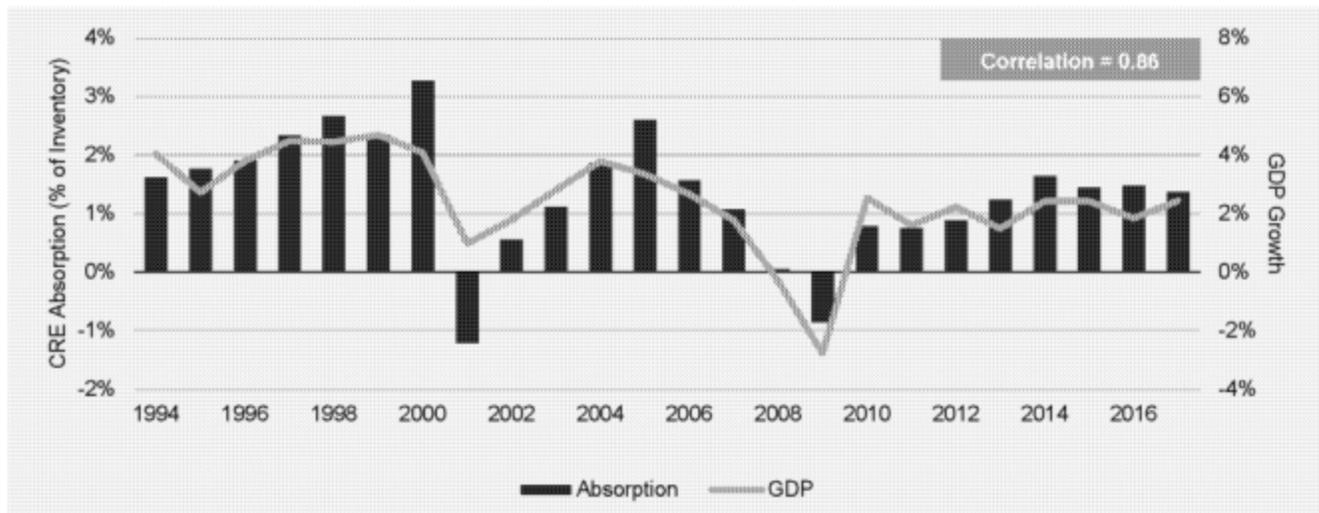


2.1 Economic and Structural Demand Drivers

Absorption across the apartment, office, retail, and warehouse sectors has closely tracked the economy over time, advancing (as a share of inventory) at roughly half the pace of GDP growth (see Exhibit 2). Economists have lamented the mediocre pace of the post-financial crisis expansion, with GDP growth averaging 2% compared with 3% in the 2000s and 4% in the 1990s.⁴ The recovery of CRE demand has also been somewhat weaker. However, since 2013 demand has increased slightly faster than economic growth alone would imply, courtesy of a declining homeownership rate (supporting apartments), strong job growth (office), and burgeoning e-commerce distribution (industrial).⁵ We believe that economic and structural support for absorption could remain firm at least through 2017.

Exhibit 2: GDP Growth and CRE Absorption



Sources: Bureau of Economic Analysis (GDP); CBRE-EA and Deutsche Asset Management (Absorption). Data as of March 2016.
 Note: Absorption is equal-weighted across the Apartment, Office, Industrial, and Retail sectors. Past performance is not indicative of future returns.

The U.S. economy has weathered multiple headwinds over the past year, including weaker Chinese growth, a surging dollar, and financial-market volatility. The economy decelerated in late-2015 and early-2016 as manufacturing (about 15% of GDP) slipped into recession.⁶ A soft global economy and strong dollar will likely continue to weigh on exports, manufacturing, and corporate profits. However, housing and consumer spending, which together constitute about 70% of GDP, are resilient and may receive additional support from lower interest rates in the wake of the UK's "Brexit" vote.⁷ Home sales, prices, and construction are rising at a solid but sustainable rate of about 5% annually and household finances are in pristine condition, with balance sheets, debt service levels, and savings rates at their healthiest levels in decades.⁸

A note of caution: The yield curve has flattened in recent months, a move that has historically signaled economic slowdown. Some observers have discounted this indicator, arguing that quantitative easing and a flight to quality around the world have artificially suppressed long-term bond yields. While there may be some truth to this assertion, we are cautious about drawing too much comfort from it. Formidable global headwinds will likely cap GDP growth at a moderate 2% pace through 2017. Resurgent financial volatility, prompted by concerns around China, Brexit, Italian banks, geopolitics, or other factors, represents an enduring risk to the U.S. economy.

⁴ Bureau of Economic Analysis. Data as of March 2016.
⁵ CBRE-EA. Data as of March 2016.
⁶ Bureau of Economic Analysis and Deutsche Asset Management. Data as of June 2016.
⁷ Bureau of Economic Analysis. Data as of March 2016.
⁸ National Association of Realtors (sales); Case-Shiller (prices). Data as of May 2016.