21/07/2021

UK ECONOMIC AND PROPERTY OUTLOOK

ECONOMICS AND FORECASTING TEAM

CBRE

MAIN POINTS

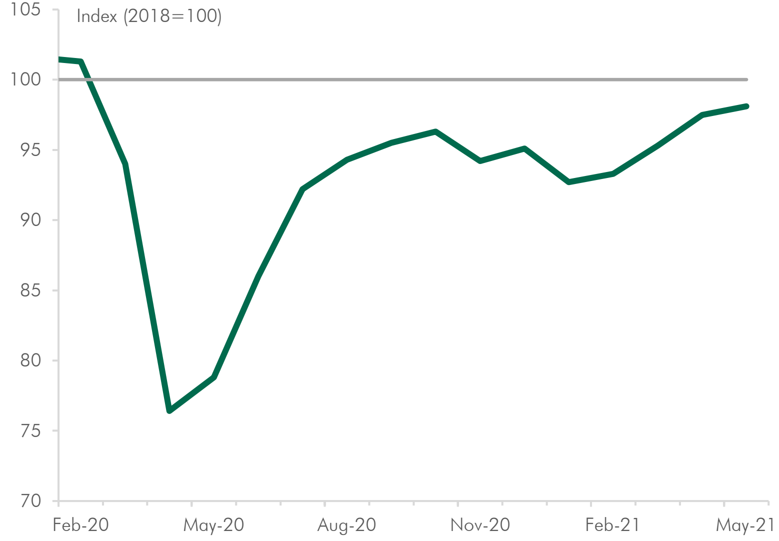
Economic recovery is well underway…	• We expect economic momentum to continue as the remaining restrictions are lifted on 19 July. • We are forecasting GDP growth of 7.7% in 2021, with economic activity returning to pre-pandemic levels in Q4 of this year.
..but there are risks to the outlook	• Rising Covid-19 cases continue to pose a downside risk to the outlook. Though the link between rising cases and hospitalisations has weakened, evidence suggests that consumer confidence can be impacted by rising case numbers. This may slow the return to normal patterns of leisure spending.
Unemployment to peak below 6%	• The number of payrolled employees increased for the sixth consecutive month and the headline unemployment rate edged down to 4.7% in the three months to May. Job vacancies are back at pre-pandemic levels, with concerns of labour shortages in some sectors. • The end of the furlough scheme has been timed about right with demand picking up and expected to remain strong. While this will minimise the degree of job losses in 2021, there will inevitably be some job losses and this is reflected in our current forecast.
Inflation is transitory and low rates to continue	• The UK is experiencing a spike in inflation. But this largely the result of base effects whereby current prices are being compared with the depressed prices a year ago at the start of the pandemic. • As this is likely to be only a temporary spike, we expect the Bank of England to keep interest rates on hold. • Long-term interest rates are expected to drift upwards from the very low levels seen during the pandemic, but we remain in a lower-for-longer interest rate environment.

ECONOMIC SETTING

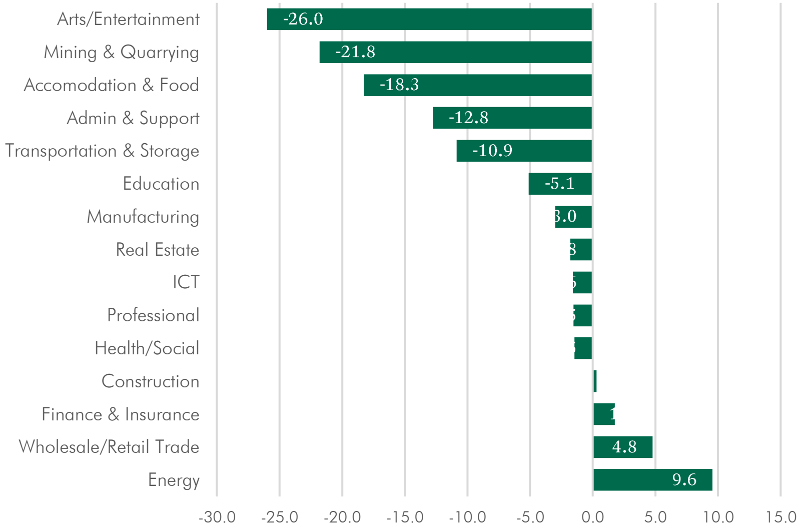
GDP was stronger than expected over the second and third lockdowns, demonstrating the resilience and adaptive nature of businesses during the months of restrictions. First quarter GDP fell by 1.6%, but the UK economy has been in recovery since January, with monthly GDP on a continuous upward path since then.

