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EXPERTS IN PROPERTY

Economics

RICS®

A significant rebound in investment is not on the horizon

UK Economy and Property Market Chart Book

Q1 2020

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Contents

RICS Survey Release Dates

Frequency	Survey	Period covering	Release date
Monthly	RICS Hong Kong Residential Market Survey	January	20-Feb-20
Monthly	RICS Portuguese Housing Market Survey	January	28-Feb-20
Monthly	RICS UK Residential Market Survey	February	12-Mar-20
Monthly	RICS Hong Kong Residential Market Survey	February	18-Mar-20
Monthly	RICS Portuguese Housing Market Survey	February	27-Mar-20
Monthly	RICS UK Residential Market Survey	March	09-Apr-20
Monthly	RICS Hong Kong Residential Market Survey	March	21-Apr-20
Quarterly	RICS UK Construction Market Survey	Q1 2020	23-Apr-20
Quarterly	RICS Global Commercial Property Market Survey	Q1 2020	30-Apr-20
Quarterly	RICS UK Commercial Property Market Survey	Q1 2019	30-Apr-20
Monthly	RICS Portuguese Housing Market Survey	March	30-Apr-20
Quarterly	RICS Global Construction Survey	Q1 2020	07-May-20
Monthly	RICS UK Residential Market Survey	April	14-May-20

Economic outlook

Following what seemed to be a rather lacklustre couple of years for the UK economy, there is some evidence of an uplift in confidence going into 2020. In particular, the Q4 2019 Deloitte survey of Chief Financial Officers suggests that the decisive general election result has bolstered spirits. Critically, the proportion of CFOs who said they were confident about the financial prospects of their company reached its highest level in eleven years whilst appetite to take greater risk on balance sheets also shot up. Alongside this, the Composite Markit PMI, a closely watched economic indicator covering the manufacturing and services sector rose to its highest reading in sixteen months (coming in at 52.4 in January 2020 from 49.3 In December 2019) consistent with a pick-up in activity.

Uncertainty is looking likely to persist in 2020

Whether this uptick in sentiment helps to revive the economy remains to be seen but, for now, there are concerns that this so called 'Boris bounce' may prove short-lived. For one, enduring macroeconomic uncertainty may keep a lid on investment (as the UK attempts to negotiate a free trade agreement with the EU over the course of this year). As things stand, the government, by deciding not to consider extending the transition period beyond December 2020, has given itself an extremely short time frame to complete an enormous task.

Analysis by Oxford Economics suggests that this could mean that a very basic deal focusing on priority areas is struck by the end of 2020 and a more detailed agreement is built over time. The overall effect on the economy under these circumstances is far from clear, however it is likely any trade frictions that may well arise as the two sides attempt to hammer out a more comprehensive arrangement are likely to damage growth prospects, at least in the short term.

Oxford Economics' baseline forecasts assume that negotiations will continue beyond this year and a new trading relationship between the UK and EU will not fully take effect until 2023. Significantly, in the Bank of England Decision Maker Panel survey, the date at which businesses expect Brexit uncertainty to be resolved has been pushed further into the future. Fewer respondents now expect a fully agreed deal to be in place by the end of 2020 while the average probability being placed by respondents on the UK and the EU still negotiating around these issues in 2021 and beyond has risen (to almost 60% January 2020 from 43% in December 2019).

GDP growth projections are modest for now

Taking all of this consideration, it is not surprising that current projections are pointing to a very modest trend in output growth this year. HM Treasury Consensus Forecasts (average of independent forecasts for the UK Economy) envisage the economy will grow by only 1.1% in 2020 slightly weaker than the 1.3% likely recorded in 2019.

On a more positive note, the employment rate has climbed to its highest levels on record according to the latest statistics. It is likely that this trend is still being driven by an increase in labour market participation with the inactivity rate edging lower to 20.6%, a record low. In response, wages are continuing to rise firmly (by 3.2% on an annual basis).

It is probable that the labour market will remain reasonably tight in the coming months which should continue to drive a solid trend in wage growth.

Stronger pay growth and soft inflationary pressures are likely to strengthen household finances

Meanwhile, consumer price inflation slipped to 1.3% in December 2019 after averaging around 1.8% for most of 2019. Lower energy and utility prices will see price growth remaining below 1.5% at least in the first half of this year. This will come as particularly good news for households, as soft price pressures combined with a firmer trend in pay growth should help to strengthen spending power.

Looser fiscal policy in the upcoming Budget could provide some support

In addition, there is the possibility of a loosening in fiscal policy in the March 11th Budget supporting the economy both this year and in 2021. So far, the big announcements have been centred around a sizeable investment in infrastructure, and an increase in expenditure across the Midlands and Northern parts of the country which, if implemented, could help steer a stronger profile for growth in the medium term.

The latest round of RICS surveys point to an uplift in sentiment

The latest RICS data points to an up-lift in sentiment on the back of greater clarity following the decisive result to the general election. This was particularly visible in the results of the RICS Residential Market survey, with key indicators pointing to an increase in activity. At the same time, sales expectations for the coming twelve months have also risen sharply. It should be noted however that projections are also pointing to an increase in prices across all regions over the coming year, a particular concern given that supply shortages and stretched affordability in many parts of the country remain key issues for the market.

The results to the latest RICS UK Commercial Property Market survey were also consistent with a modestly stronger outlook for rents and capital values for the year ahead. That said, this pick-up was confined to the industrial and office segments. Indeed, no let-up is envisaged for retail with the sector expected to continue struggling against structural headwinds this year.

As far as the construction sector is concerned, in the RICS UK Construction and Infrastructure Market Q4 2019 survey, the headline net balance is still consistent a very modest rise in workloads. Still, the results do point to renewed optimism for the year ahead with twelve-month expectations for workloads, profit margins and hiring revised higher. Alongside this however, financial constraints, planning delays and skill shortages are continuing to be cited as major impediments to activity.

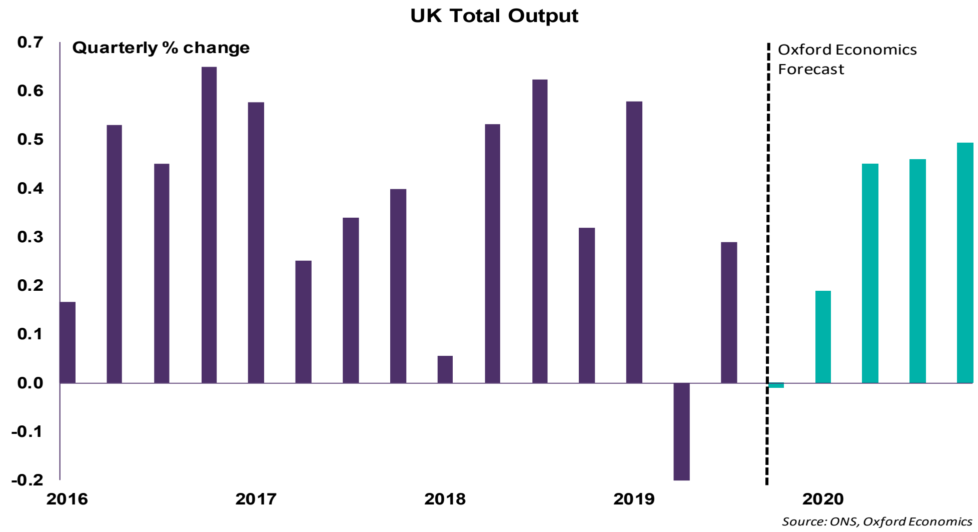
UK Economy

Consensus forecasts for this year suggest that over the course of the full twelve months, growth will be little different from that recorded in 2019. Oxford Economics' analysis indicate that the first quarter of 2020 will show only a modest uplift. Further out, growth is expected to pick-up over the course of this year on the back of looser fiscal policy and strengthening consumer spending power (Chart 1).

