

15/04/2021

# UK ECONOMIC AND PROPERTY OUTLOOK

**ECONOMICS AND FORECASTING  
TEAM**

**CBRE**



## MAIN POINTS

### **GDP is expected to fall 2% over Q1**

- Monthly GDP grew 0.4% in February. This is a marked uptick from the 2.2% fall in January, despite no change in lockdown restrictions. This brings economic activity to around 8% below pre-pandemic levels.
- The consumer-facing service sector remains far below pre-pandemic levels, even though service sector activity did increase marginally over the month.
- High-frequency indicators, such as job vacancies and CHAPS payment data, coupled with the reopening of schools reopening, suggest continued improvement. So we expect positive economic growth in March.
- All in, we expect a 2% fall q/q in Q1 2021.

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### **Vaccine rollout success and strong recovery from Q2**

- On April 12 England took the second step of the four-part roadmap, relaxing restrictions on non-essential retail and outdoor hospitality. If the vaccine roll-out continues as planned a large part of the economy will re-open in mid-May, with the remaining restrictions lifted in late June. This will unlock considerable service sector consumption and give energy to the recovery.

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### **Fiscal policy remains expansionary**

- The government has extended Covid-19 related support to the end of the Autumn, a few months after the expected lifting of restrictions. Given our view of strong consumer demand in Q2 and Q3 we now expect unemployment to peak below 6% in Q2 2021. This is a considerable improvement on our January 2021 forecast.

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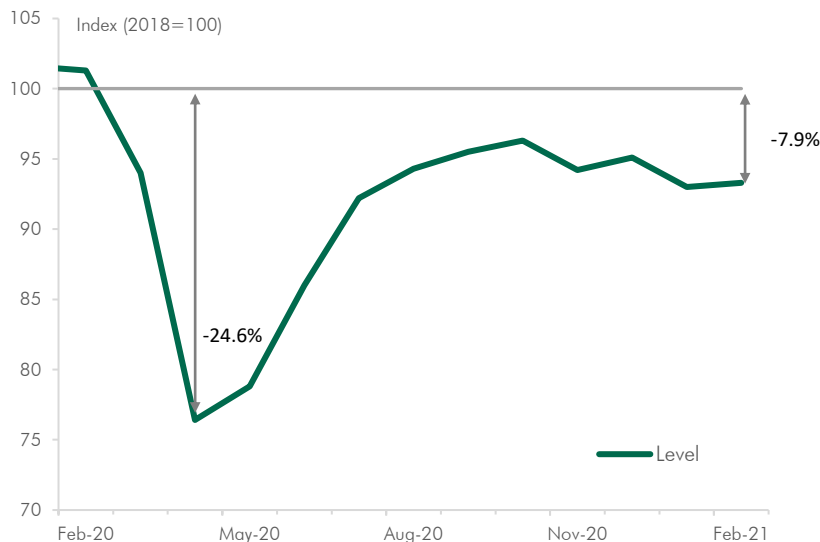
### **Low interest rate environment to continue**

- Our view remains that inflation will rise to 2% in H2 2022 following base effects and rising commodity prices, but that a general and sustained rise in inflation is unlikely. Because of this, we maintain that the Bank of England will keep rates on hold until at least 2023 while continuing to purchase £150bn worth of assets as agreed at the November MPC meeting.