Following May's GDP growth, the UK economy is around 3% below its pre pandemic level. Consumer-facing services continued to grow in May, and with the easing of hospitality restrictions there has been a notable shift in demand from food stores to restaurants and pubs. In contrast, manufacturing stalled in May because of problems with the supply of key components.

UK GDP (GVA)



Gross Value Added, by sector, % change since Feb 20



Source: ONS, CBRE Research

LOOKING AHEAD

Economic recovery is well underway. Despite a relatively underwhelming GDP increase of 0.8% m/m in May, we remain confident that momentum will build again in Q3 following the lifting of the outstanding restrictions on 19 July. This includes previously closed settings, such as nightclubs and large events, and the removal of social distancing restrictions that required venues to operate at reduced capacity. We expect UK GDP to grow by 7.7% in 2021, with GDP returning to pre-pandemic levels in Q4 of this year. Rising Covid-19 cases continue to pose a downside risk to the outlook. Though the link between rising cases and hospitalisations has weakened, evidence suggests that consumer confidence can be impacted by rising case numbers and this may slow the return to normal patterns of leisure spending: eating out, theatres, holidays.

UK: Real GDP

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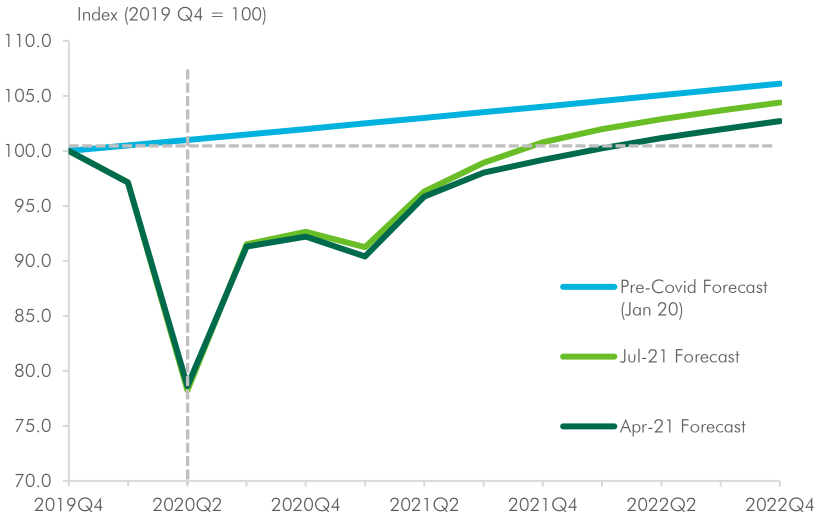
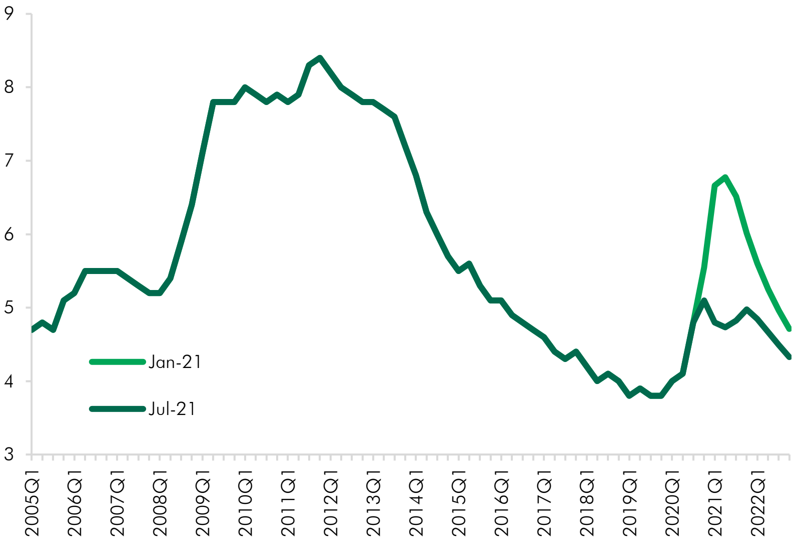