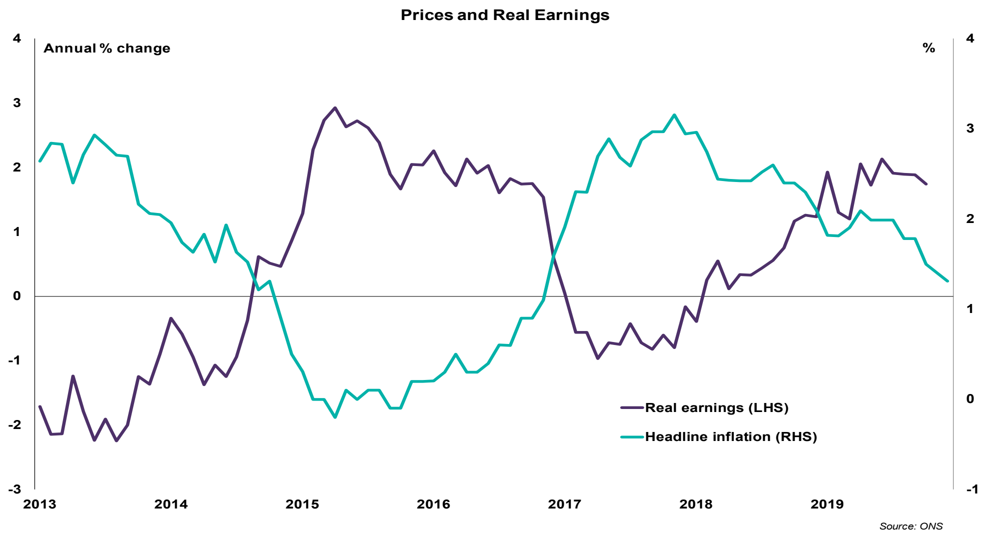
Real earnings edged up in 2019 driven by a solid trend in nominal wage growth and cooling inflationary pressures (Chart 2). The annual change in pay growth is likely to hover around the 3% mark in the first half of 2020. At the same time, headline inflation is envisaged to continue softening and remain well below 2% due to lower utility prices. Together, this should drive a positive trend in real wages and in turn, help strengthen household spending power.

The latest data still points to what seems to be a tight labour market (the employment rate is still at a record high of 76.3% in October 2019). However, the number of job vacancies have dipped over the past few months which could mean that employment growth begins to slip back later on in the year (Chart 3).

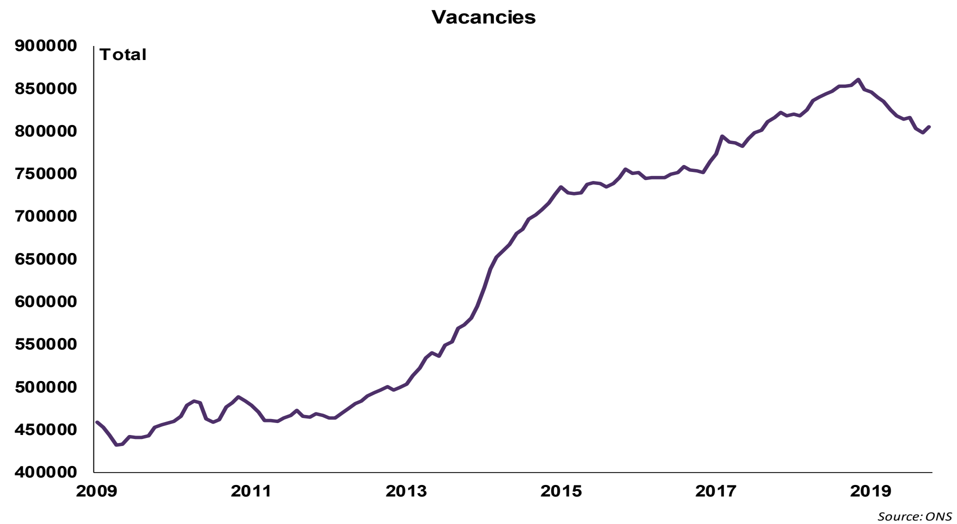
1. Quaterly GDP growth is expected to pick-up slightly in 2020



2. Real earnings growth has accelerated



3. Job vacancies have dipped



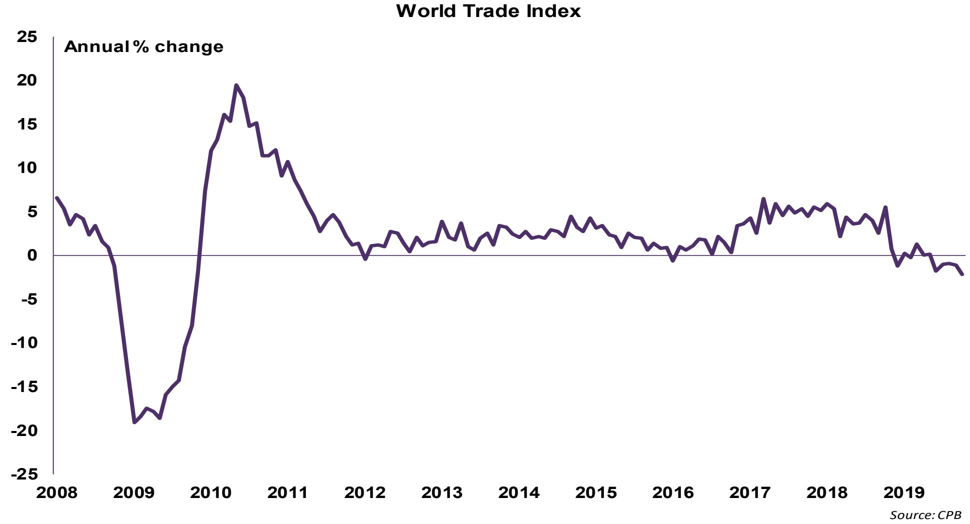
UK Economy

World trade volumes slipped on a year-on-year basis at the fastest pace since the financial crisis in closing stages of 2019 predominately driven by the US-China trade war. This seemed to be weighing on global output growth and business sentiment and, in turn, also on UK exports (Chart 4). Tensions do appear to have subsided to some extent, which could, in the absence of other macroeconomic shocks, steer a pick-up in world trade growth this year.

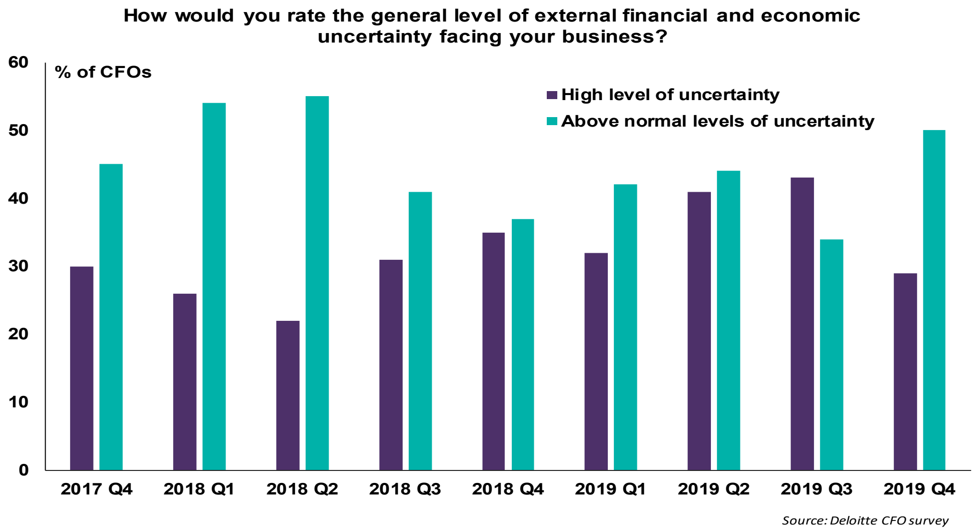
For businesses, uncertainties surrounding UK's future relationship with the EU remain a particular concern. In the latest Deloitte quarterly survey which gauges sentiment among the UK's largest firms, there seemed to be an uplift in business confidence following the decisive result to the general election. However, in spite of this, a significant proportion of CFO's still said their businesses were facing high levels of uncertainty (Chart 5).

