

EUROPEAN LOGISTICS REPORT - ISSUE 1

European Industrial & Logistics: A long-term view

Key Takeaways:

- › China and India are set to play an increasing role in global trade in the next decade and beyond.
- › Trade between Europe and Asia will increase markedly, putting pressure on existing supply chains and creating new ones.
- › The emergence of larger, stronger economies in Eastern Europe will play a key role in influencing new infrastructure and supply chains within Europe.
- › Poland, in particular, is set to emerge as a major force as it benefits from new infrastructure, manufacturing and consumer demand growth.
- › The North Adriatic Ports (NAPA) will play an increasing role as they expand their container capacity.
- › The emergence of new deep-water ports in Turkey will help to facilitate increased transshipment activity in the Eastern Mediterranean.
- › Istanbul is already integrated into the European rail network and, as tracks are widened and improved, this will drive increased freight through Europe's south easterly border.



In this paper, the first of a series of white papers on Europe's industrial and logistics markets, we take a look at the broad macroeconomic trends that we expect to impact the market over the next decade, and beyond.

With the key emerging markets, China and India, set to take a larger stake in the global economy as we move forward, it is expected that their trade with Europe will increase. We take a look at where this increased trade is likely to enter and exit the continent in the future.

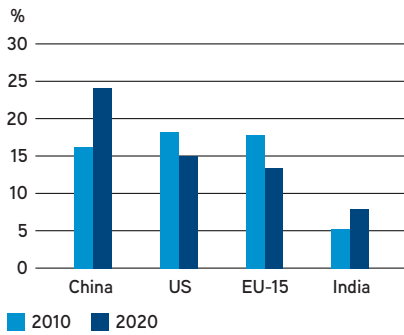
We also look at the economic growth story in Eastern Europe, from both a production and consumption perspective, reviewing the likely demands that increased economic activity will place on its existing infrastructure, and the key role that infrastructure development has to play in enabling forecast growth to be achieved.

Turkey occupies a strategic position between Europe and Asia, and potentially has a key role to play in facilitating trade between the two. We take a view on the form that this is likely to take.

Meanwhile, from an internal infrastructure perspective, developing infrastructure in Eastern Europe will play a key role in linking it more closely with Western European and global economies, and enabling very positive expectations of economic growth to be achieved. We assess the current and future state of Poland's motorway network alongside other key transport corridors.

Finally, we name a few key markets which we believe have the potential to emerge as new logistics hubs, whilst also identifying existing hubs with the potential for further notable growth.

FIGURE 1 - WORLD OUTPUT SHARES 2010 VERSUS 2020



Source: The Conference Board

GROWING TRADE WITH ASIA WILL DRIVE NEW SUPPLY CHAINS AND INFRASTRUCTURE

At present, the dominant trade route into and out of Europe is via ports in the Le Havre – Hamburg range. These ports feed the dominant European core, whilst activity in the more peripheral Mediterranean ports is small in comparison.

However, a continual shift in world trading patterns is likely to exert a significant impact on Europe’s logistics infrastructure going forward.

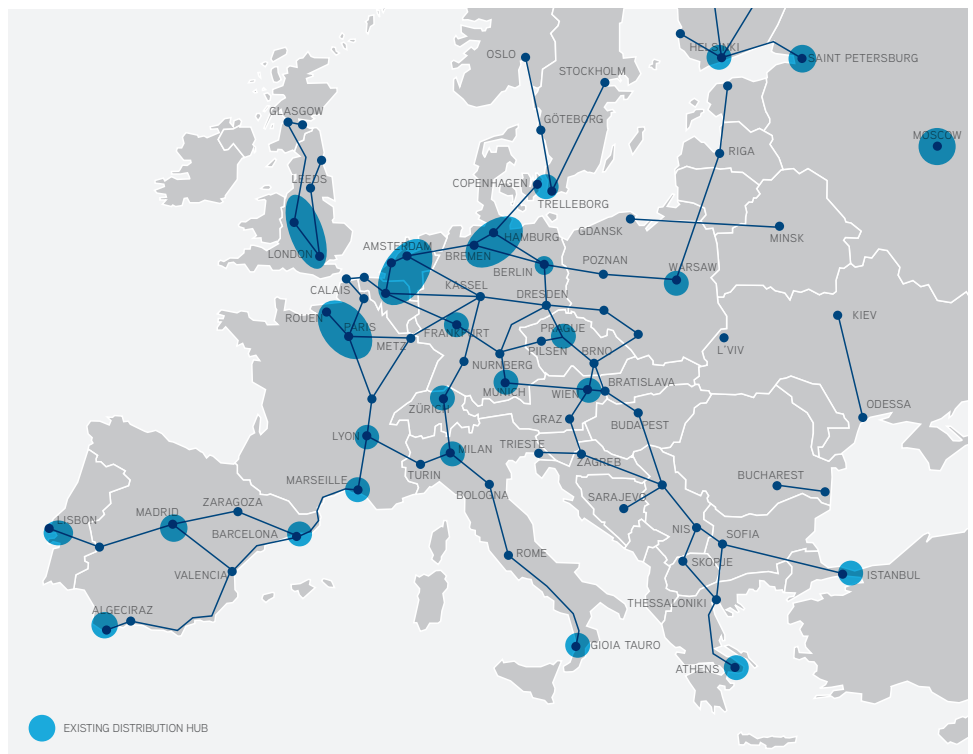
As China and India’s share of world output is set to increase markedly over the next decade, this implies increased trade between themselves and Europe, relative to the more traditional trading route between the US and Europe

