AVISON YOUNG

RESEARCH

EPMR

Economic & property market review

Spring 2020

View >

Summary

- UK GDP growth was marginal in the three months to February 2020 at 0.1%.
- In response to Covid-19, public spending may rise to 13.9% for 2020-21 as the government looks to offset the impacts of lockdown restrictions.
- It is strongly anticipated that the UK will enter a deep recession in Q2 2020, with GDP contracting by 35% according to the OBR, and unemployment rising to 7.1%. Although forecasts vary, the consensus heavily suggests a recession of higher magnitude than the GFC.
- Universal credit applications have hit an all-time high of 1.4 million in the four weeks to 16 April, with 950,000 in the two weeks from 16 March alone. Over 140,000 firms applied to the Coronavirus Job Retention Scheme on the first day of the scheme opening, rising to claims for more than 3.2 million employees within the first three days – 10% of the UK workforce.
- Prior to the Covid-19 crisis, the UK occupier market was performing relatively well earlier in the year, with take-up activity just below average in Central London and the Big Nine despite the events of March curtailing some activity.
- Brexit negotiations are being continued over video conference, with significant progress required in advance of the next scheduled meeting in June.

Economic Trends

The impact of Covid-19 will be the main driver of economic performance in the near term and we expect a dramatic decline in GDP during the course of Q2. Despite the monetary and fiscal measures being enacted to combat the economic fallout of the virus, it is strongly anticipated that the UK will enter a deep recession in 2020 which will exceed that observed in 2008-09 and indeed may surpass other historical crises. Among economists, there is a wide disparity on the case for the strength and speed of economic rebound.

Whilst political and economic focus is understandably centred on Covid-19, the UK has now entered the next phase of trade negotiations, following the official departure from the European Union on January 31st 2020. The already tight timeline set out will be stretched further as negotiations are forced to be resumed over video conferencing following a temporary pause. There remains a high level of uncertainty surrounding UK's future relationship with EU.

Preliminary figures indicate UK GDP growth flatlined in Q4 2019 with annual growth for the year of 1.4%. During the three quarters to February 2020, growth was marginal at 0.1%, with the potential post-election 'Boris-bounce' not materialising through growth in the economy. Since then, the UK, and a significant portion of the global economy, has seen considerable disruption to business activity and a dramatic impact on the economy over at least the short-term. Significant repercussions are already visible across liquid asset classes.

The March 2020 budget committed to spending increases over the next five years intended to boost economic growth and provide defence against the economic uncertainties from Brexit, particularly around trading relationships.

Initial figures set out in the budget have been obliterated by measures taken to bolster the economy against Covid-19 with the OBR forecasting government spending rising from around 3% to up to 13.9% of GDP for 2020-21. This includes the Coronavirus Job Retention Scheme where employers can temporarily furlough staff who would have otherwise been made redundant, with them receiving up to 80% or £2,500 of their monthly salary instead via a government grant until the end of June, a moratorium on commercial lease forfeiture due to non-payment of rent, and multiple grants and loans for businesses across the UK.

The Markit / CIPS Purchasing Managers Indices for services declined at the fastest rate since the measure was introduced, falling to 34.7 from 53.2 March to February. Construction PMI scores fell considerably, down to 39.3 for March from 52.6 in February due to site closures and near-absent new starts. The manufacturing PMI was also down in March, decreasing to 47.8 from 51.7 in February. These falls come off the back of positive growth earlier in the year.

"Despite the monetary and fiscal measures being enacted to combat the economic fallout of the virus, it is strongly anticipated that the UK will enter a deep recession in 2020 which will exceed that observed in 2008-09 and indeed may surpass other historical crises.

Economic Trends

Labour market

Labour market statistics suggest that employment was in a solid position prior to the Covid crisis. Employment rose to 33 million (77.6%) in the three months to February 2020, a new record high, while the unemployment rate rose slightly to 4%. Although the labour market remained strong, there were signs that employment growth was cooling prior to major coronavirus impacts with vacancies falling marginally and wage growth slowing to 1.2% in February, the slowest since 2018. These figures do not include recent coronavirus effects, which will only become visible in later data releases.

The Coronavirus Job Retention Scheme had 140,000 firms apply on its first day, rising to claims for more than 3.2 million employees within the first three days – 10% of the UK workforce. Covid-19 is expected to push unemployment up to 6% from 3.9% (Capital Economics) as businesses struggle to meet staff requirements with significantly curtailed incomes, although the OBR forecasts that this figure may rise to 7.1%. In the two weeks from 16 March, 950,000 successful universal credit applications were made. A typical figure for this period would be around 100,000 applications. This has risen to around 1.4 million universal credit applications for the four weeks to 16 April.