Critically, it seems that Brexit uncertainty will continue weighing on investment decisions this year. In the Bank of England Decision Panel survey, the share of respondents expecting Brexit uncertainty to be resolved in 2020 has dipped whilst the proportion anticipating greater clarity in 2021 onwards has risen sharply (Chart 6).

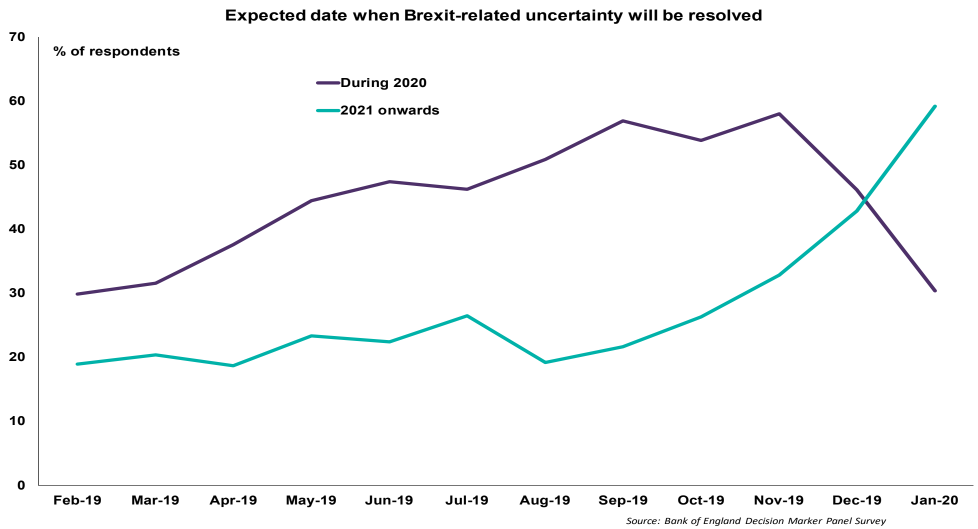
4. World trade volumes have slipped due to trade tensions



5. Businesses are still facing high levels on uncertainty



6. Brexit uncertainty is expected to persist in 2020



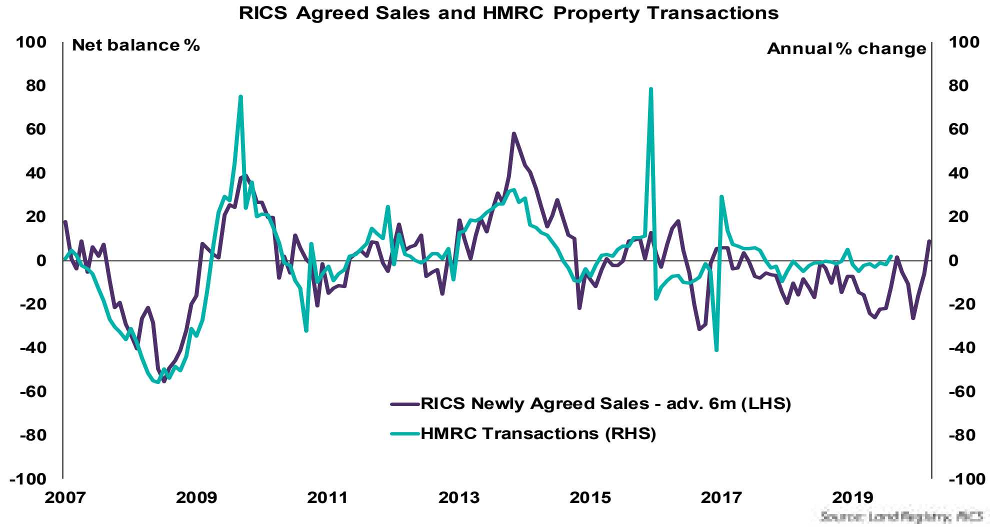
Housing Market

Following the decisive result of the general election, key indicators to the RICS UK Residential Market survey pointed to an uplift in sentiment. In particular, the agreed sales net balance edged up to +9% in December 2019, the most positive reading for this series in two years. This indicator has a six month lead over the HMRC transaction numbers and points to a pick-up in housing sales volumes in the coming months (Chart 7).

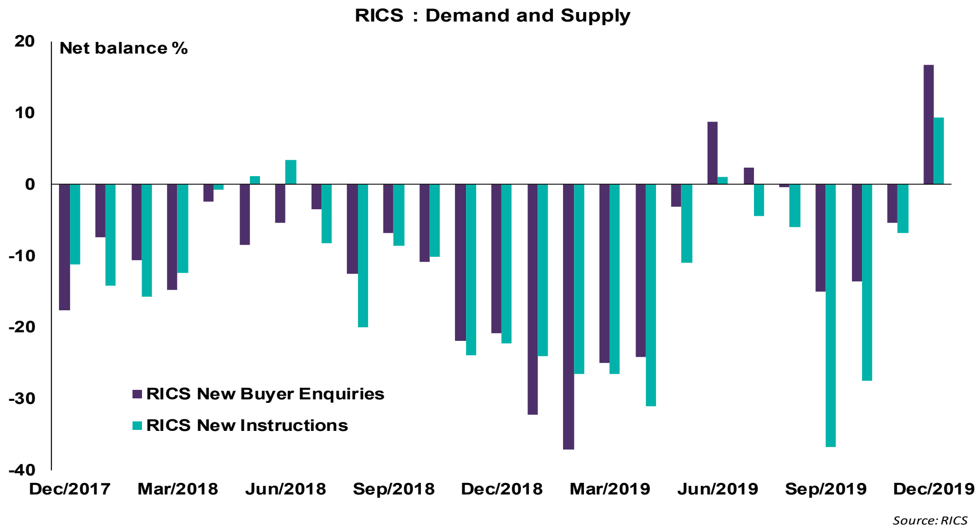
Other activity metrics to the latest RICS survey also point to a slightly more upbeat picture. New buyer enquires (an indicator of demand) posted a balance of +17, the highest result for this series in three years. There were also some positive signals on the supply side with the new instructions indicator moving out of negative territory. That said, whether this pick-up will be sustained remains to be seen, given that average stock levels reported on estate agents' books remain close to record lows.

The RICS national price balance is consistent with a flattish picture for house price inflation in the first half of this year. Still, this headline gauge is being weighed down by negative price trends in London and the South East whilst prices are still reportedly rising in other parts of the country (Chart 9).

