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Economics

RICS

Rising unemployment likely to inhibit the economy's recovery

UK Economy and Property Market Chart Book

Q2 2020

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RICS Survey Release Dates

Frequency	Survey	Period covering	Release date
Monthly	RICS Hong Kong Residential Market Survey	April	21-May-20
Monthly	RICS Portuguese Housing Market Survey	April	29-May-20
Monthly	RICS UK Residential Market Survey	May	11-June-20
Monthly	RICS Hong Kong Residential Market Survey	May	18-June-20
Monthly	RICS Portuguese Housing Market Survey	May	26-June-20
Monthly	RICS UK Residential Market Survey	June	16-July-20
Monthly	RICS Hong Kong Residential Market Survey	June	21-July-20
Quarterly	RICS UK Construction Market Survey	Q2 2020	23-July-20
Quarterly	RICS Global Commercial Property Market Survey	Q2 2020	30-July-20
Quarterly	RICS UK Commercial Property Market Survey	Q2 2020	30-July-20
Monthly	RICS Portuguese Housing Market Survey	June	31-July-20
Quarterly	RICS Global Construction Survey	Q2 2020	06-Aug-20
Monthly	RICS UK Residential Market Survey	July	13-Aug-20

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Economic Outlook

Initial optimism that an easing of lockdown measures would allow the UK economy to fully recover from a sharp, pandemic related, contraction appears to fading. The Office for Budget Responsibility (OBR) estimates that a three-month lockdown may have led to 35% drop in real GDP in Q2 of this year, and although they feel output could rise by a significant 27% in Q3 as restrictions ease, this would still leave a substantial shortfall.

Likewise, more recent projections by the Bank of England point to a near 30% fall in real GDP in the first half of this year. In this scenario, even after allowing for an improvement in H2, GDP for the whole of 2020 is anticipated to slip by 14%. The Bank thinks it will take until the third quarter of 2021 for output to return to the level it was prior to the crisis. Other forecasters (IMF, Oxford Economics) at least for now, anticipate a similar pattern.

The economy could remain subdued for a while

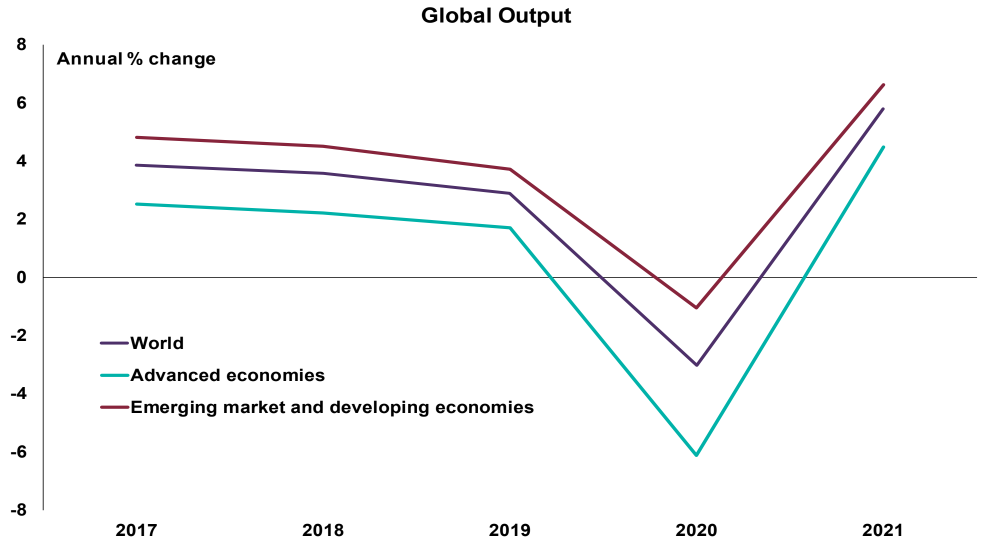
The path to economic recovery is likely to be heavily influenced by developments in the labour market. On that front, the Bank of England estimates, in spite of the government's efforts, that the unemployment rate could increase from under 4% in 2019 to above 9% this year, a much more elevated level than during the aftermath of the 2008 global financial crisis. This in turn is likely to keep a lid on household consumption in the coming months.