Given pressure to lower both business and environmental costs in supply chains, we expect an increased push for additional trade with Asia to begin to flow increasingly through Europe’s southern entry points. This will be both via the Suez Canal sea route and the rail link via Istanbul.

This, coupled with increasing economic and manufacturing growth in Eastern Europe and the region’s further integration into global supply chains, will continue to spur the necessary infrastructure investment.

These are, however, all concurrent factors. A let up in planned infrastructure improvements and port capacity in Eastern Europe, will, of course, act as a constraint on trade and economic growth.

FIGURE 2 - EUROPEAN LOGISTICAL HUBS 2012



IN EUROPE NEW CENTRES OF CONSUMPTION AND PRODUCTION ARE EMERGING

Looking first at Figure 3, we can see the absolute increases in consumer spending expected across Europe from 2011 to 2020.

What immediately stands out is Poland's presence in the big league, with overall consumer spending in the economy trumping that of much of established Europe, with the exception of France and the UK.

What is also noteworthy is the strong showing of both the Czech Republic and Romania. Both are expected to report increases above that of much larger Western European economies.

This growth in consumer spending will drive an increased need to direct goods to these locations. What is also key, is the fact that the increased size of these markets will make direct supply chains more scalable and cost efficient, and help to drive their national logistics markets.

Low wage rates, strong transport links with Germany and central Europe, and independent, floating currencies will prove key in driving manufacturing growth in Eastern Europe in the short to medium-term. In the longer-term better linkages to global supply chains will help to sustain growth – providing the improvements in infrastructure continue.

Overall, the largest growth in manufacturing activity in Europe will be in Germany and Poland, whose economies will remain entwined.

Manufacturing growth in the Czech Republic and Romania will be ahead of forecast increases in Austria, France, Spain and Sweden, further signifying the shift of manufacturing east.

FIGURE 3 - CONSUMER SPENDING INCREASES 2011 - 2020 (€ MILLIONS)

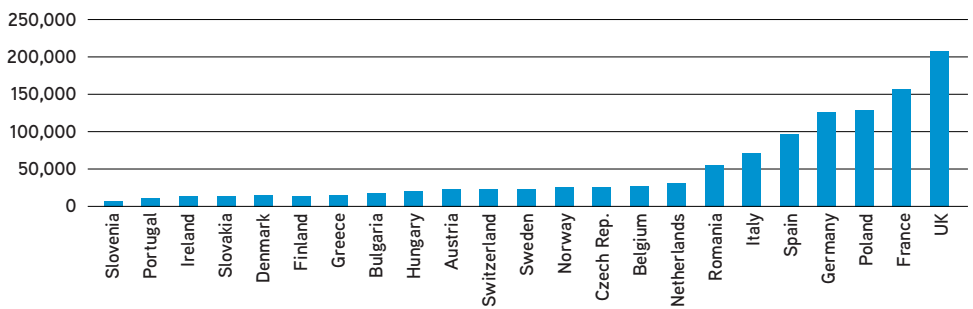
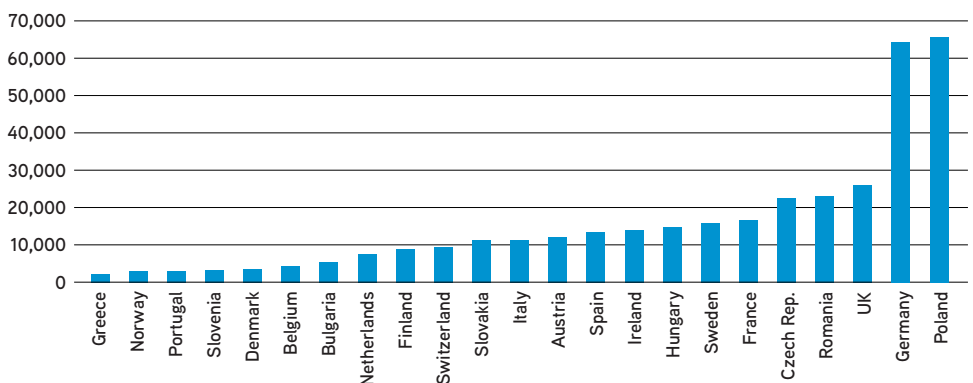