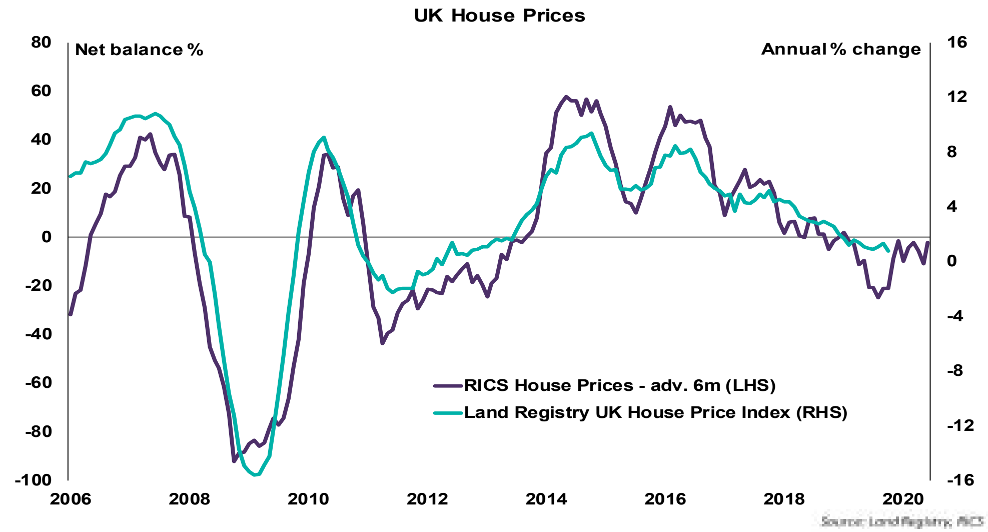
7. The latest RICS survey results point to an uplift in activity



8. Buyer enquiries have risen in the latest results



9. Price growth is set to remain broadly flat at the national level



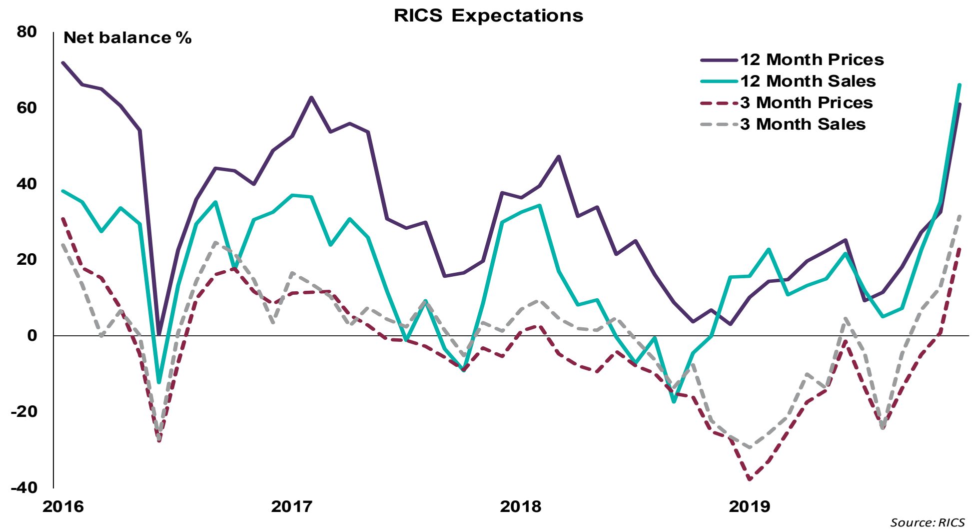
Housing Market

Outlook for both sales and prices strengthened in the latest RICS numbers, conceivably, a result of greater clarity following the decisive general election outcome. The twelve-month sales expectations next balance jumped to +66% in December 2019; this represents the strongest result for this series since 2014. At the same time, a net balance +61% envisaged prices to increase in the year ahead, signalling a material uplift in sentiment in comparison to the last couple of years (Chart 10).

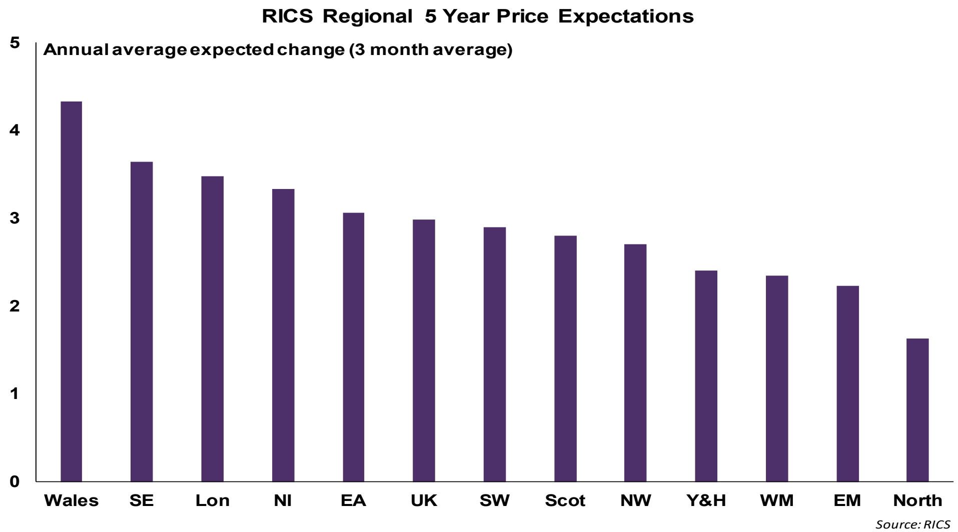
Significantly, following a broadly subdued price picture across London and the South East in recent years, RICS contributors expect a reversal in this trend over the medium term. As Chart 11 shows, projections for both regions are among the highest in the UK, with prices anticipated to rise by around 3.5% per annum over the next five years.

This is a particular concern given that affordability remains stretched in London and the South East. Indeed, house prices in London are more than twelve times average earnings. This compares to a ratio of eight for the UK and around five for the Northern Ireland, Scotland and North East (Chart 12).

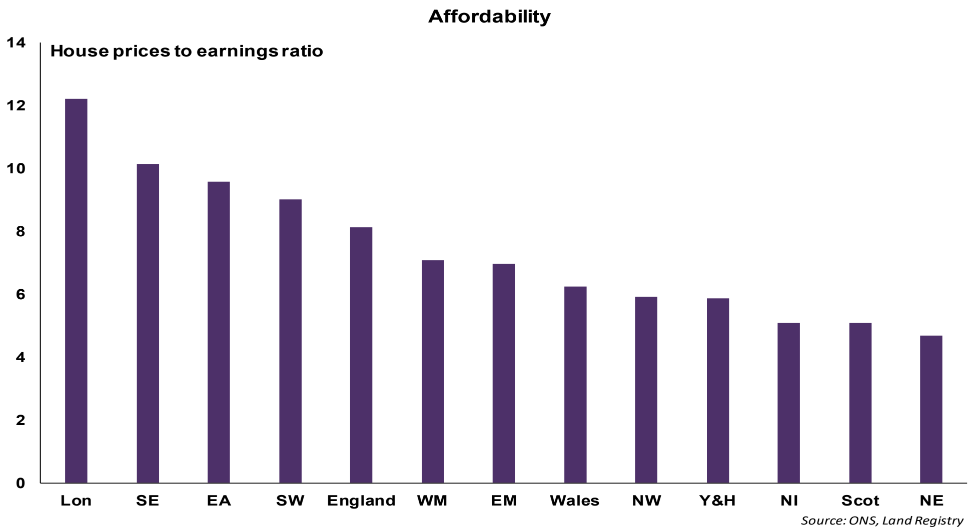
10. Outlook for activity and prices has strengthened