Furthermore, business investment, after remaining broadly flat last year, is anticipated by the Bank to decline by 26% in 2020. Already, there are indications that business confidence has taken a significant hit in survey data. In the latest Deloitte survey of Chief Financial Officers, 83% said they were less optimistic about the financial prospects of the company, the lowest in the survey's twelve-year history. Alongside this, appetite to take greater risk on balance sheets hit a new record low. These results suggest that a much more cautious approach from business is likely to persist in the remainder of the year. This also poses a longer-term fundamental challenge for policymakers as a prolonged dip in investment will weigh on productivity growth over time.

RICS surveys point to a sharp deterioration in market sentiment

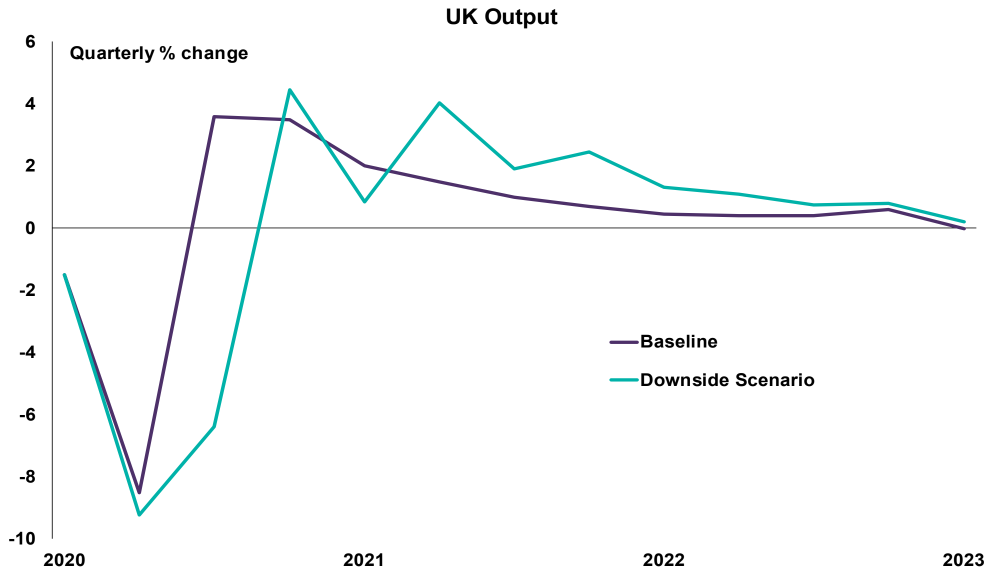
Feedback from the latest round of RICS surveys unsurprisingly points to a sharp deterioration in sentiment. The results from the Q1 2020 UK Commercial Property Survey show the crisis has accelerated the downturn in retail. CBRE data shows capital values posted monthly declines of 3% and 2% in March and April respectively at the all-sector level. Within this, although the retail sector suffered the steepest declines, values also slipped across the office and industrial sectors.

Advanced economies are projected to see a much more sharper decline in output relative to emerging markets and developed countries



Source: IMF

Oxford Economics expects UK output to begin to bounce back in H2 2020 but the risk of a more severe and prolonged recession remain high