FIGURE 4 - MANUFACTURING GVA INCREASES 2011 - 2020 (€ MILLIONS)



Source: Experian

TURKEY HAS A KEY ROLE IN GROWING SEA AND RAIL FREIGHT BETWEEN EUROPE AND ASIA

Sitting as it does on the “silk road” between Europe and Asia, Turkey is set to play a key role in facilitating trade between the two continents and helping that trade to be cost effective and environmentally friendly.

In the first instance the development of large “hub” ports, with deep-water facilities, at Candarli (Izmir) and Mersin, will enable the largest container ships (10,000+ TEU) to dock and their goods transhipped via smaller vessels to key entry points such as the North Adriatic ports of Koper and Trieste, for example, or even the Black Sea ports.

The development of larger ports in the North Adriatic and on the Black Sea, and the improvement of their links with the rest of Europe, will be key in making the argument against ships sailing past Gibraltar towards the main northern ports.

Additionally, Turkey’s rail links to the Middle East, Iran and Pakistan will allow goods to pass into Europe through both the Istanbul rail connection and the Black Sea ports. The links between Istanbul and Europe have been developed as part of CREAM, an EU funded project established to improve the overall operating conditions for rail freight services along a corridor running from the North Sea ports to Turkey and Greece. It came to an end in 2010 having achieved its objectives.

The rail routes also intersect key European rail and road corridors in Budapest, Ljubljana, Salzburg and Vienna, allowing access to markets in Central and Eastern Europe. Significant investment is continuing in Turkey’s internal rail network, with the 2023 development plan including an additional 14,336 km of extra track, of which 10,000 km allows for high speed rail. This will support the growth of overland links between Europe and the Middle East.

FIGURE 5 - TURKEY’S DEEPWATER PORTS TO HELP FEED THE NAPA PORTS



FIGURE 6 - WHILST ISTANBUL-EUROPE RAIL LINKS PROVIDE FURTHER FREIGHT CAPACITY



WITH EASTERN EUROPE FORECAST TO SEE STRONG ECONOMIC GROWTH, THE PRESSURE IS ON FOR THE INFRASTRUCTURE TO HELP MAKE THIS HAPPEN

The large increases in the scale of consumption and production in Eastern Europe that we expect to see in the next decade and beyond, will begin to exert increasing pressure on supply chains. Logistics activity around the major ports, such as Hamburg, will gradually become less optimal compared to options such as shipping straight to Tricity or using transshipment hubs in the Eastern Mediterranean to feed the ports in the North Adriatic. Capacity expansion plans of these ‘emerging’ ports alongside a concurrent improvement in road and rail links will further advance their deployment as growing logistics centres, provided that planned investments are seen through.

The proposed future expansion of the North Adriatic (NAPA) ports will increase container capacity to some six million TEU by 2020, helping to drive goods through this location into Europe. Improving rail links will help to drive freight between the NAPA ports and Europe. However, there are constraints to rail capacity, so the continual development of future rail corridors will be key.

Equally, developing road links from this location, especially those linking the area to Poland, will be vital. A number of key links in the Polish road network are still to be completed to motorway standard – namely the A1 and A4 motorways improving links with Germany. Improved transport links running from the north Adriatic to Upper Silesia, central Poland and Tricity will also prove key in bringing the Baltic States into play.

Investment in port capacity and deep-water facilities, alongside road improvements will provide Tricity with the opportunity to emerge as a major container hub in keeping with Poland’s growing economic status. Lodz has the opportunity to emerge as a key distribution hub of Poland given its central position, while growth will also focus on Wroclaw and Upper Silesia to support large population concentrations.