11. Medium term price projections are solid for London and SE



12. Affordability is particularly stretched in many parts of the UK



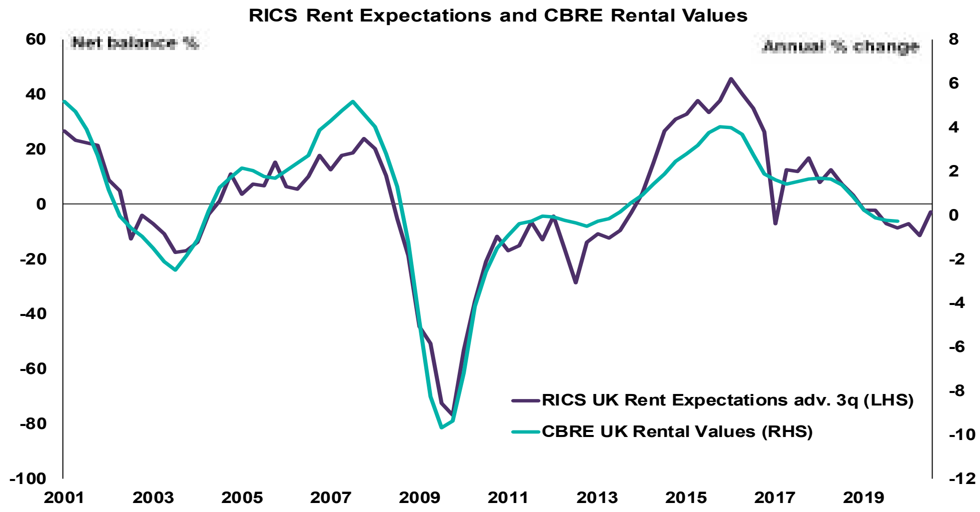
Commercial Property Sector

The UK commercial property market still seems to be shaped by diverging trends in the office, industrial and retail sectors. In the RICS survey, the headline rent expectations series is consistent with a broadly flat trend in all sector rental value growth over the coming quarters (as shown in Chart 13). However, this is mainly a result of a sharp fall in rental values envisaged for the retail sector whilst expectations for industrial and offices remain positive.

The retail sector is continuing to struggle against structural headwinds. According to CBRE data, rental values are declining by almost 4% on a year-on-year basis for shops and retail warehouses. Shopping centres appear to be the hardest hit, with rents falling by nearly 8% annually (Chart 14).

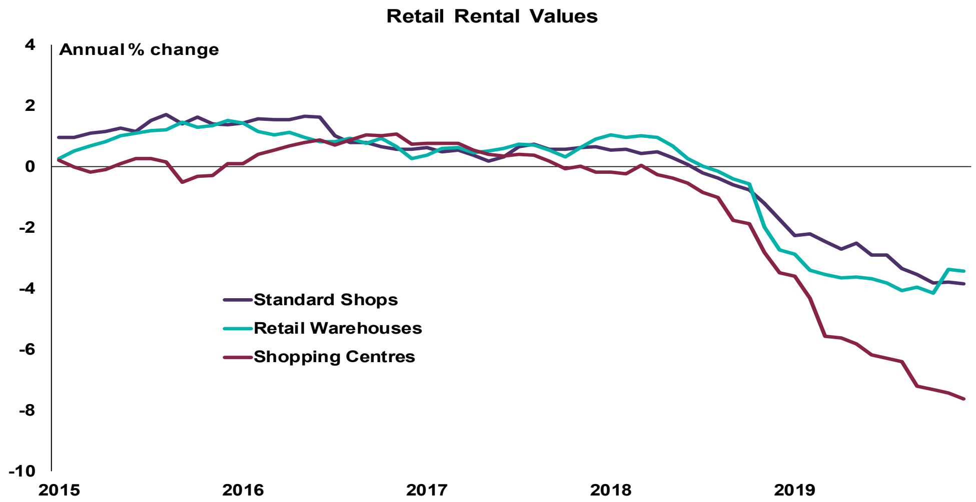
Rental value expectations for the coming year strengthened modestly in the latest RICS survey results with anecdotal evidence suggesting that greater political clarity is expected to drive a pick-up in momentum. That said, whilst contributors upgraded projections for industrial and office segments, no such improvement was envisaged for the retail sector (Chart 15).

13. Rental value growth is likely to remain flat in the near term



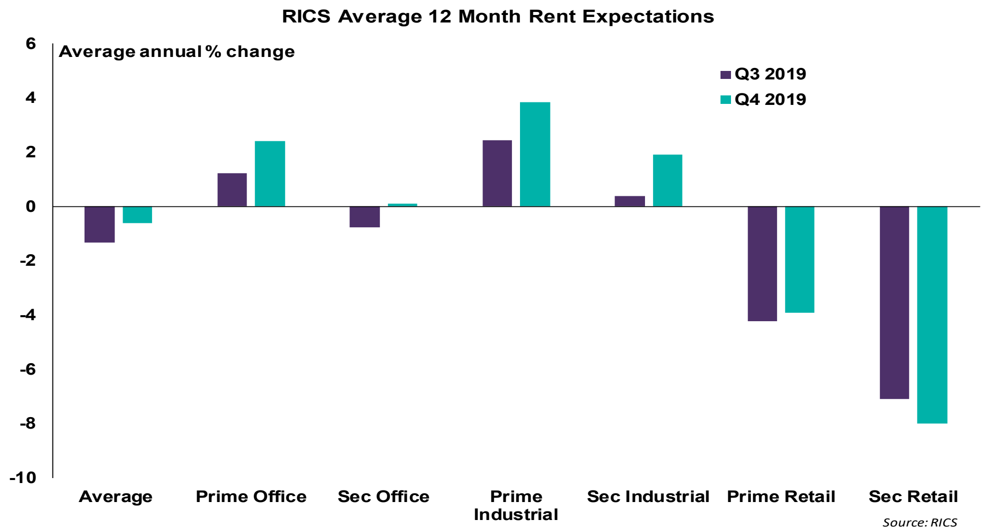
Source: CBRE, RICS

14. Rents are continuing to slip sharply across the retail sector



Source: CBRE

15. The downturn in the retail sector is likely to continue in 2020



Source: RICS

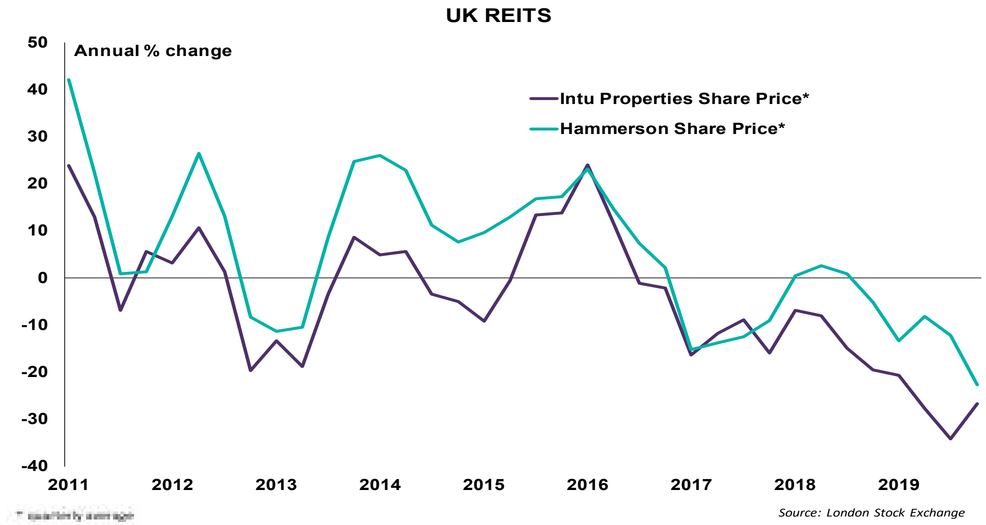
Commercial Property Sector

The performance of Real Estate Investment Trusts (REITS) is one instrument that helps to shed a little light on the challenges facing the retail portion of the market. Indeed, the share price of Intu and Hammerson, owners of shopping centres, retail parks and shops across the UK have seen their share prices drop significantly in the last three years on the back of a structural shift towards online spending (Chart 16).