Source: Oxford Economics

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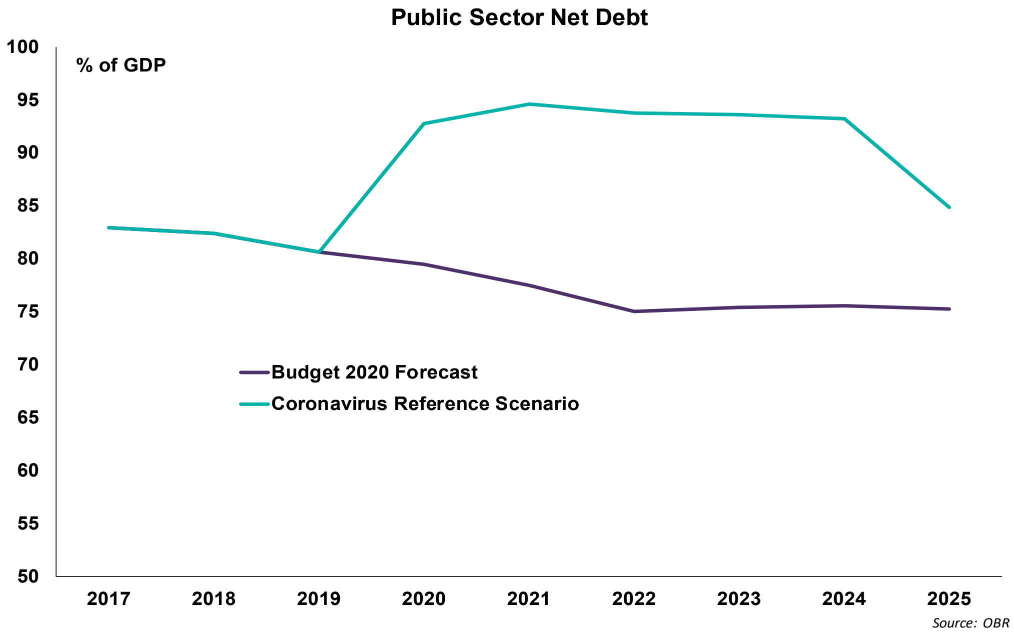
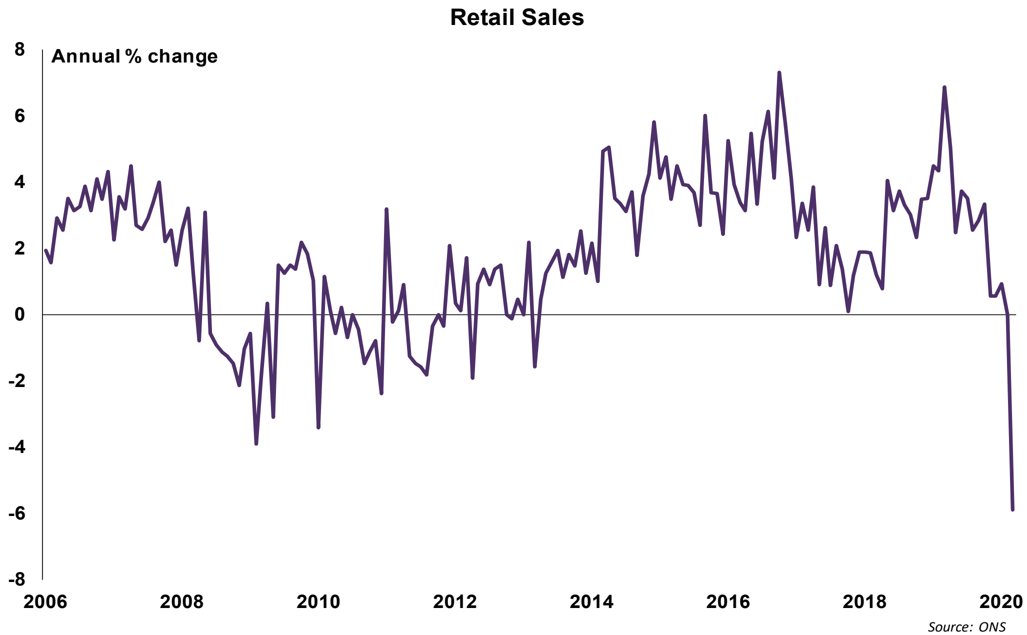
1) Government debt is envisaged to reach almost 95% of GDP



2) Retail sales saw a sharp decline in March



UK Economy

The Office of Budget Responsibility (OBR) in its Coronavirus Reference Scenario estimates that the significant fall in UK output, and the fiscal policy measures undertaken to mitigate the impact on the economy, will lead to government borrowing rising significantly in the near term.

The OBR's judgement is that public sector net borrowing is likely to reach £298 billion this year. This is £233 billion more than what the OBR anticipated in the March Budget. In this case, net debt is projected to be £399 billion higher this year compared to the March Budget forecast. Chart 1 shows that this will take public sector net debt to just under 95% of GDP in 2020/21.

Crucially, government debt is projected to remain high in subsequent years; above 90% of GDP until at least 2024. The risk is that the government may have to consider raising taxes or decreasing expenditure in the medium term to lower it's debt burden, which in turn could constrain the economic recovery further out.

Meanwhile, ONS's data points to retail sales collapsing in March following the closure of non-essential shops in the final week of the month. Sales fell by 6% on annual basis, the largest fall since records began (Chart 4). It is likely that April's data will show a much bigger decline. Indeed Q2 is likely to see a significant drop in consumer spending and GDP. Further out, retail sales could start to recover in Q3 as the government begins to ease restrictions in the coming weeks.

Public sector net borrowing is expected to rise substantially this year coming at £233 billion more than what the OBR's projected in its March Budget.

