Drive for resilience recalibrates global logistics

Global supply chains have been reorganizing since the pandemic, but that does not necessarily mean deglobalization, reports Mark Cooper

Global supply chains have been shifting in response to the global pandemic and also to changing political circumstances. To some, this is deglobalization, where interdependence and integration lessens between nations and regions. To others, the globalized world is simply shifting to reflect new circumstances. Regardless of who is correct, there are profound impacts on the logistics and industrial real estate sectors.

Data from the World Trade Organization is not conclusive. Global trade dropped sharply from 2019 to 2020, but then rose again before faltering again last year.

Indraneel Karlekar, global head of research and strategy at US manager Clarion Partners, says: "The patterns of globalization are shifting; it's not globalization itself that is in danger. Established trading patterns and trading partners are shifting but global trade numbers have exceeded pre-pandemic levels, even after adjusting for inflation.

"We are moving from China as the sole manufacturer to the world to a diversified group of economies participating in the way globalization is occurring, particularly in manufacturing and assembly."

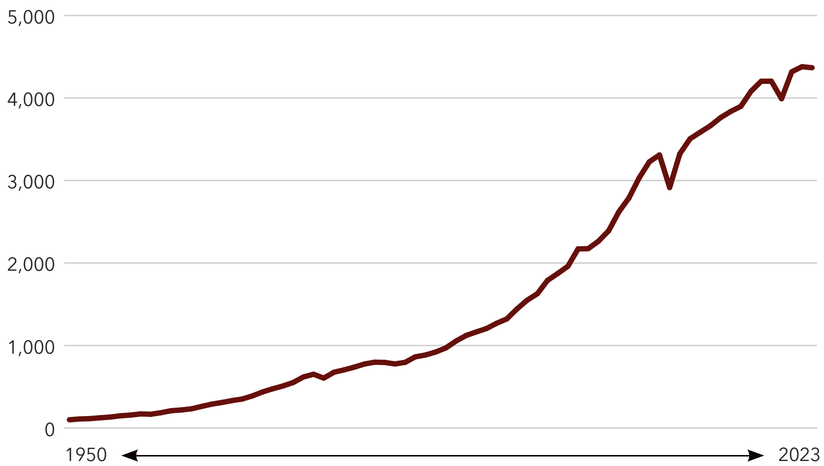
Indicators of change

Global trade levels are greater today than they were before the pandemic, but within these overall numbers are indicators of change. China's market share of US imports has dropped, but other nations have made up the slack, and the volume of US imports is up substantially over the past decade.

Furthermore, according to the Peterson Institute for International Economics, US trade openness – measured by trade in goods and services as a percentage of GDP – has been falling since 2012, and there is a widening gap in trade openness between the US and the world as a whole. This could be taken to mean that the US is deglobalizing, in the sense that trade is a shrinking part of its economy. However, continued economic and population growth means the amount of US trade keeps rising.

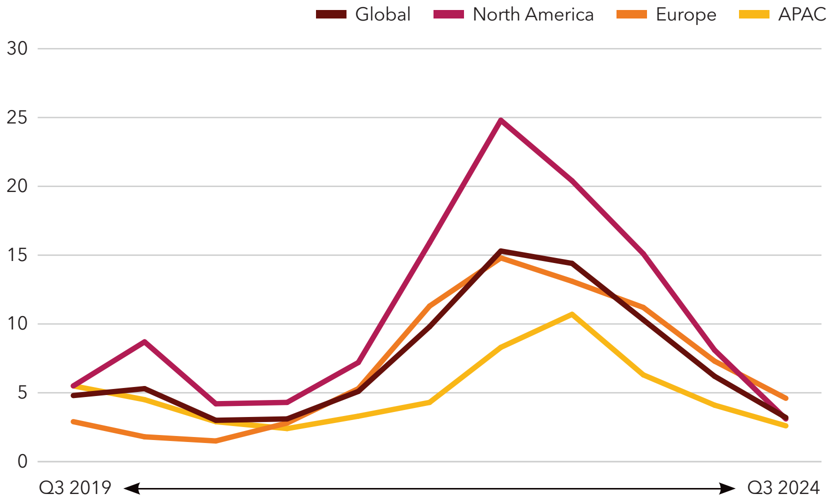
"Some countries have deglobalized and others have integrated further," says Michael Balcom, managing director at Crow Holdings Capital, the investment management business of developer Crow Holdings. "In the US, globalization seems to have peaked around 2012. Reshoring, nearshoring and friendshoring have all increased, but not necessarily in a zero-sum way opposite globalization, but because total consumption domestically has increased, and increased consumption requires more imports."