Source: Oxford Economics, Macrobond, CBRE Research

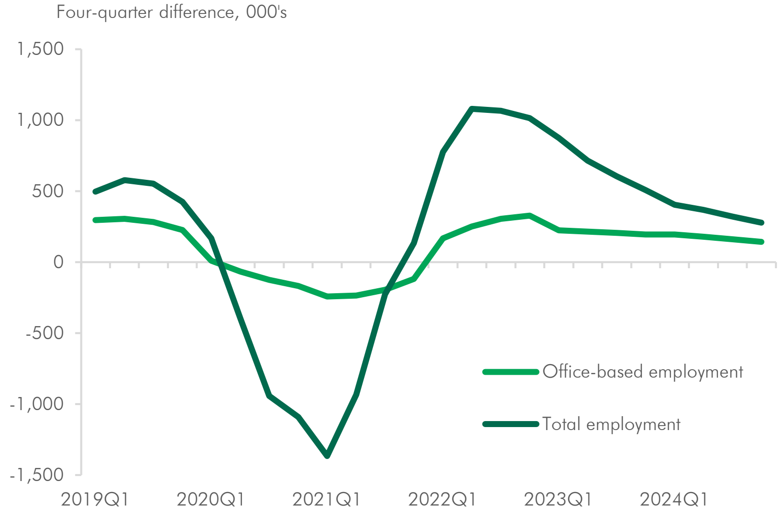
EMPLOYMENT

The labour market continues to improve. The number of payrolled employees increased for the sixth consecutive month in May 2021 and the official unemployment rate edged down to 4.7% in the three months to May. Job vacancies are back at pre-pandemic levels, with many sectors now reporting labour shortages. If our view on GDP returning to pre-pandemic levels in Q4 of this year is correct, the end of the furlough scheme will concide with a period of strong demand - supporting the demand for labour and minimising the number of job losses towards the end of 2021. That said, it is inevitable that the winding down of the furlough scheme will lead to some job losses and this is reflected in our current forecast. On the positive side this may ease the labour shortages that are emerging in some sectors.

UK: Unemployment rate (ILO)



UK: Employment



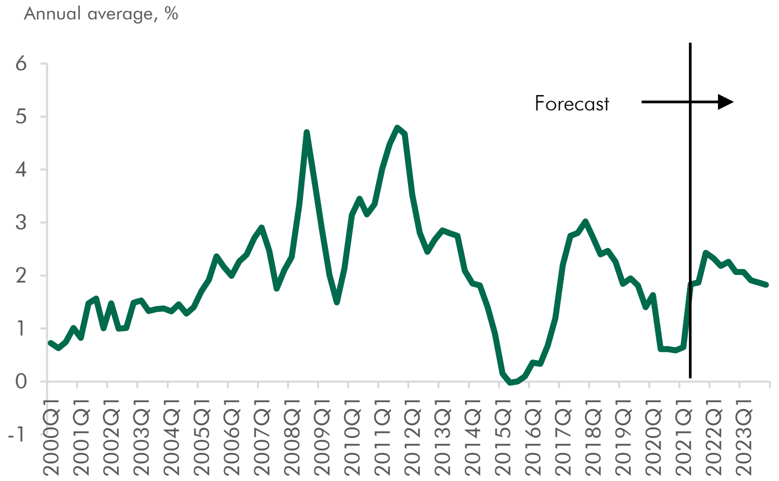
Source: Oxford Economics, CBRE Research

INFLATION AND INTEREST RATES

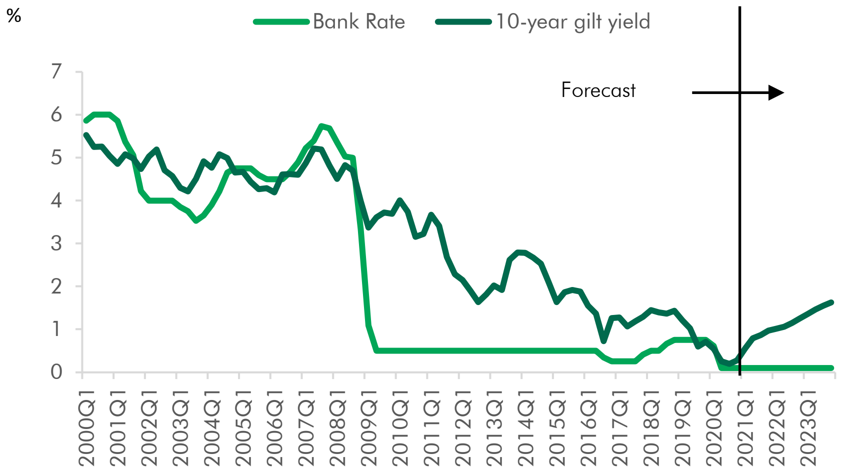
Inflation has picked up in recent months, with annual CPI inflation rising to 2.5% in June. This is largely the result of base effects, with current prices being compared with the depressed prices during the initial pandemic period. In addition, reopening sectors have started to raise prices, which they were unable to do for more than a year. We expect these effects will only have a temporary impact on inflation.