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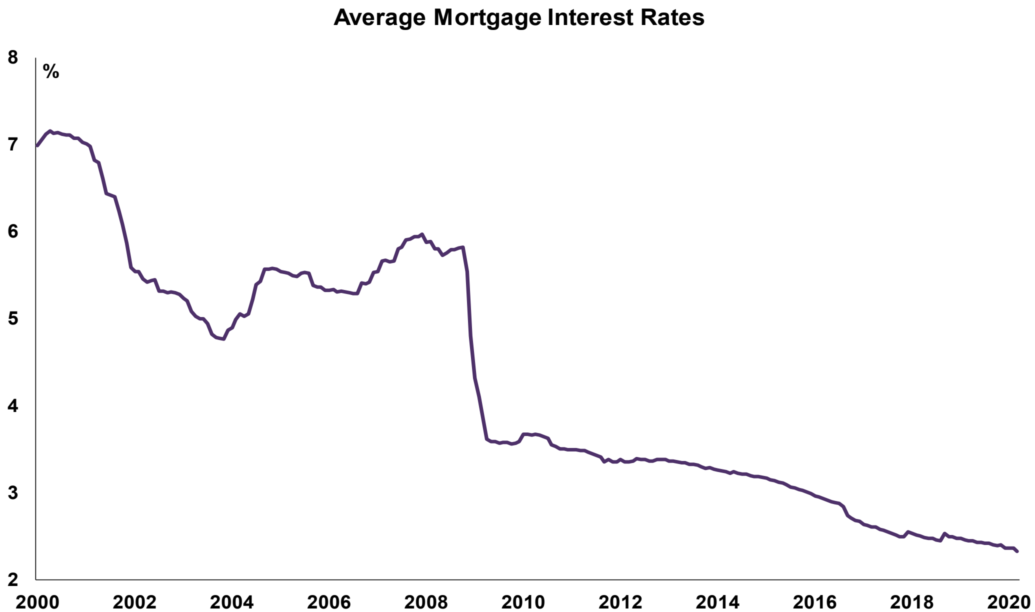
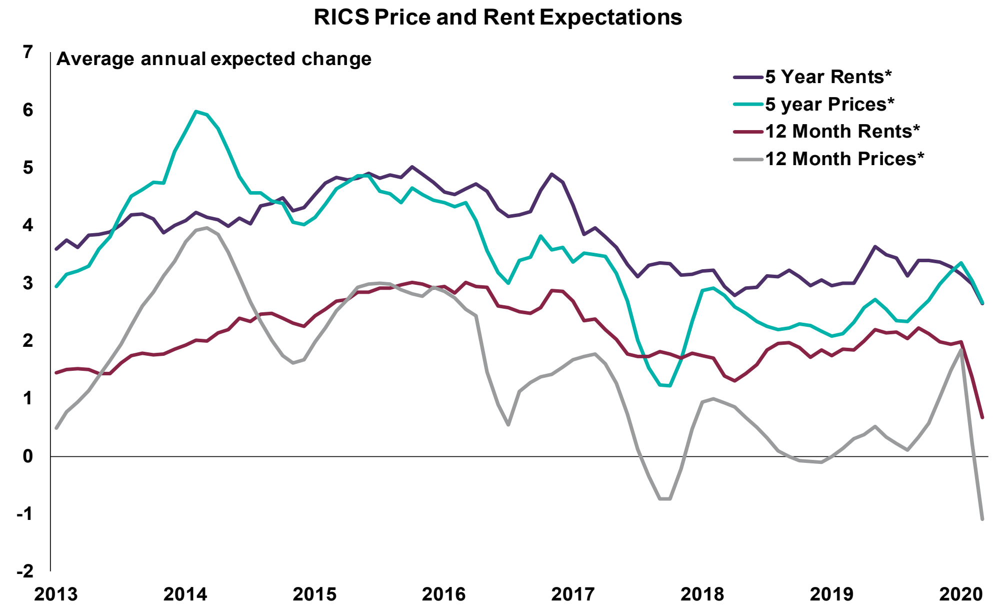
3) Average mortgage lending rates have dipped further



Source: Bank of England

4) Prices and rents still seen rising over the medium term



* 3 month rolling average

Source: RICS

Housing Market

Government measures introduced to combat the spread of the coronavirus required estate agents to close their offices in late March and in April which led to activity across the housing market grinding to a halt. Evidence of this decline in momentum was apparent in the March mortgage approval statistics. Approvals for house purchases fell by 24% over the month to 56,200, the lowest in seven years. With government restrictions now loosened, activity could begin to pick-up in the coming months, though a sharp turnaround still seems unlikely. Meanwhile, average mortgage interest rates have dipped a little further near the end of Q1 in response to the Bank of England's decision to cut interest rates to a record low of 0.1% (Chart 3).