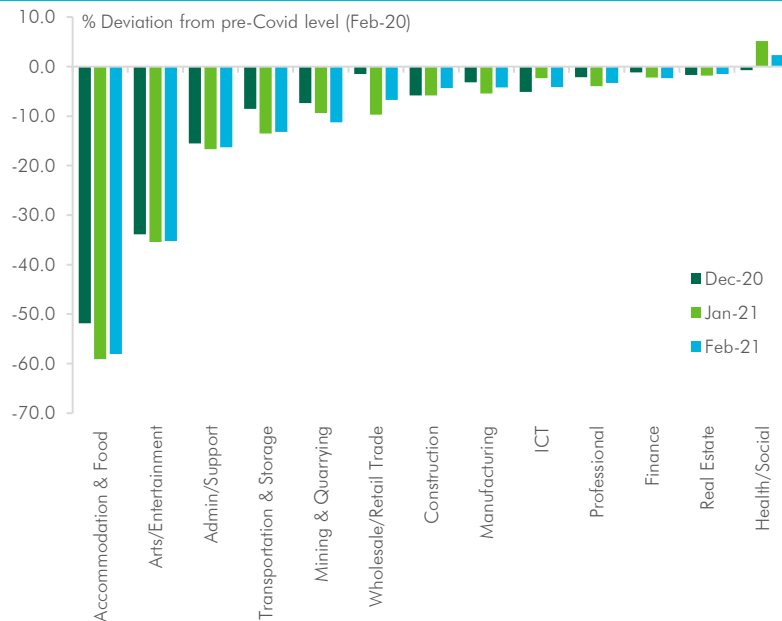
## ECONOMIC SETTING

Monthly GDP in the UK increased by 0.4% in February. This suggests that economic activity is around 8% below pre-Covid levels. Despite increasing 0.2% month-on-month, the service sector remained weak in February as the lockdown restrictions meant consumer-facing services remained closed. On the other hand manufacturing and construction output, which are less affected by the current set of restrictions, continued to grow strongly. High-frequency indicators point to a continued increase in activity in March, with credit and debit card spending and job advertisements trending notably higher. Coupled with the reopening of schools on 8 March (which will have also boosted activity) we expect Q1's GDP fall to be just 2% quarter-on-quarter; a fraction of the 19% quarter-on-quarter fall seen in the first lockdown in Q2 2020.

### UK GDP (GVA)



### UK GDP by Sector (GVA)



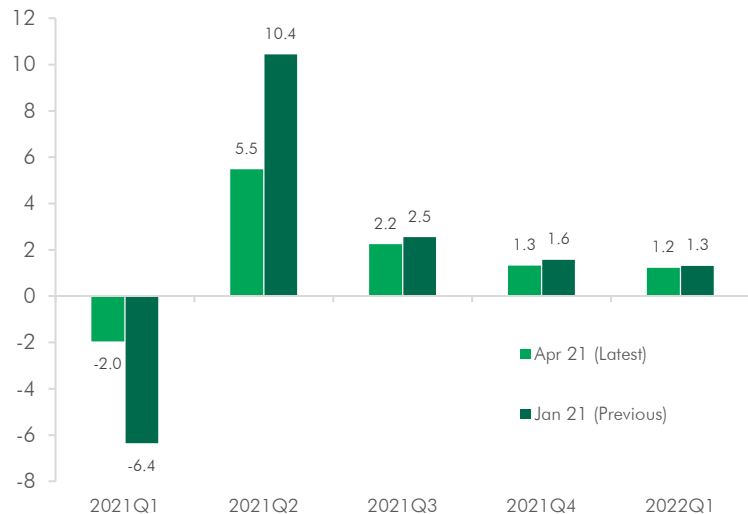
Source: ONS, CBRE Research

## LOOKING AHEAD

Looking forward, we remain confident of a strong consumer-led recovery from the second quarter. As a consequence of the Covid-19 pandemic restrictions on spending and travel, households have amassed excess savings of around £180bn, or 10% of 2020 UK GDP. If all goes well with the vaccine roll-out and the emergence of vaccine-resistant variants does not become an issue, a large part of the economy will be open in mid-May. The remaining restrictions will be removed in late June, unlocking considerable service sector spending in the economy. We therefore remain optimistic about the UK outlook for the rest of the year. We expect GDP growth of 5.5% in Q2 and 6.7% for 2021 as a whole. This is considerably higher than our 4.2% forecast for the Euro Area which is wrestling with another wave of Covid-19 infections.

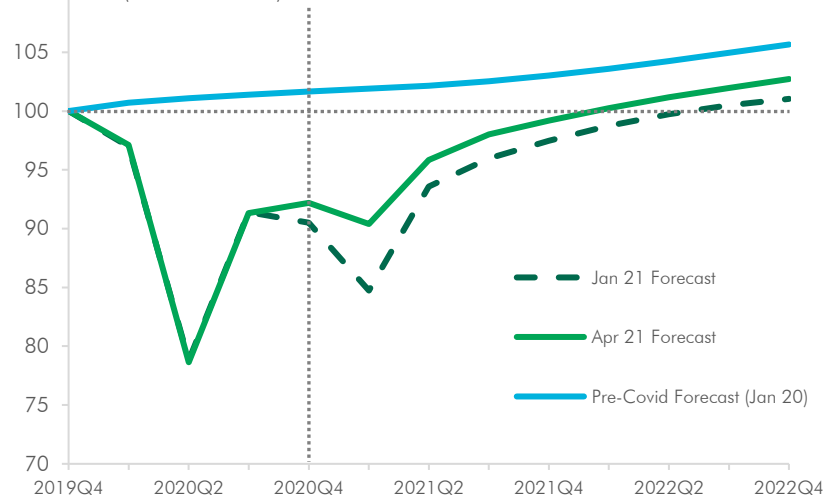
### UK: Real GDP

Q-o-Q %, (non-annualised)



