RICS

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Economy and Property Market Update

November 2024

Tentative signs of improvement evident across property markets

ECONOMICS

Summary

The recent continued easing in inflationary pressures allowed the Bank of England to deliver a second cut to policy interest rates in November, with the general macro backdrop turning a little more favourable for property markets during Q3. Indeed, data from the suite of RICS surveys points to a modest improvement in sentiment, with forward-looking indicators also exhibiting more positive momentum. Nevertheless, with the Chancellor's October Budget widely seen as inflationary, and therefore likely to limit the scope for further monetary policy loosening in the months ahead, this could weigh on the recovery as we move into 2025.

Economy

The latest data tracking activity across the UK economy suggests momentum has faded recently, with the composite purchasing managers index for October posting the softest reading over the past eleven months. Moreover, ONS statistics show GDP growth slowed to just 0.1% in Q3, noticeably softer than the 0.5% expansion seen in Q2. Nevertheless, consensus forecasts still point to the UK GDP expanding at an average annual rate of approximately 1% for 2024 (Chart 1), marking an improvement on the stagnation seen in 2023. Also reflected in Chart 1, the outlook for 2025 is somewhat more positive, with average growth projections hovering closer to the 1.5% mark.

The highly anticipated Autumn budget delivered by Chancelor Rachel Reeves is expected to provide a short-term boost to the economy, given the direct impact of the policy changes announced increases current spending by £25bn this fiscal year. That said, this near-term support is expected to be transient for a few reasons. Firstly, the Office for Budget Responsibility estimates that Budget policies will push up inflation by around 50 basis points, leading to fewer interest rate cuts from than Bank of England than would have otherwise been delivered. In addition, the fiscal watchdog sees the rise in employer national insurance contributions as likely to reduce labour supply by around 0.2% (a little over 50,000 on an average-hours equivalent basis). Meanwhile, although the plans announced in the Budget raise cumulative public investment spending by £100 billion by 2029-30, the OBR expects this to crowd out some private investment in an economy with little spare capacity (Chart 2).

Turning to monetary policy, the recent MPC meeting saw base rates cut by 25bps to 4.75%, the second reduction in policy rates since the easing cycle was initiated in August. However, the likelihood of a further cut as soon as December seems uncertain. The latest data from Refinitiv shows that 65% of respondents now believe a December cut is probable, down from 85% last week, with the Bank of England now expected to take a more cautious approach to unwinding monetary policy. Nonetheless, with the UK unemployment rate ticking up to 4.3% recently (compared to an estimated 4.1% last month) this is one factor that could perhaps raise the chances of seeing one further cut before the end of the year. Indeed, this suggests labour market conditions are continuing to weaken, which should place further downward pressure on wage growth moving forward. As it stands, though, pay growth across the private sector is still running at an annual pace of 4.9% (Chart 3). The Bank of England would be more comfortable with a rate of closer to 3-3.5%, as this pace of earnings growth is seen to be consistent with inflation remaining sustainably around the 2% target. As such, there remains plenty of reasons for the MPC to tread carefully for now, even if the headline rate of consumer price inflation has fallen back in-line with target in recent months.

Chart 1: Growth forecasts for 2024 remain close to 1% but the outlook is a little stronger regarding 2025

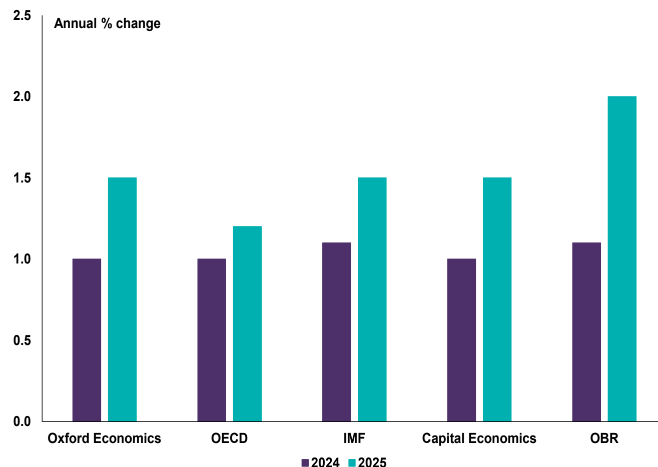


Chart 2: The OBR sees only a temporary boost to GDP from policy measures announced in the Budget