FIGURE 8 - IMPROVING THE POLISH ROAD NETWORK

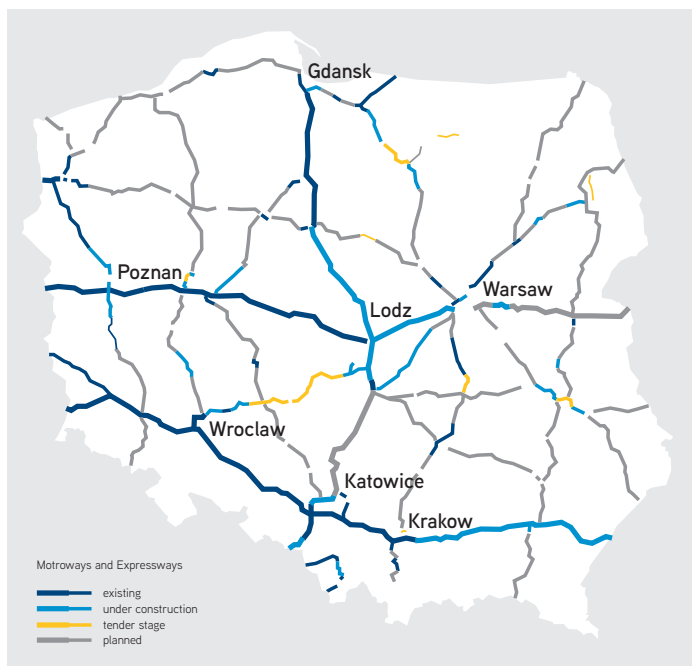


FIGURE 7 - TRANSPORT LINKS BETWEEN THE NORTH ADRIATIC PORTS (NAPA) AND EASTERN EUROPE

Corridor	Road links status	Rail links status
Adriatic - Baltic axis	The route partially overlaps Helsinki Corridor VI and provides a connection between Gdansk and the Adriatic ports by two routes (via the Czech Republic or Slovakia). The main disruptions in the network take place in Poland as large parts of the A1 highway remain either under construction or planned.	RNE Corridor 07 links the Baltic ports of Tricity (Gdansk and Gdynia) with the North Adriatic ports of Trieste and Koper. The route is in use with many sections undergoing modernisation in order to increase speed and capacity.
Helsinki Corridor V	The route links the NAPA ports with Budapest and then Kyiv. The only gap on the EU side is the planned M3 section in Hungary. M06 motorway connects Ukrainian/Hungarian border with Lviv and Kyiv.	RNE Corridor 08 links Koper and Trieste with Budapest, and crosses RNE Corridor 11 in Ljubljana.
European Route E55	This road connects Scandinavia with the Adriatic ports (and runs further south to Italy and Greece). It is a network of modern roads with some disruptions mainly in the Czech Republic.	This route meets RNE Corridor 11 at Ljubljana. C11 is the rail route between Istanbul and Munich - where it then joins RNE Corridor C04 connecting to Hamburg.

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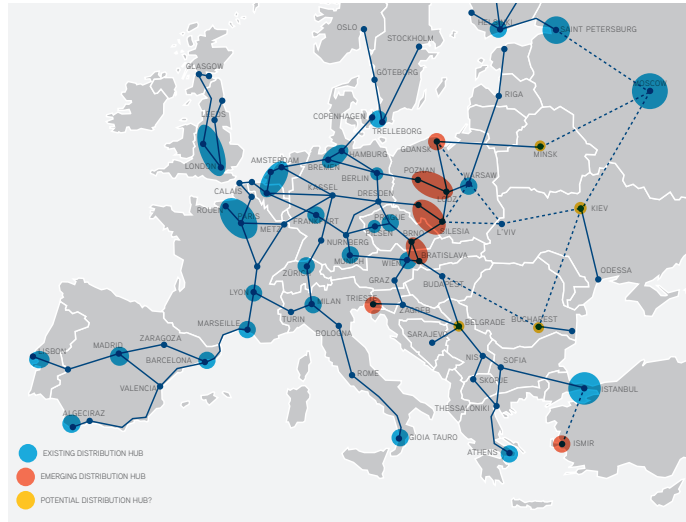


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FIGURE 9 - EUROPE'S LOGISTICS HUBS IN 2020



- Emerging Distribution Hubs 2020
- > Gdansk/Gdynia
 - > Lodz
 - > Katowice/Wroclaw
 - > Bratislava/Brno
 - > Koper and Trieste
 - > Izmir
 - > Belgrade/Nis
 - > Istanbul to grow into a major hub
 - > Moscow and St Petersburg to grow into major hubs

CONCLUDING COMMENTS

In this paper we have briefly touched upon some of the key macroeconomic factors that will drive change in Europe's logistics markets over the next decade and beyond. The notable factors being internally increased economic scale in Eastern Europe, and externally increased scale in Asia – with the two combining to drive new supply routes and infrastructure requirements.

Alongside this, we have looked at how parallel infrastructure development, often under the auspices of the EU, is likely to shape future supply chains. This is providing it continues on its current trajectory, considering the current uncertainty hanging over the eurozone.

However, it is important to note that much of the scheduled development is set to be funded through the EU budget, which is yet to come under great pressure. Hence current economic concerns are not likely to severely impact infrastructure development in the short to medium-term.

In a following series of papers, we will look more closely at the impact these changes will have on specific markets, such as Poland. We will also focus on specific infrastructure issues, such as the development of larger container ships and the demands they are placing on ports and their hinterland services.

Most importantly, we will look at some key future hubs and expected trends in investment, development and leasing.