The latest results to the RICS Residential Market Survey point to a sharp deterioration in sentiment with key activity indicators such as new buyer enquiries and newly agreed sales declining significantly. Unsurprisingly, average three month expectations for sales, prices, and rents are deeply negative.

That said, sentiment over the twelve month horizon is somewhat less downbeat. Chart 4 shows that contributors anticipate a modest fall in prices in the coming year while the outlook for rents is now broadly flat. Interestingly, medium term projections are more resilient with contributors expecting average annual growth in prices and rents to average around 2.5% per annum over the next five years.

Mortgage approvals slipped materially in March

In the RICS survey, prices and rents are seen falling in the coming months

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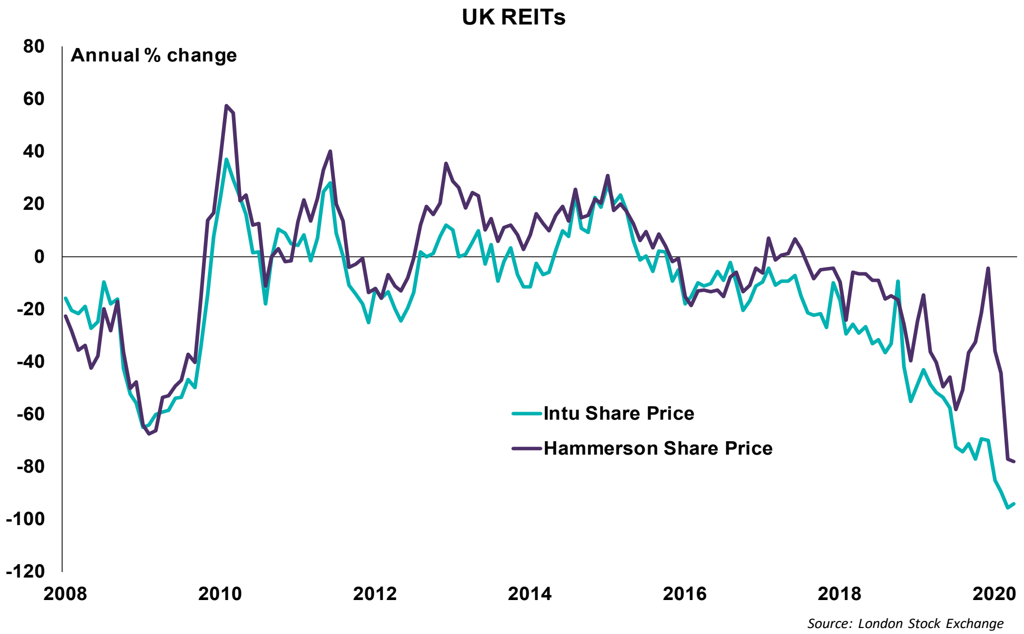
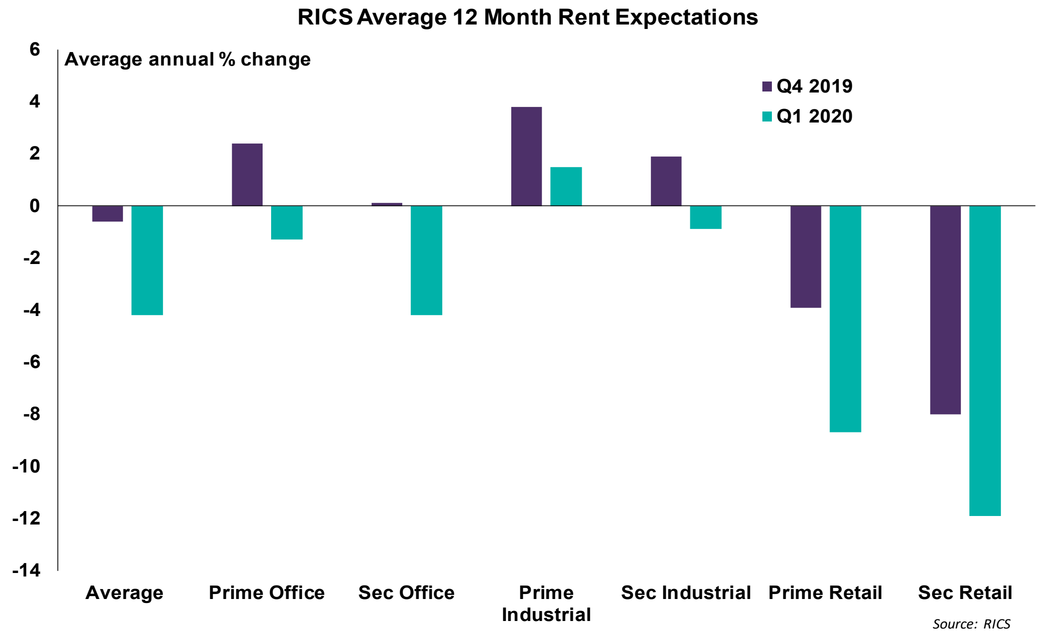
5) Share prices of Intu and Hammerson have collapsed