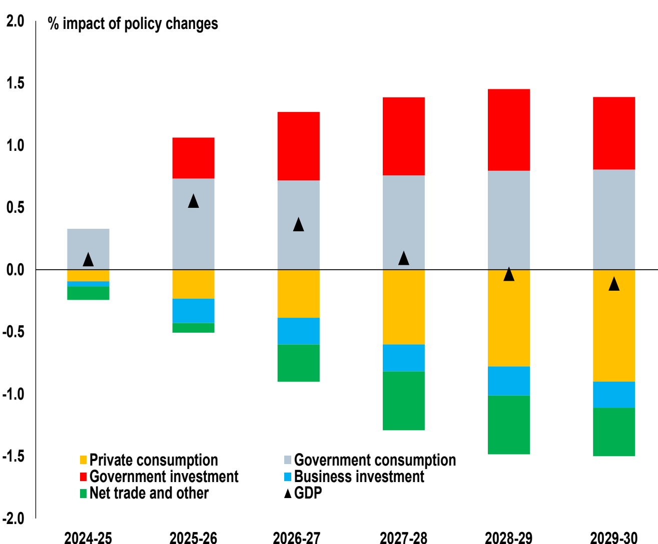
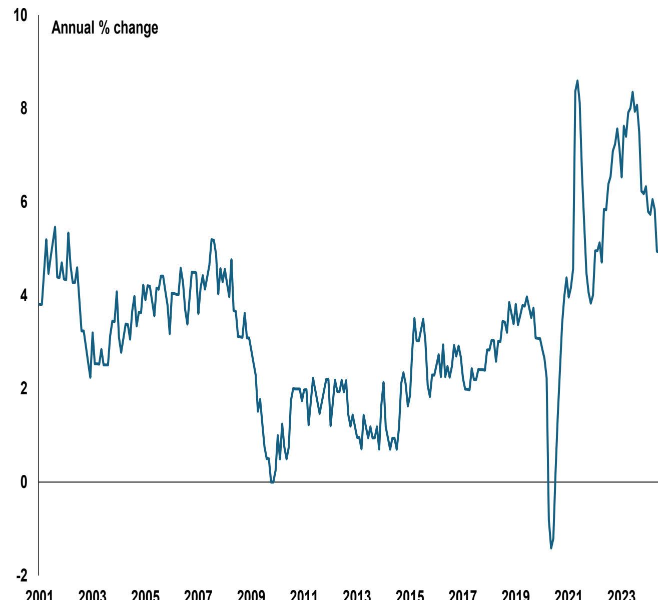


Chart 3: Although growth in earnings has cooled, it remains stronger than the level thought to be consistent with 2% inflation



Commercial Property

Buyer activity across the UK commercial property market remains relatively subdued, despite a modest improvement emerging over the summer period. The latest data from Lambert Smith Hampton (Chart 4) shows CRE investment volumes came in at £11.2bn during Q3, up from £9bn in the same quarter of 2023, albeit still 6% below the five-year average. On a more positive note, the number of transactions increased by 30% compared to Q2, with the number of deals completed reaching a three-year high. Similar to last quarter, the data points to something of a resurgence in the retail segment, with £2.7bn of assets changing hands, the strongest total in over seven years.

The latest results from the RICS UK Commercial Property monitor included a few tentative signs of encouragement for the market going forward, even if momentum remains quite underwhelming at present. Chart 5 depicts that just under half (44%) of respondents now believe that market conditions are consistent with the early stages of an upturn, marking a continued increase 38% and 41% in Q1 and Q2 respectively. Supporting this shift in sentiment, recent rate cuts from the Bank of England, alongside the prospect of further cuts in the coming quarters, appears to be feeding into an improved credit environment across the sector. Indeed, a net balance of +27% of respondents reported some degree of easing in credit conditions during Q3, up significantly from last quarter's +7%. That said, the recent rise in bond yields, on the back of what has been seen as an inflationary Budget, may prove a headwind for the market moving forward. Even so, this is likely to slow the rate of recovery in buyer activity, rather than derail it entirely.