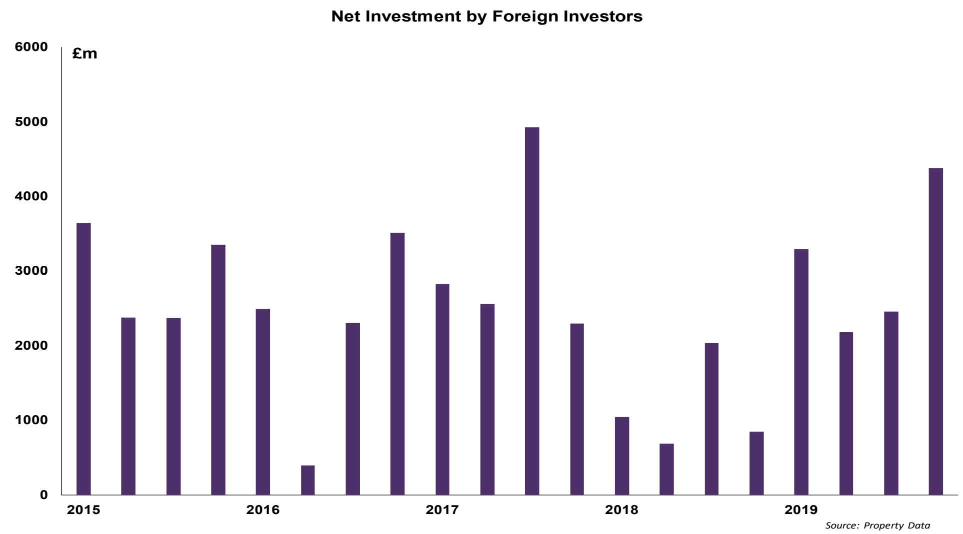
Meanwhile, there are signs that a modest fall in Brexit uncertainty in the final quarter of the year has led to a pick-up in foreign investment activity. Property Data estimates that net investment in the UK by overseas buyers was over £4.3 billion in Q4 2019, almost double the total for Q2 and Q3 (Chart 17).

In the RICS survey, near term capital value expectations ticked up in Q4 2019 suggesting a stable trend in prices could begin to emerge as the year progresses (Chart 18). The sector breakdown suggests that capital values are expected to rise across the industrial sector and (to a slightly lesser extent) in the office segment. In contrast, retail property prices are envisaged to fall over both the three and twelve month horizon.

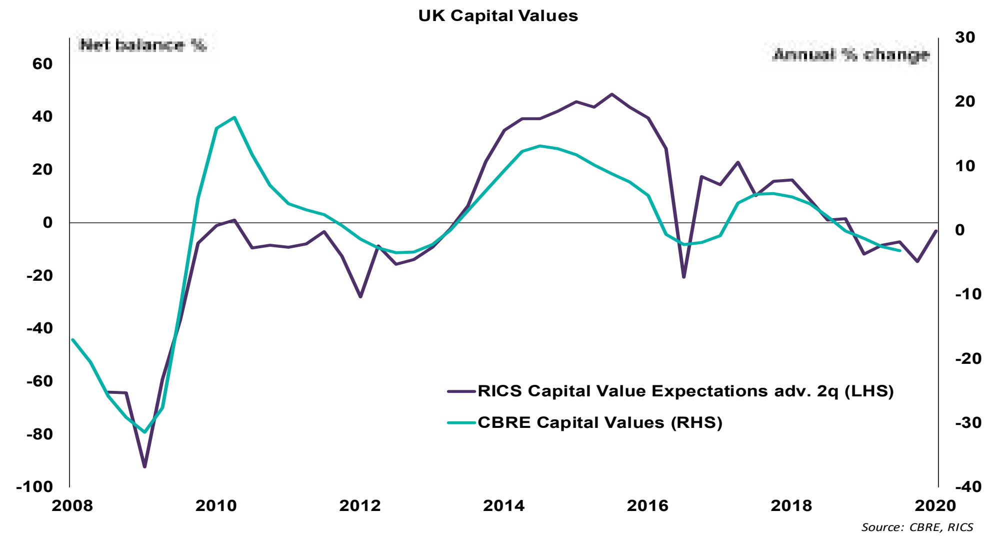
16. Share prices of Retail REITS have declined significantly



17. Investment activity bounced back in Q4 2019



18. Capital value growth looks likely to stabilise



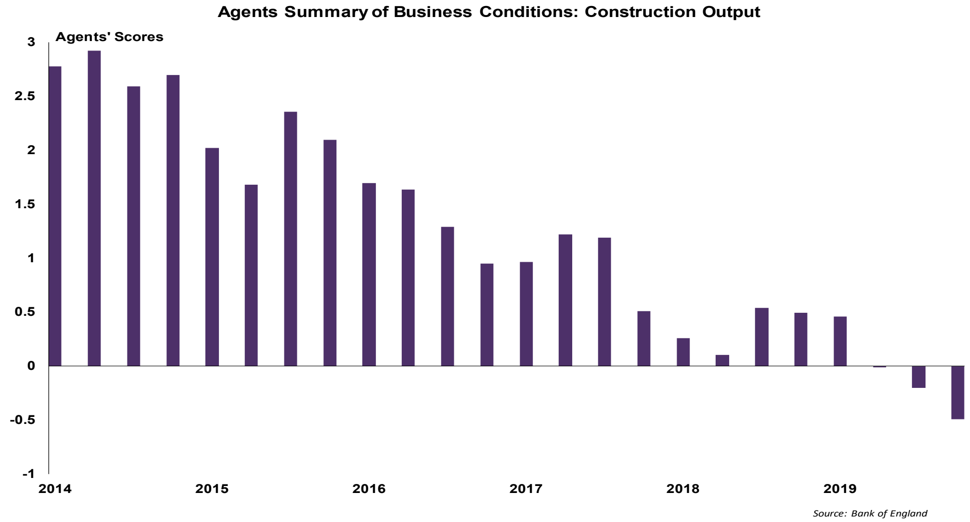
Construction Sector

Momentum across the construction sector appeared to be broadly subdued last year with economic and political uncertainty leading to delays in projects. This seems to be quite clearly visible in the Q4 2019 results to the Bank of England Agents Summary of Business Conditions survey where the Agents' score for construction output fell to its lowest level in more than six years (Chart 19).

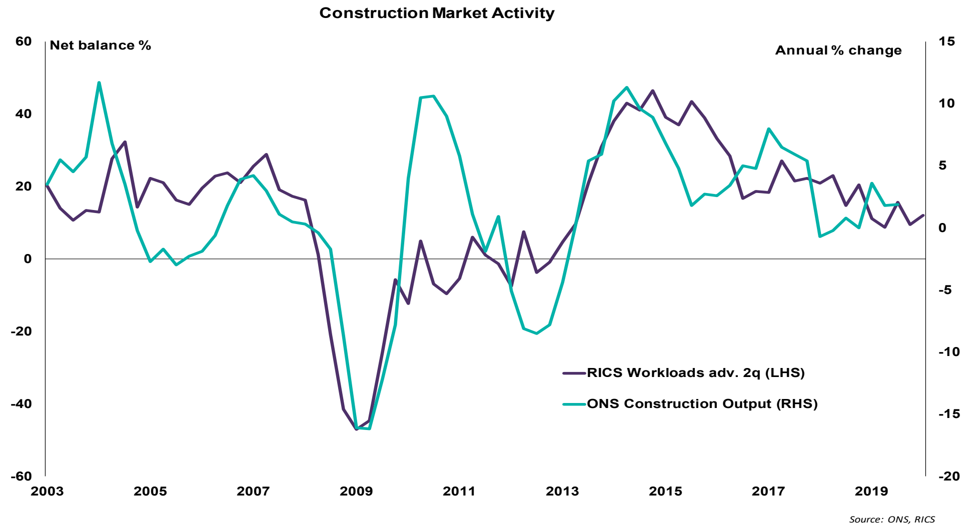
In the Q4 2019 RICS UK Construction and Infrastructure Market Survey, a net balance of 12% of surveyors reported an increase in workloads in Q4 2019. Although still consistent with a modest increase in output across the sector, this result represents a slowdown in activity when compared to the last few years (Chart 20). This indicator is now pointing to flattish trend in construction output growth in the first half of 2020.