World trade volume today is 44 times higher than the level recorded in 1950, per the WTO's index*



*For the volume index, 1950 is set to 100. Trade is calculated as average of exports and imports, and excludes significant re-exports or imports for re-exports
Source: World Trade Organization

Around the world, logistics annual rental growth is slowing to more sustainable levels (%)



Source: JLL Research

Forces at play

Supply chains have shifted since the pandemic in order to diversify and to build in more redundancy. "Businesses are recalibrating supply chains to enhance resilience," says Melinda McLaughlin, global head of research at logistics real estate specialist Prologis. "This includes reshoring, nearshoring and friendshoring strategies to address risks highlighted by the covid-19 pandemic and geopolitical tensions, as well as reduce transportation time and costs."

This might mean manufacturers are moving to a "China plus one" system and locating some facilities in a market such as Vietnam. Alternatively, they might move some manufacturing closer to the markets where the products are sold, such as moving production destined for the US to Mexico, due to rising costs involved in the transportation and shipping of goods over long distances.

"It became clear that supply chains had become a little too global and did not have enough redundancy built in," says Justin Curlow, global head of research and strategy at AXA IM Alts, the insurer's investment management business.

However, there is also a politically inspired move in several nations to bring certain industries closer to home or back home. Curlow adds that supply chain shifting "has been exacerbated by geopolitical and security concerns around sensitive industries, whether that is semiconductors, defense or pharmaceuticals."

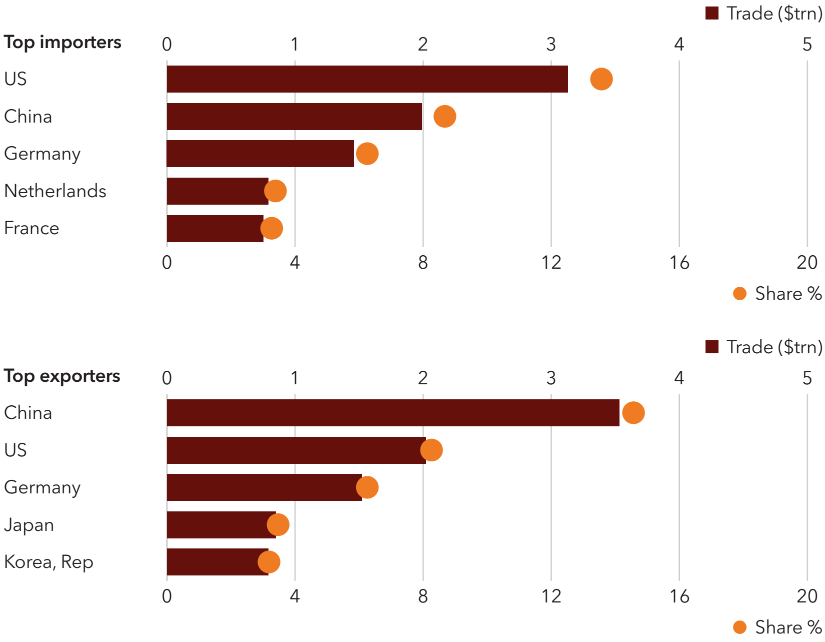
The US, in particular, has begun to move such sensitive industries onshore. For example, Taiwan Semiconductor Manufacturing Company's US subsidiary received government funding to locate semiconductor production in Phoenix. Annualized manufacturing construction spending in the

US reached $237 billion in July 2024, up from $128 billion two years previously, according to US Census Bureau data.

"We're seeing a significant ramp-up of supply chains around the onshoring phenomena in the US," says Karlekar. "It is estimated that there is about $750 billion-$1 trillion in manufacturing projects that are happening or will happen over the next five years across the US."