Chart 6 illustrates expectations (captured from RICS members) for both rents and capital values amongst different asset classes at a twelve-month time horizon. All alternative asset classes featured in the survey display positive expectations for both variables, with the most upbeat projections being exhibited across multifamily residential, data centres, aged care facilities and student housing. Once again, prime properties are expected to continue to outperform their secondary counterparts, reinforcing the divergence seen in recent quarters. This disparity is most evident within the office market, where positive capital value and rental expectations for prime stand in stark contrast to the continued negative views on secondary. On a similar note, research conducted by Savills found that the UK office market saw strong office take up in Q3 (the best since 2018), primarily driven by businesses increasingly seeking out grade A buildings which comply to environmental and sustainability standards.

Chart 4: Investment volumes have improved over the past couple of quarters but remain subdued on a longer term comparison

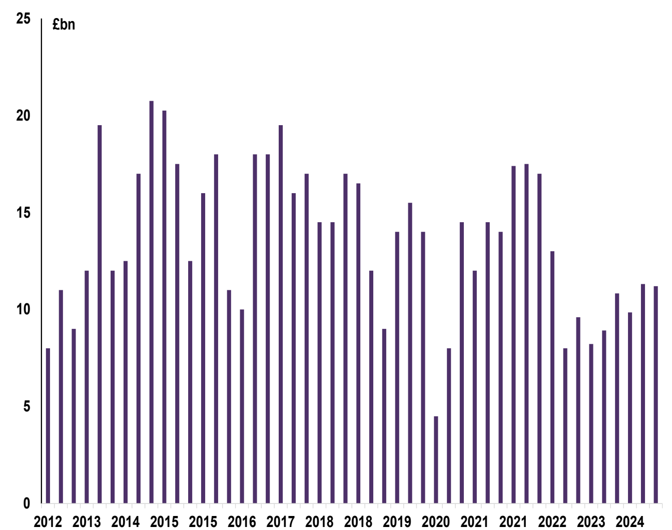


Chart 5: Views on the current stage of the cycle continue to shift gradually in a more positive direction

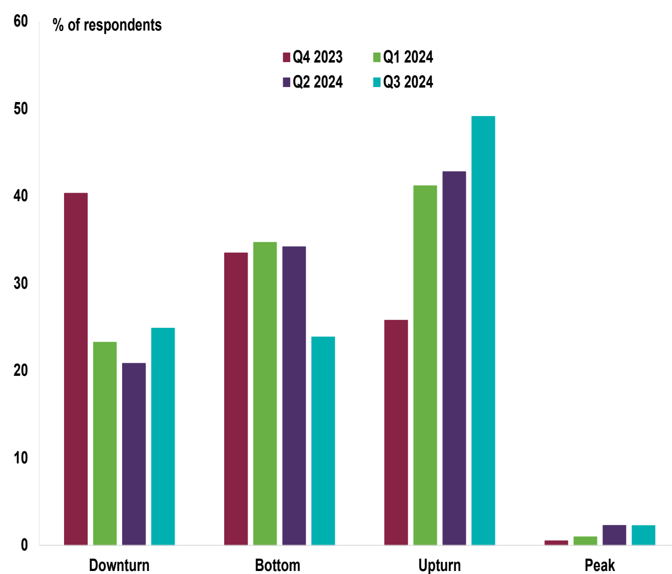
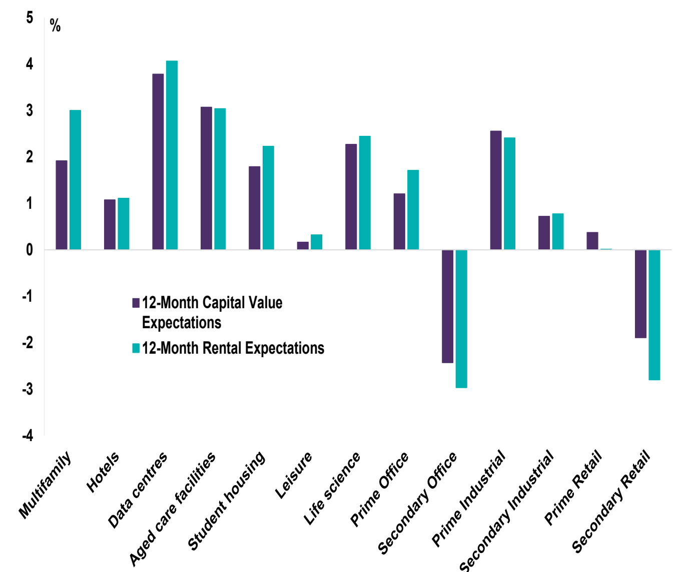