However, looking at the results on a sector level, RICS survey contributors did note a pick-up in activity across the private commercial sector with the net balance edging up to +11 in Q4 from +2 in Q3 (Chart 21). Alongside this, both housing infrastructure workloads were also said to have risen firmly which may continue with additional fiscal spending expected to be announced in the upcoming budget.

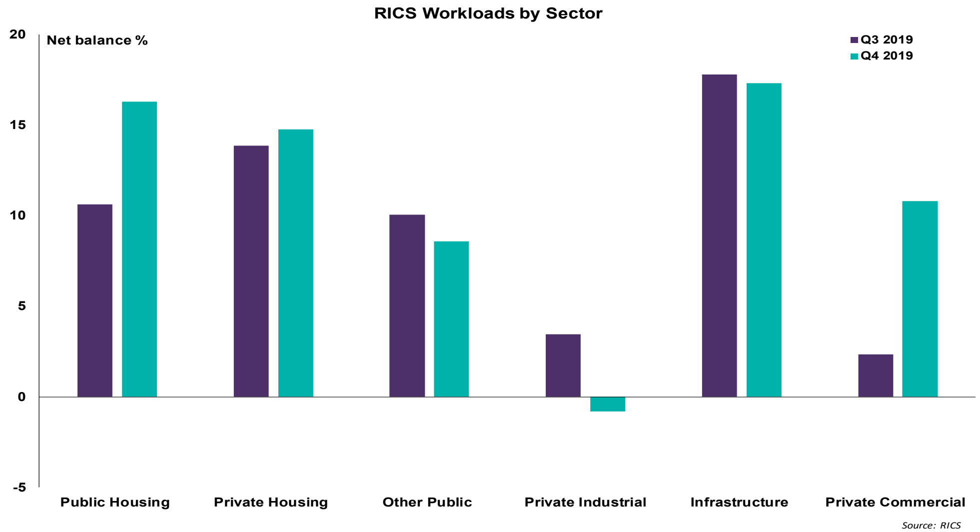
19. Construction output dipped near the back end of 2019



20. Construction output growth looks likely to remain flat



21. Though workloads are still reportedly rising in most sectors



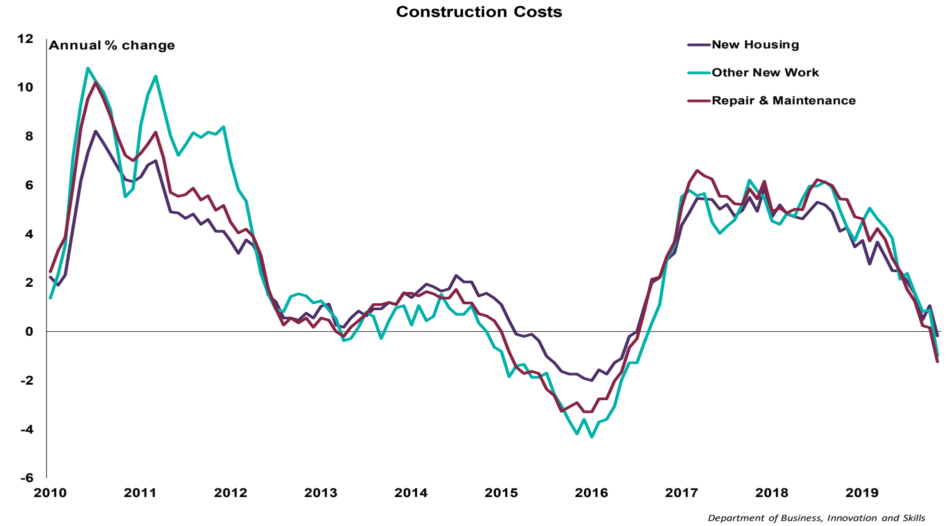
Construction Sector

According to government statistics, prices of building materials have slipped on a year-on-year basis (as shown in Chart 22). Taking a closer look at the data, the largest price fall was a 20% annual decrease in imported plywood. Alongside this, after rising firmly in the last three years, the price of steel appeared to have stabilised. However, this trend could significantly reverse in the medium term if tariffs are put in place on imports from the EU after the transition period comes to an end.

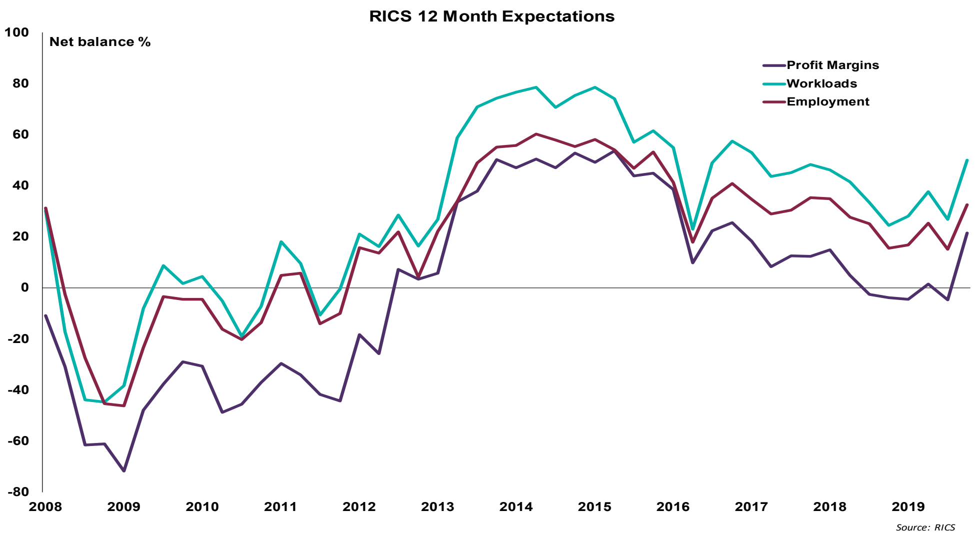
The results to the latest RICS survey point to an uptick in market confidence. The twelve-month expectations for profit margins net balance reading edged into positive territory, coming in at +21% after remaining in -/+5% range for more than a year. At the same time, contributors also envisaged an acceleration in workloads and employment (Chart 23).

At the same time, the latest RICS data continues to highlight significant skills shortages across the sector with the deficiency particularly acute in quantity surveying and bricklaying. Crucially, a likely drop in immigration following Brexit could exacerbate this shortage further (Chart 23).