6) Rental values are seen falling substantially in the retail sector



Commercial Property Sector

According to CBRE data, capital values fell by 7.6% on an annual basis in April. However, this was predominantly driven by a 18% drop in retail commercial property prices. In comparison, capital values fell only modestly by 1.2% in the office sector and were more or less stable across the industrial segment.

Even before the Covid-19 crisis hit, the retail sector was looking vulnerable in the face of a structural shift towards online shopping. Significantly, it seems that social distancing measures enacted by the government to combat the spread of the virus have put further pressure on retail. This is clearly visible in official data by CBRE as well as in the recent performance of Retail Reits.

Intu and Hammerson, UK Reits that specialise in retail, had already seen their share prices drop significantly in the past few years and, more recently, prices have plunged further (as shown in Chart 5).

In the RICS Q1 2020 UK Commercial Property Market survey results, 64% of respondents view the market to be in the downturn phase of the property cycle. Average twelve month rental value projections have turned negative across virtually all sectors. The weakest projections are for secondary retail sites with rents seen falling by almost 12%. What's more, the outlook is not much better for prime retail properties. At the other end of the spectrum, prime industrial rents, for the time being at least, are expected to rise marginally in the coming year (shown in Chart 6).

The current crisis has put further pressure on the retail portion of the commercial property market

64% of respondents in the RICS survey view the market to be in a downturn

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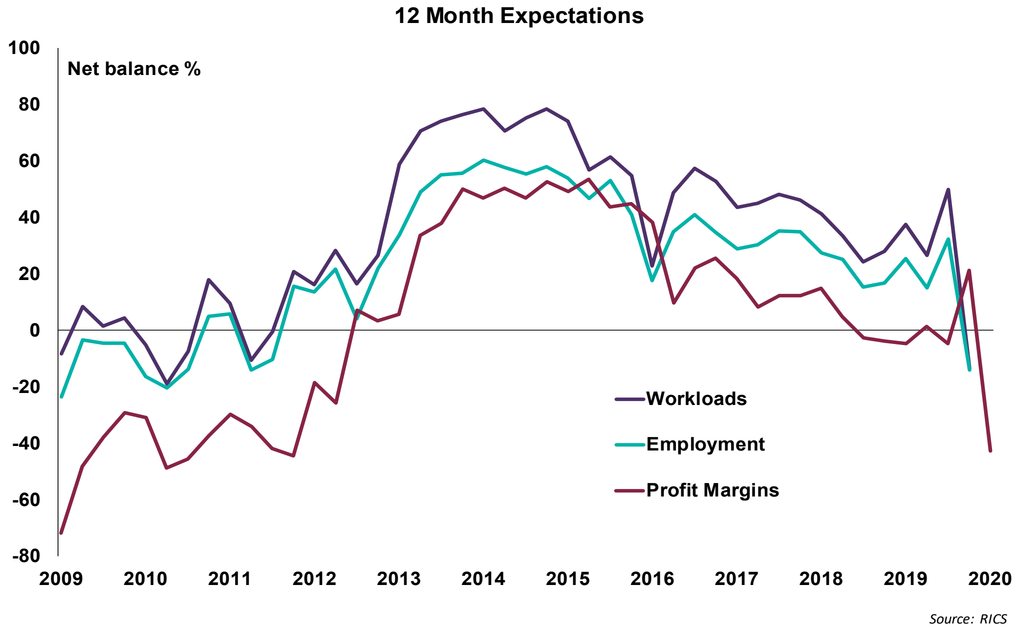
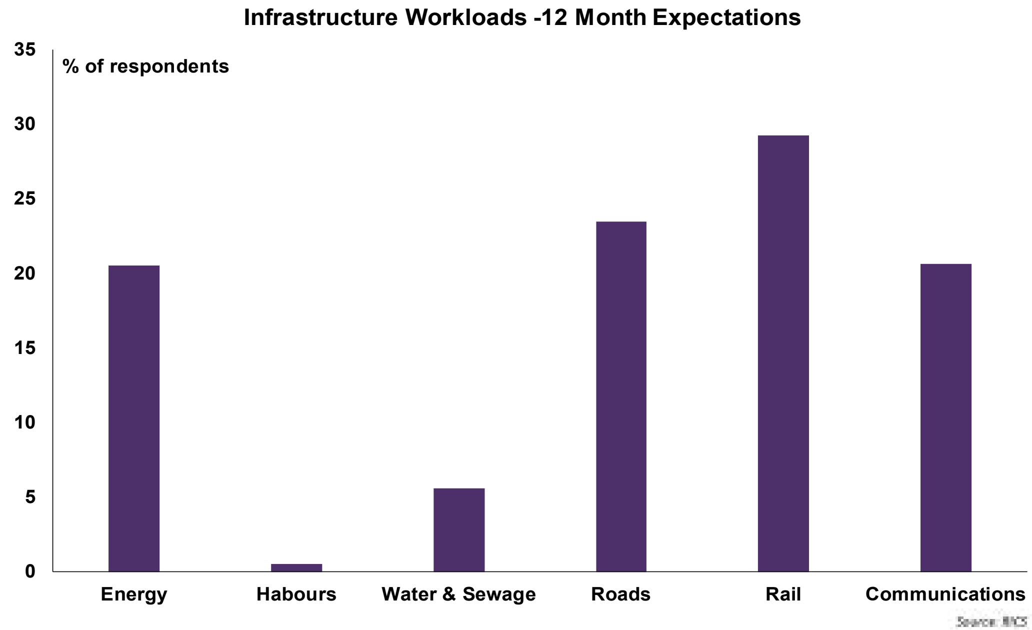
7) Profit margins are expected to contract