### UK: Real GDP

Index (2019 Q4 = 100)



Source: Oxford Economics, Macrobond, CBRE Research

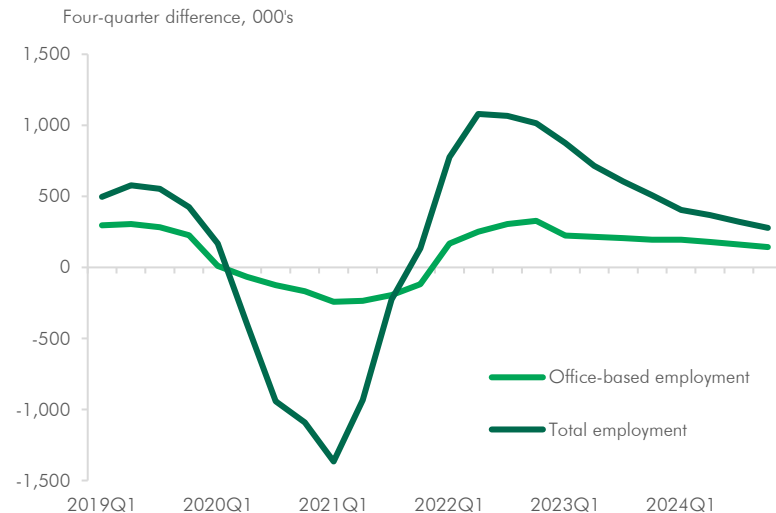
## EMPLOYMENT

In addition to the strong consumer-led recovery, the government loosened the fiscal stance in 2021/22, extending Covid-related support until the end of the Autumn and implementing a two-year 130 per cent 'super deduction' capital allowance that should incentivise firms to bring forward capital spending plans and boost business investment. With the Job Retention Scheme (furlough) extended beyond the lifting of restrictions, we now expect strong demand in the consumer-facing service sector to limit the extent of joblessness; we expect unemployment to peak below 6% - considerably lower than 7.2% we had factored in in our January 2021 forecast. Office-based employment, which is a better predictor of office demand, continues to fare better in the forecast period.