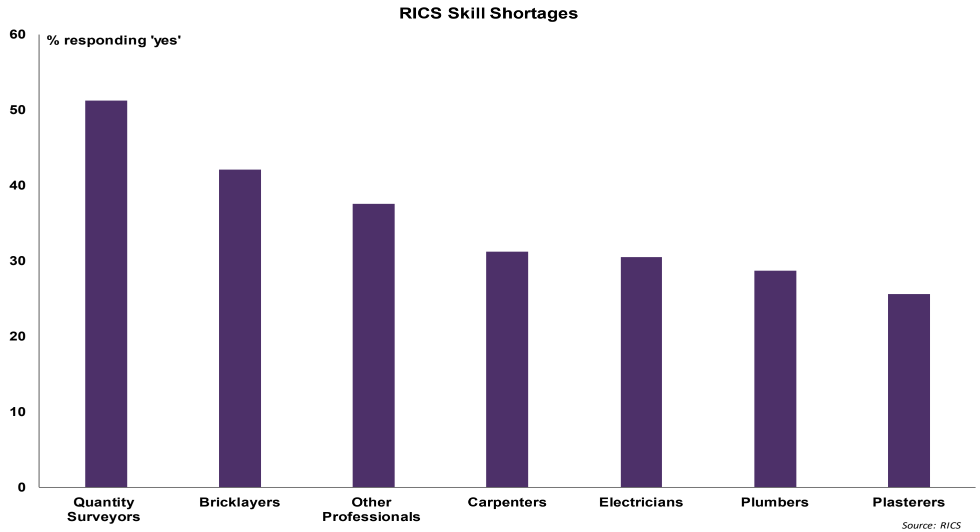
22. Material costs are falling on an annual basis for now



23. Market confidence ticked up in Q4 2019



24. Contributors continue to report a shortage of skilled labour



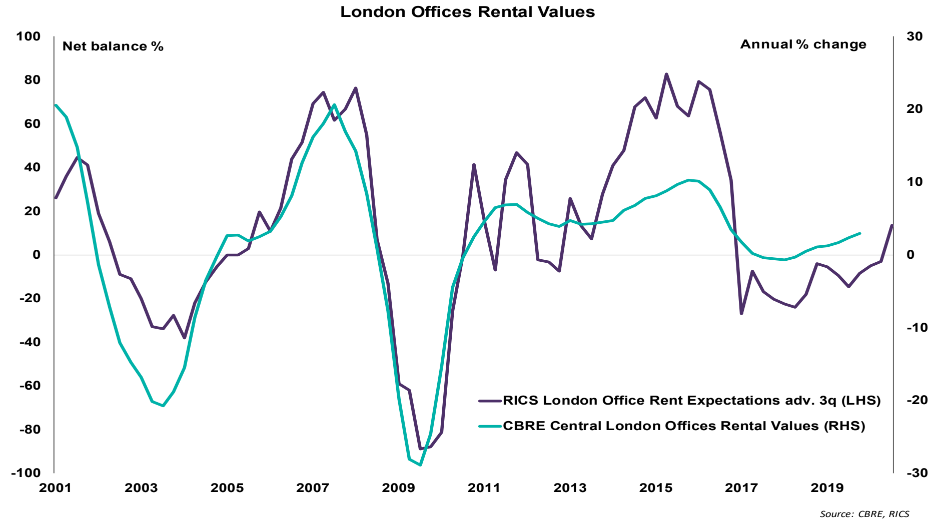
London

London's labour market remains firm with the employment rate at 66.5%, the highest since records began. This is reflected in the generally firm trend in demand for commercial property in the capital. In RICS UK Commercial Property survey, the London office rent expectations net balance edged up to +14% in Q4 2019 pointing to an increase in office rental values in the coming months (Chart 25).

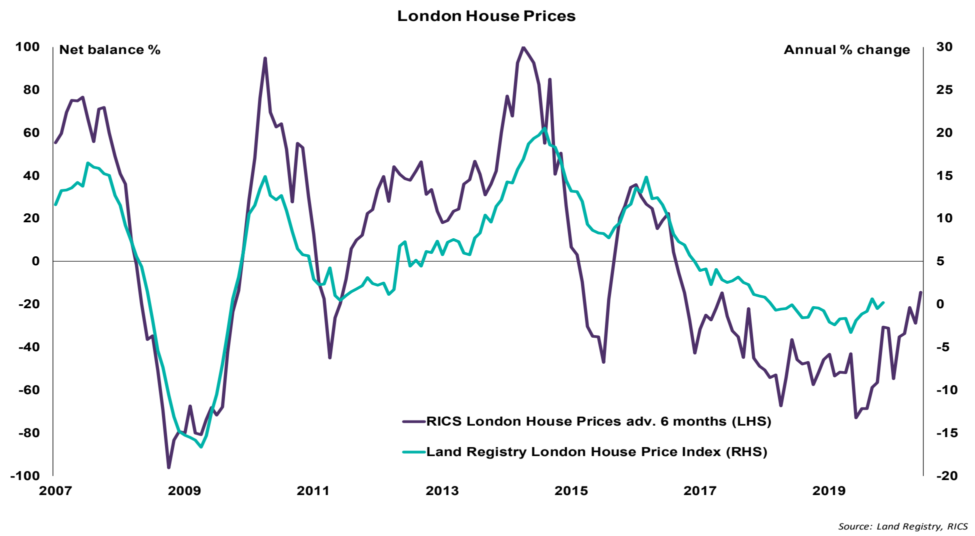
Moving to the residential market, analysis by Knight Frank suggests that the mood music in the prime London property market has become more positive since the general election with a significant uplift in high-end deals reported. In the RICS survey, the London price picture also looks relatively less downbeat when compared to the previous two years. The house price balance nudged up to -14% in December 2019 from -29% in November (Chart 26).

Critically, in the lettings market, RICS survey results continue to suggest that landlord instructions are falling in London on the back of changes in the tax treatment of buy-to-let properties. Alongside this, tenant demand is still rising across the capital. As a result of this imbalance, rents look likely to rise firmly over the course of the year (Chart 27).

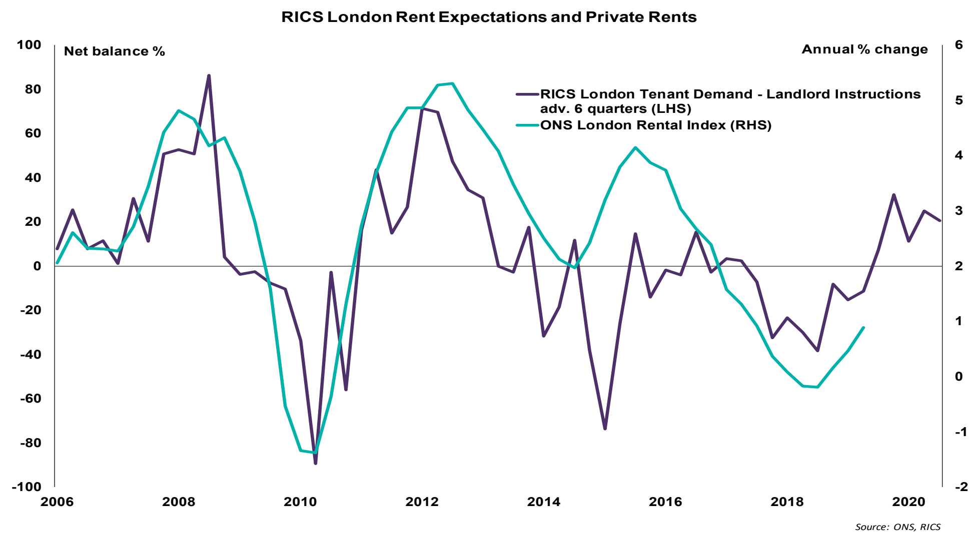
25. London office rents are envisaged to rise



26. It looks as if the London price trend is beginning to stabilise



27. Rents look likely to rise sharply in the coming year

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