Chart 6: RICS member's twelve-month projections for capital values and rents remain more positive for alternative assets



Residential Property

Data from the RICS UK Residential Market Survey shows market conditions continuing to brighten of late. At the national level, a net balance of +12% of respondents reported a rise in buyer enquiries during October, representing the fourth consecutive month in which this indicator has been in expansionary territory. Moreover, the improvement in demand has translated into a pick-up in the volume of sales being agreed, evidenced by a net balance reading of +9% being posted for the survey's gauge of sales activity (the best reading since 2021). This chimes with the most recent data on mortgage approvals from the Bank of England, which has increased in four successive months, with the September total 49% higher on an annual comparison (and now broadly in-line with the average monthly volume seen over the past decade).

Accompanying the recovery in buyer demand, house price growth appears to have gained momentum over the past few months. Indeed, the RICS house price net balance rose to +16% in October, a noticeable increase from the reading of -16% seen as recently as July. Moreover, the twelve-month house price expectations series posted a net balance of +47% in the latest iteration of the survey, signalling a firmly positive outlook. Given the RICS sentiment data typically offers a six-month lead over the house price indices produced by various sources, this implies growth will accelerate in the months ahead. As it stands, the latest figures from the Nationwide house price index point to a 2.5% annual increase at the national level, while the Land Registry's data is marginally firmer at 2.7% (Chart 8). The Lloyds index, meanwhile, signals even stronger momentum, with their estimate suggesting prices have risen by 4.3% over the past year. By way of contrast, Rightmove's measure of asking prices shows a flatter trend, increasing by just 0.8% compared with this point last year.

Turning to the lettings market (Chart9), the RICS tenant demand gauge registered a reading of +19% in Q3 (unchanged from last quarter). Although still consistent with an upturn in demand, growth does appear to have cooled relative to the exceptionally strong picture seen through much of 2023. It is important to note, however, that there has been a sharp drop in landlord instructions being listed on the market, with the net balance slipping to -29% for Q3 2024, from -17% in Q2. Crucially, respondents have consistently highlighted that landlords are leaving the market amidst tougher regulations imposed on them and rising mortgage payments. This is subsequently exacerbating the existing mismatch between supply and demand in the rental market. Furthermore, the additional stamp duty surcharge that landlords pay when purchasing a buy-to-let property was increased from 3% to 5% in the latest Budget. This is likely to place even more pressure on supply across the lettings market. That is certainly the assessment of Capital Economics, with their estimates pointing to a net loss of half a million homes to rent, as a result of the policy change, over the next 10 years.

Chart 7: Increased positivity continue to strengthen with agreed sales and enquiries up from last quarter

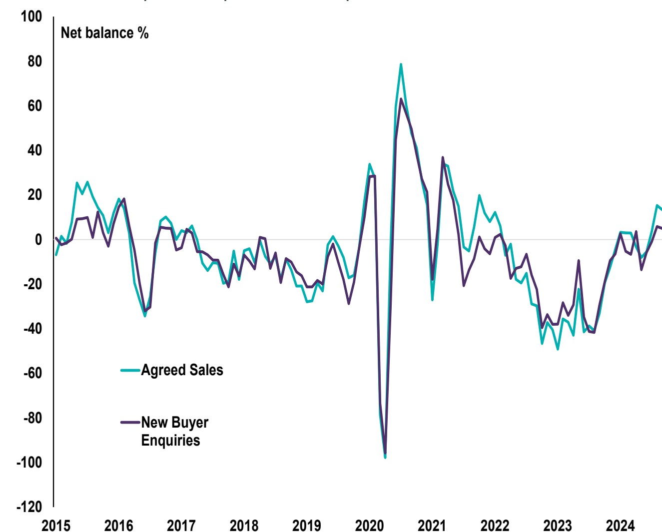


Chart 8: House prices gain further momentum across the various indices on annual basis