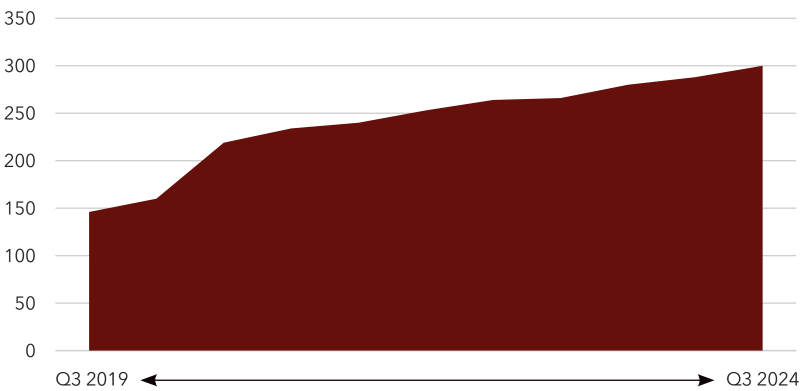
Governments worldwide are also trying to encourage the onshore manufacturing of products required for the ongoing transmission to cleaner energy. The US Inflation Reduction Act was focused on growing domestic green industries, while the UK government has been subsidizing domestic battery production and carbon capture projects.

The US and China top the largest importers and exporters lists by share of global trade



Source: Worldbank's World Integrated Trade Solution

US e-commerce volume passed $300bn in Q3 2024 ($bn)



Source: US Census Bureau, CommercialEdge

Change takes time

"This is a slow, steady burn phenomenon which will develop over the next decade and beyond," explains Curlow. "Building new semiconductor and pharmaceutical manufacturing facilities takes time."

While the gradual move of certain sectors of manufacturing back to the US will take time, there have already been significant shifts as manufacturing has been brought closer to target markets. Perhaps the biggest winner has been Mexico, "which is uniquely positioned as a nearshoring hub due to its proximity to the US, trade agreements and availability of labor," notes McLaughlin.

Data from CBRE and PGIM Real Estate shows that Mexican logistics rents have risen by 39 percent since 2022. In a November report entitled *Industrial Real Estate: The Case for Mexico*, PGIM wrote: "Rents in many major markets are growing at double-digit rates over the year to third quarter 2024."

PGIM says it expects the electronic, machinery, medical device and automotive industries will continue to expand in Mexico's leading manufacturing hubs, generating high single-digit rent growth in US dollar-denominated leases, "with quality tenant credit comparable to, and tenant retention superior to, typical tenants in US industrial properties."

This boom in Mexican manufacturing is also benefiting logistics markets in the US itself, especially in the Southwest.

James Breeze, global head of industrial and logistics research at CBRE, says: "Cities that are along Interstate 35 in the US are already benefiting from increased transportation and storage of goods from Mexico. These markets include San Antonio, Dallas-Fort Worth and Kansas City."

However, overall growth in imports means traditional US logistics hotspots have not suffered, says Balcom. "Logistics real estate has benefited from increased consumption and import growth. Overall, the key gateway markets like Southern California, New

Trump and his tariffs

New trade restrictions may not have a huge impact on real estate

President Donald Trump has reiterated that one of his favorite words is tariff. On the campaign trail, he had suggested his administration would impose substantial tariffs; not only tariffs of up to 60 percent on Chinese goods, but also tariffs on Mexico and Canada, which have benefited from the diversification of supply chains through nearshoring.

Tariffs on China are not new and had been maintained by the Biden administration, so logistics real estate experts expect more of the same. However, tariffs on Mexico and Canada would be a new development as trade has thrived under the United States-Mexico-Canada Agreement, which expires in 2026.

In a recent report, PGIM suggested three possible scenarios.

First, a renewed agreement with minor changes would mean little change and a positive outlook for Mexico. Second, major changes to trade, which make manufacturing in the US more attractive – this would reduce potential logistics rental growth in Mexico, but it would remain positive. Third, USMCA is allowed to expire and tariffs are imposed, which would significantly downgrade rent growth and pricing expectations.

PGIM believes the first two scenarios are more likely but that there are "high tail risks" of the third coming to fruition.

The US is not the only nation introducing tariffs or other constraints on trade. The EU is considering removing a customs exemption for small value goods, for example. This could force Asian e-commerce companies to store goods nearer the target market.

Overall, however, logistics owners are sanguine about tariffs.

Indraneel Karlekar, global head of research and strategy, Clarion Partners, says: "We have been living with tariffs for the past decade, not in some sort of laissez-faire environment. And that really hasn't dented either the import of goods or the demand for logistics."

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>
> **JACK COX**
> **CBRE**

York/New Jersey and Laredo have continued to grow in the period where the US has moderately decoupled from China.

"This is because even though supply chains have diversified away from China, imports have grown in total, and the fastest growth from imports to the US has been from Asia ex-China; those countries still rely on the same key gateway and port markets in the US to import their goods, specifically the major coastal port markets."