### UK: Unemployment rate (ILO)



### UK: Employment

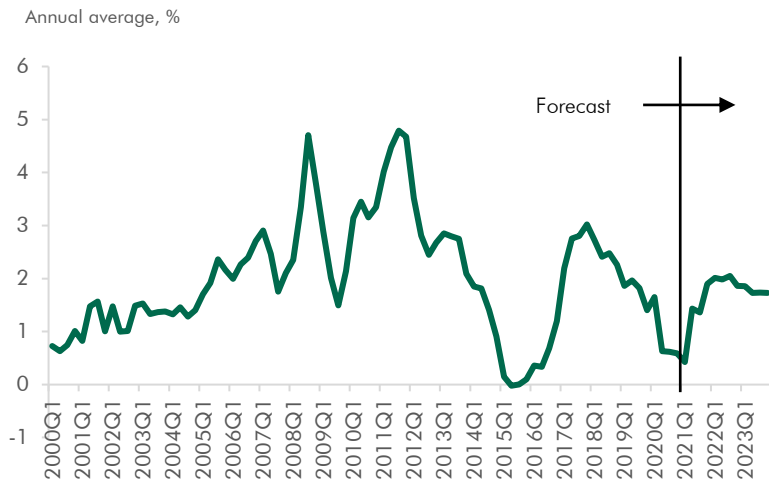


Source: Oxford Economics, CBRE Research

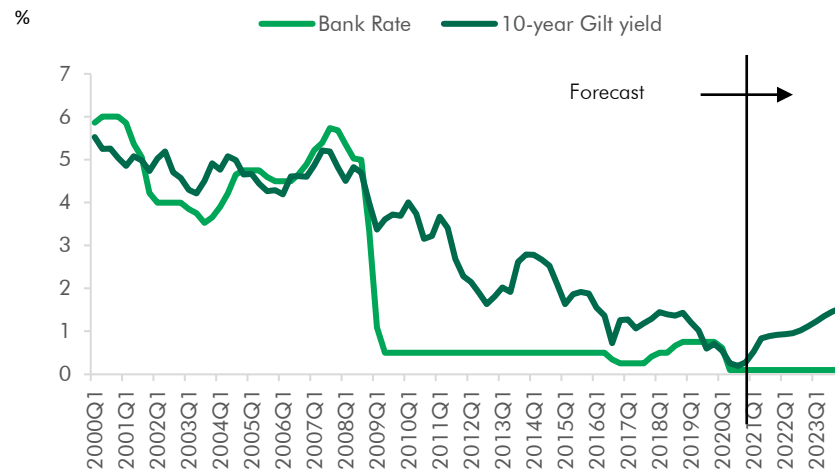
## INFLATION AND INTEREST RATES

A swift recovery could lead to supply bottlenecks and strong demand will cause some prices to rise temporarily. However, our view remains that while base effects and rising commodity prices will push up headline CPI inflation to 2% in H2 2022, the conditions for a sustained rise in general inflation remain muted. As such, the Bank of England will remain committed to maintaining a low interest rate environment – keeping the Bank Rate on hold until at least 2023 and continuing the £150bn worth of asset purchases authorised at its November 2020 meeting. Long-term interest rates have drifted up from the extremely low levels seen during the peak of the Covid-19 pandemic, and will continue to rise further as the economy recovers. That said, we maintain that this is still very much a lower-for-longer interest rate environment, which remains favourable for prime property markets.