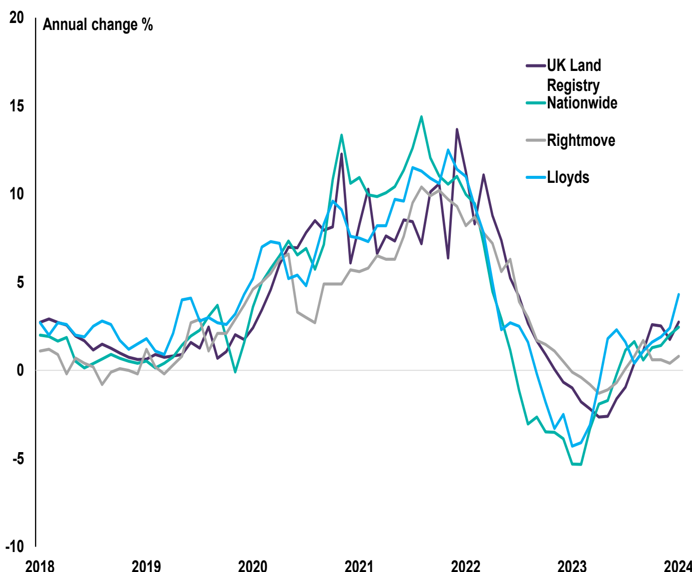
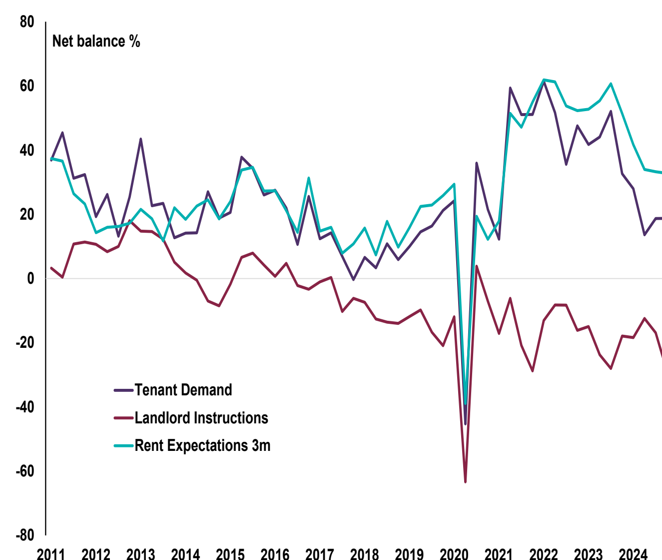


Chart 9: Tenant Demand continues to cool whilst Landlord Instructions moves furhter into negative territory



Construction

Official data signals a modest improvement across construction output recently, with the latest estimate pointing to a 0.8% increase in the three months the September. When viewed in annual terms however, the trend is more subdued, as output is still down by 0.4% compared with a year earlier. Meanwhile, the headline measure of activity captured in the Q3 2024 RICS UK Construction Monitor, although no longer negative, remains somewhat flat (posting a net balance of +2%). Even so, Chart 10 provides a sectoral breakdown of workloads and shows that all sectors have at least seen a small improvement in their respective net balances compared to the previous quarter. Infrastructure remains the strongest performing sector (+17% net balance), continuing the prolonged positive trend in growth seen over previous quarters.

Looking ahead to the next twelve months (Chart 11), expectations point to a better outlook for both headline workloads and employment, with a net balance of +24% of respondents anticipating a rise in the former and +18% for the latter. Unsurprisingly, when viewed at a sector level, twelve-month workload expectations are strongest across infrastructure, where a firmly positive net balance reading of +30% was recorded. Within this, the energy subs-sector displays the brightest outlook, with 62% of respondents indicating they believe it will be the fastest growing infrastructure segment over the next year. Recent government decisions such as lifting the ban on onshore wind farm developments, alongside investment in energy projects, lend further support to this view. Meanwhile, although the net balance for profit margin expectations remains subdued at -3%, there has been a noticeable stabilisation in forward-looking sentiment compared to the deeply negative readings seen during 2022 and 2023.

With respect to the challenges being faced across the industry, the RICS survey results continue to show that financial constraints are the most widely cited factor seen to be an impediment for firms (Chart 12). Indeed, 61% of participants singled out financial constraints as a barrier to activity in Q3, unchanged from last quarter. On a more encouraging note, the recent easing in monetary policy and macroeconomic headwinds may see help to reduce these types of pressure to a certain degree in the months ahead. In keeping with this idea, a net balance of +11% of respondents envisage an improvement in credit conditions over the next twelve months. Looking at other factors seen as obstacles, just over half of respondents cited planning and regulations as a hurdle for their business, with this share mirroring last quarter's figure. Labour shortages also remain a commonly mentioned barrier, with 44% of respondents highlighting this issue in the latest survey round. The problems in this area are well demonstrated in a recent report from the Resolution Foundation, which found that the construction sector is shrinking with an ageing workforce and insufficient new workers entering to fill the void.

