says cost remains a powerful lever of location decisions. But rising labour costs in China mean it is not as cost-effective as it once was, particularly when domestic incentives to reshore and ongoing security concerns are factored in.

He says: "Companies already embedded in China are not necessarily withdrawing. But there may be a slowdown in new facilities being established there."

Harkness points out that many companies with facilities in China are looking to complement rather than replace existing plants. Apple, for example, has announced plans to diversify away from China, while Siemens has said it is looking at other locations in Southeast Asia.

Countries such as Vietnam and Indonesia could be beneficiaries if firms start to look for other low-cost production centres in Asia, particularly when it comes to labour-intensive and low-margin industries. India also offers strong growth potential for commercial real estate investors in the future.

Harkness adds: "This process is being accelerated across sectors deemed strategically important to US and European industrial policy.

"Furthermore, there has been scepticism around state influence of some Chinese tech firms, which suggests the Western expansion of Chinese firms will be more constrained in the future." ■

'THERE MAY BE A SLOWDOWN IN NEW FACILITIES BEING ESTABLISHED IN CHINA'