8) Rail and road projects are expected to rise firmly



Construction Sector

ONS's preliminary estimates show that after rising in 2019, construction output declined by 3% on a year on year basis in the first quarter of 2020 owing to government restrictions imposed in March.

In the RICS Q1 2020 UK Construction market survey, the headline workloads indicator slipped into negative territory for the first time in eight years with activity reported to have fallen in all market segments. Interestingly, we noted that sentiment turned progressively weaker towards the end of the survey period as stricter lockdown measures came into force. In addition, feedback points to a drop in market confidence with contributors anticipating workloads, employment and profit margins to decline in the coming year (Chart 7). On the back of this, participants expressed the intention to decrease investment on fixed assets, equipment and software.

Having said that, contributors still appear to be upbeat with regards to infrastructure workloads with the rail, road and energy components expected to see the strongest growth in output in the coming twelve months (Chart 8). This could be in response to a substantial rise in investment into transport infrastructure promised by the government in the Budget. However, whether all of these projects will be able to materialise is open to question given that government borrowing and net debt are expected to increase significantly this year in consequence to the sizeable fiscal spending during the pandemic.

Feedback to the RICS survey shows market confidence has taken a hit

Infrastructure workloads still seen rising in the coming year

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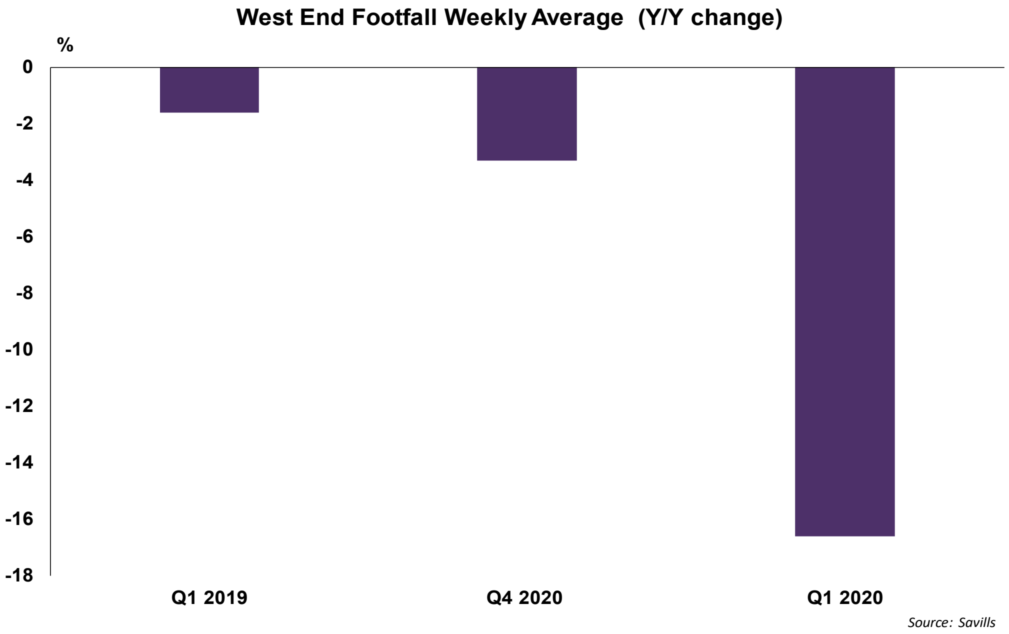