Chart 10: All sectors of the construction market saw a small improvement in their workloads net balance compared to Q2

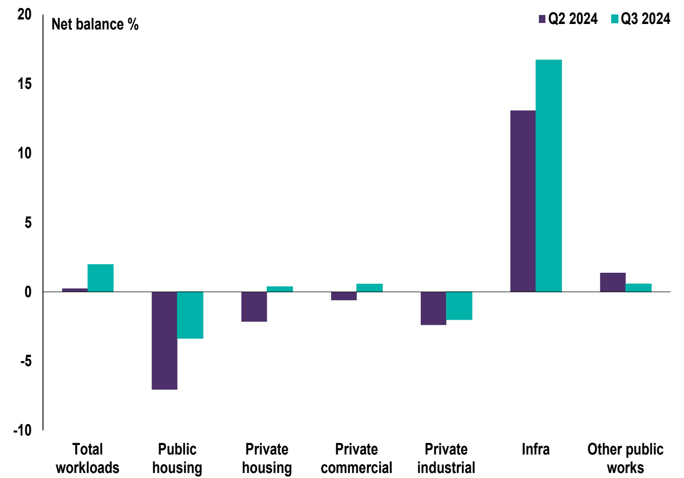


Chart 11: The outlook for profit margins has turned less downbeat in recent quarters

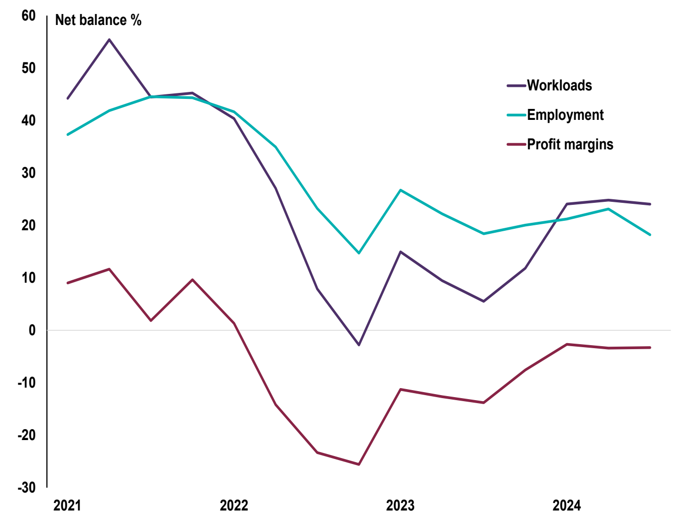
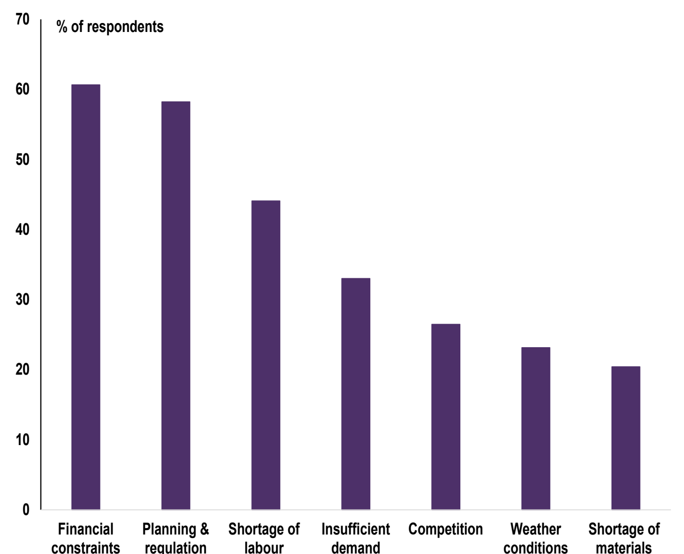


Chart 12: Financial constraints remain the main challenge for the sector followed closely by planning and regulation



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