Though there are signs of labour shortages, the ending of the furlough scheme will give a clearer indication of the degree of labour market slack. Our view remains that inflation will peak in H1 2022, gradually returning towards the Bank of England's 2% medium run inflation target. As such, we expect the Bank of England to look through the temporary increase in inflation, keeping short-term interest rates on hold.

UK: CPI inflation



UK: Interest rates



Source: Oxford Economics, Macrobond, CBRE Research

PROPERTY SECTOR: RENTAL OUTLOOK REFLECTS THE RISKS AROUND THE SECTORS

Our forecasts, based on MSCI data, show the expected rental performance by sector and quality. Across the board rents are falling in the retail sector, with the largest declines in shopping centres. Prime high street and retail warehouses are anticipated to fare better over the next five years. I&L has performed well during the pandemic and rental growth is anticipated to continue.

But, it should be noted that these are national figures, which hide some of the regional variations. The office sector continues to be mired by the spectre of working from home hanging over it. We forecast rental falls in the lower quality space, but we predict modest growth for low yielding better quality assets. These forecasts align with our view of a present flight to quality.

Rental growth (5 year %pa to end-2025)

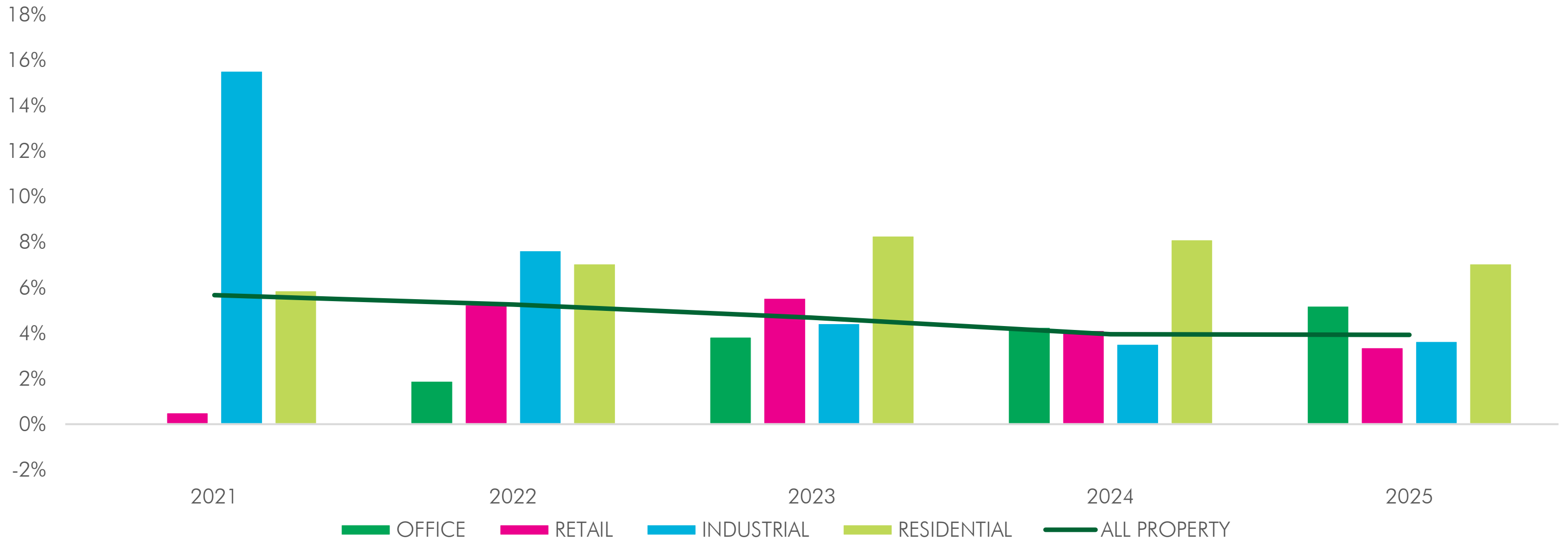
Source: MSCI, CBRE Research

PROPERTY SECTOR: INCOME RETURNS AND VALUE GROWTH SUPPORT TOTAL RETURNS

Aggregate All Property total returns look fairly stable over the next five years, with a high of 5.3% in 2022 and a low in 2025 of 3.9%. The top level data, more so now than ever, hides the performance divergence of the assets. At a sector level the industrial sector is the top performer over the next two years, this reflects the continuation of yield falls pushing values.

We forecast a recovery in retail in 2023 as yields stop rising and market pricing moderates at a new level. The residential sector, which is producing steady and high returns, is the top performing sector 2023-25.
We predict modest rental activity, steady income and some value appreciation in the office sector, which leads to gradually improving returns over the next five years.

Total returns (year % change)



Source: MSCI, CBRE Research

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