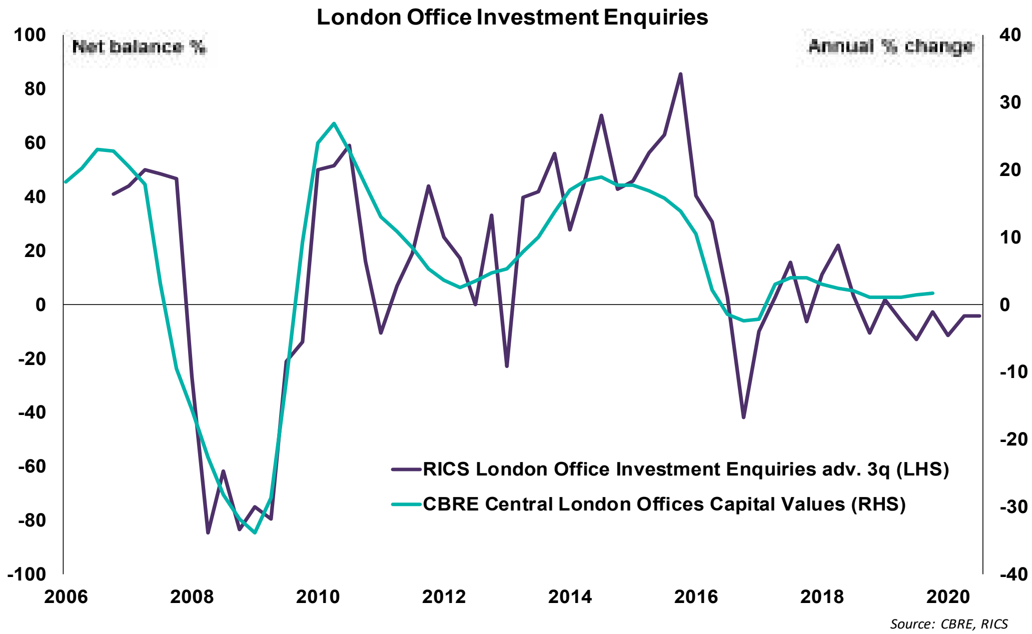
9) Average weekly footfall plummeted in Q1 2020



10) London office capital values look likely to remain stable



London

In the face of changing consumer spending habits, feedback to the RICS UK Commercial Property survey has pointed to diminishing appetite for retail sites across Central London in the last three years. On the back of this, availability of vacant retail properties has reportedly risen sharply putting further downward pressure on rents.

Savills research indicates that average weekly footfall across the West End fell over the course of 2019. It looks like the lockdown enacted by the government in March has exacerbated this trend, with the year on year decline in footfall coming in at -17% in Q1 2020 compared to -3.3% in Q4 2019 (Chart 9). Alongside this, Savills estimates that prime headline rents in Central London have fallen by 8.4% on annual basis in Q1, an acceleration from a decline of 5.8% in the previous quarter.

Overall, investment across the London commercial property market has slipped in the past few months. Savills estimates that transactional volumes in April were 39% down on the same point last year as investors adopt a wait and see approach.

Feedback to the RICS commercial survey suggests that investor appetite for London office space has remained relatively flat in the last four quarters. On past form, this points to a broadly stable trend in London office capital values (Chart 10). Nevertheless, given the current economic climate, the risks to this are firmly skewed to the downside.

Prime Central London retail rents have slipped sharply

In the RICS survey, investor demand for London offices is more or less flat


Which way is the wind blowing?
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