That said, Southern California, while remaining a critical hub for logistics, is "experiencing a volatile cycle as businesses recalibrate after the pandemic-driven leasing and pricing surges from 2020 to 2022," reports McLaughlin.

International impacts

In Asia-Pacific, a number of nations have benefited from China's decreasing market share of US imports and the emergence of so-called China plus one strategies.

Vietnam has been a major beneficiary and not just for supply chain reasons – manufacturing wages are less than a third of those in China. Savills research says exports rose 15.5 percent year-on-year in the first eight months of 2024, with the US the biggest export market. Vietnam is also seeing growing foreign direct investment in manufacturing, particularly in electronics and electrical equipment, indicating a move up the value chain.

Other beneficiaries have been Thailand, Taiwan, Malaysia and India. The latter is already a center for pharmaceutical production, but it is beginning to diversify and it has huge potential due to its large, educated and young population.

Exports from China have continued to rise in 2024, up 5.2 percent to $5.05 trillion, according to government data. New logistics stock continues to be added, but the country's overall vacancy rate hit a record 17.2 percent in June, according to services provider Cushman & Wakefield. Government stimulus and a focus on boosting consumption may aid the sector next year.

In Europe, Poland and other Eastern European markets have been the major beneficiaries of nearshoring, says Clarion's Karlekar.

"As a result, the Polish industrial market has been deeply integrated into the broader European logistics market. This suits companies that don't want to take the risk of outsourcing their sensitive logistics footprint outside of Europe."

However, the effect of nearshoring in Europe has not been as significant thus, not least because the war in Ukraine has dissuaded manufacturers from locating in countries near that region, says Jack Cox, head of industrial and logistics, Europe at CBRE.

"If the war persists, occupiers that want to implement nearshoring strategies in Europe might need to explore alternative markets in the region such as Southern Europe, where labor is also generally affordable and widely available."

Less nearshoring means that Europe's incumbent logistics centers and related real estate remains steady, says Karlekar. "We still see the big ports of Rotterdam, Antwerp and Hamburg as pre-eminent in terms of trade in and out of Europe; we haven't really seen a major shift there."

Building resilience

While moves to increase supply chain resilience are affecting the logistics real estate market, the effect of the US and other nations bringing sensitive industries onshore is not yet having a significant effect, due to the timescales involved.

Balcom also points out: "The impact of reshoring has been net positive to domestic manufacturing and aggregate industrial demand, but since manufacturing only accounts for 5-10 percent of industrial leasing in any given year and much of the manufacturing growth has been in categories like semiconductors or green industry market segments which rely less heavily on warehouse space than other segments of production, such as consumer goods, the net positive effect has been relatively small."

In this shifting market, logistics occupiers and asset owners are responding. "Occupiers are making strategic shifts to enhance resilience and efficiency. Many are investing in technology, optimizing space utilization and adopting multi-location strategies to reduce risk," says McLaughlin.

CBRE's Cox notes that third-party logistics occupier activity has surged as more and more companies look to outsource their logistics because 3PLs can offer economies of scale, and outsourcing means manufacturers and retailers can concentrate on their own business.

Meanwhile, asset owners are "leveraging their platforms to provide real estate solutions for their global customer base. Some have increased their focus on manufacturers, which aligns well to acquiring larger development sites in markets which offer a combination of flexible labor and government support via grants."

$237bn

Annualized manufacturing construction spending in the US in July 2024, up from $128bn two years previously

39%

Rise in logistics rents across Mexico since 2022

$1trn

Estimated US manufacturing project pipeline over the next five years

Investors take notice

A shifting logistics market means some investors are looking for generic, adaptable assets. "As an investor in logistics, we look for a generic box in an established distribution location with a number of potential occupiers," says Curlow. "Apart from anything else, this strategy insulates an asset owner from a particular tenant or industry deserting a particular location."

Meanwhile, McLaughlin adds that investors are also aligning development starts with market conditions to avoid risk of speculative oversupply. She says that Prologis intends to increase its presence in Mexico and other nearshoring hubs.

Market participants suggest the effects of reshoring sensitive industries will take the better part of a decade to play out. However, over the next four to five years "regionalization" will gain momentum, suggests McLaughlin.

"Nearshoring hubs like Mexico and parts of Southeast Asia will see further growth," she says. "Logistics real estate will evolve to emphasize automation, digital infrastructure and ESG priorities. To remain competitive, owners should focus on geographic diversification, partnerships for technological innovation and advancing sustainability." ■