### UK: CPI Inflation



### UK: Interest rates

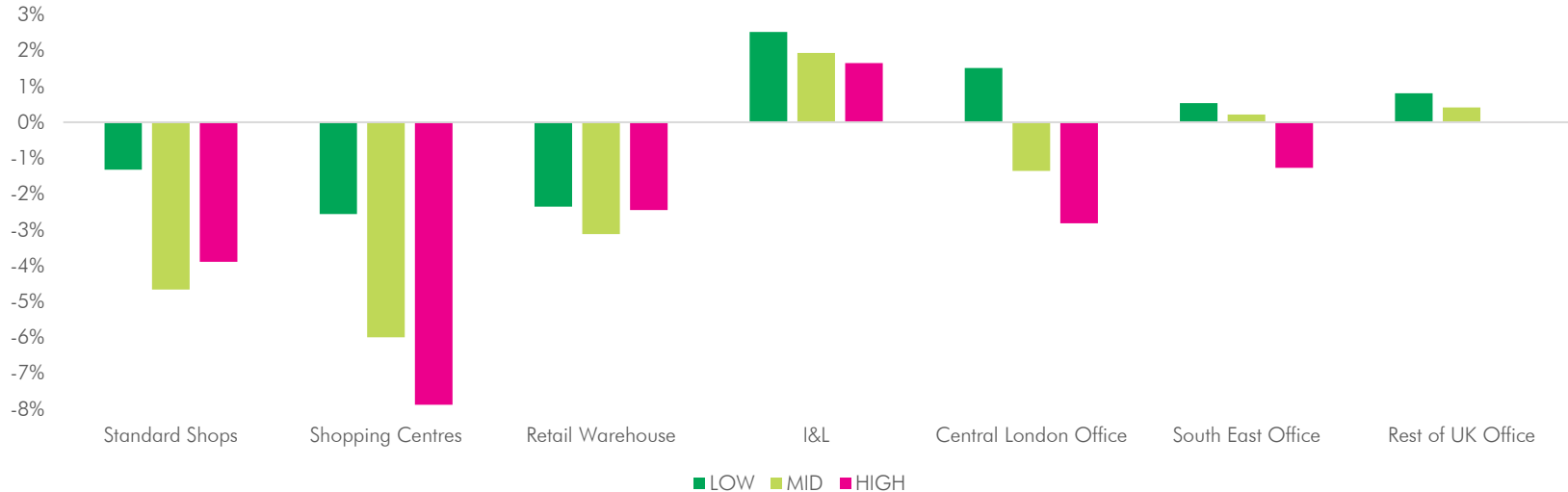


Source: Oxford Economics, Macrobond, CBRE Research

## PROPERTY SECTOR: RENTAL OUTLOOK REFLECTS THE RISKS AROUND THE SECTORS

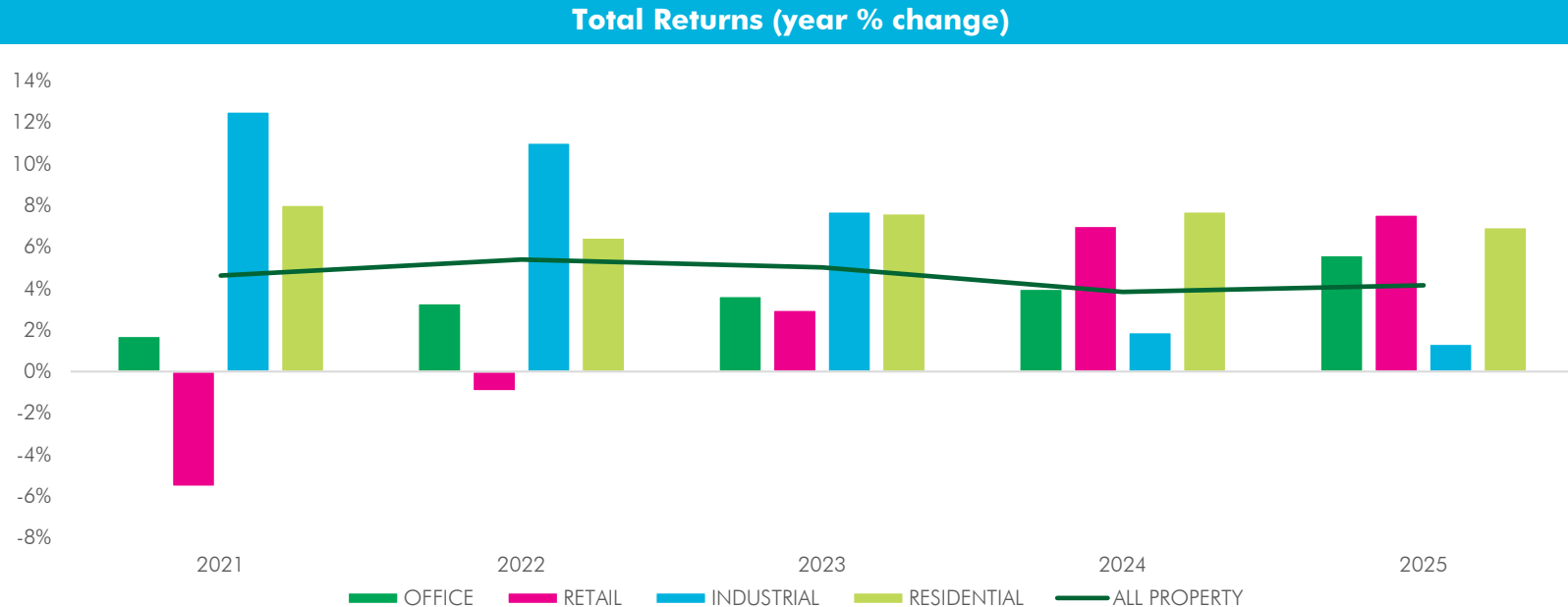
Our forecasts, based on MSCI data, show the expected rental performance by sector and quality. Across the board rents are falling in the retail sector, with the largest declines in shopping centres. Retail warehouses are anticipated to fare better, and have less variation across the qualities. I&L has 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. Overall, we assume that low yielding quartiles are de facto prime so expect a similar performance for prime over the next five years.

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



## PROPERTY SECTOR: INCOME RETURNS AND VALUE GROWTH SUPPORT TOTAL RETURNS

Aggregate All Property total returns look fairly stable over the next 5 years, with a high of 5.4% in 2022 and a low in 2024 of 3.8%. 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 three years – as the continuation of yield falls pushes values. We forecast a recovery in retail in the later years as yield rises stop as the second reaches a new pricing condition. The residential sector provides both steady and high returns and this is in part due to the demand and supply conditions combined with investor appetite supporting pricing. We forecast modest rental activity, steady income and some value appreciation in the office sector that produces steady returns.







## CONSIDERATIONS

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- Our forecast assumes the relaxation of restrictions follows government road map set out in February. Implicit in this assumption is that no vaccine-resistant variants emerge in such a way as to disrupt the timetable for the opening of the economy. As the timing and extent of the lifting of restrictions remains a key factor in our near-term outlook, any deviation from the road map will have ramifications for our short-term outlook.
- We have taken a cautious view on the extent to which excess savings will be spent over the next two years. This is because a large proportion of excess savings have been accumulated by wealthier households who typically have a lower marginal propensity to consume. If we have been overly cautious this remains a clear upside risk to the outlook.
- We have taken the view that the Covid-19 pandemic will not do too much permanent damage to the supply side of the economy, though long-term scarring is possible. This would imply that there is less slack in the labour market, and a faster closing of the output gap. This is an upside risk for inflation. The same would be true if excess savings are run-down faster than we've assumed in our base case.

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