Inflation

Inflation fell slightly to 1.5% in March, down from 1.7% in February. There will undoubtedly be a considerable shock to both supply and demand drivers, without clarity on which will dominate. Furthermore, Sterling has weakened comparative to other currencies, and whilst this will increase import prices, this is unlikely to be passed onto consumers in the short term. The Bank of England (BoE) cut interest rates to a record low of 0.1% in mid-March, following earlier cuts to combat the negative impact of Covid-19.

Outlook

Covid-19 escalation will significantly hit economic growth, with a deep recession. How long this lasts will be determined by the timescale of return to normality. Fiscal stimulus from the Budget and the emergency interest rate cut are likely to go some way to mitigating impact. Capital Economics most recently forecasted GDP growth at -12% for 2020, revised down for the third time from their original 1% forecast at the beginning of the year, while the OBR sees a 12.8% contraction. There is expected to be a strong resurgence in 2021, with forecasts of 10% and 17.9% from Capital Economics and the OBR respectively. Although these forecasts vary (as seen in the adjacent figures) and are being revised often, the consensus is that the UK will enter a recession of a higher magnitude than the GFC, but recovery is expected to be quicker.

LATEST CONSENSUS FORECASTS, JANUARY 2020

	2020	2021	25-year trend
Economic growth (GDP)	-4.7%	4.3%	2.5% pa
Private consumption	-6.2%	3.8%	
Employment growth	-2.1%	1.3%	0.7% pa
Bank Base Rate	0.1%	0.1%	
CPI – Inflation (Q4)	1.2%	1.9%	
RPI – Inflation (Q4)	1.6%	2.9%	

Source: HM Treasury (Compilation of forecasts, Avison Young)

2020 ECONOMIC GROWTH FORECASTS

UK **-6.5%**

WORLD **-3%**

EUROZONE **-7.5%**

Source: IMF

KEY STATS

GDP GROWTH

0% ▼ Q4 2019

1.4% ▲ 2019

PMI WEIGHTED AVERAGE

MARCH **34.7** ▼

FEBRUARY **52.6**

UNEMPLOYMENT RATE

4%

REAL EARNINGS GROWTH

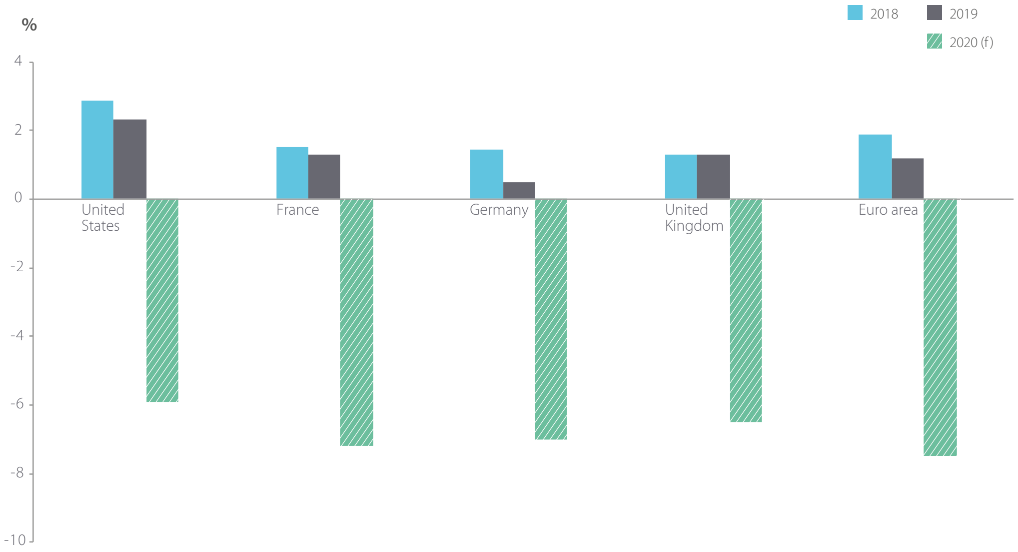
1.2% (INCLUDING BONUSES)

1.3% (EXCLUDING BONUSES)

CPI INFLATION **1.5%**

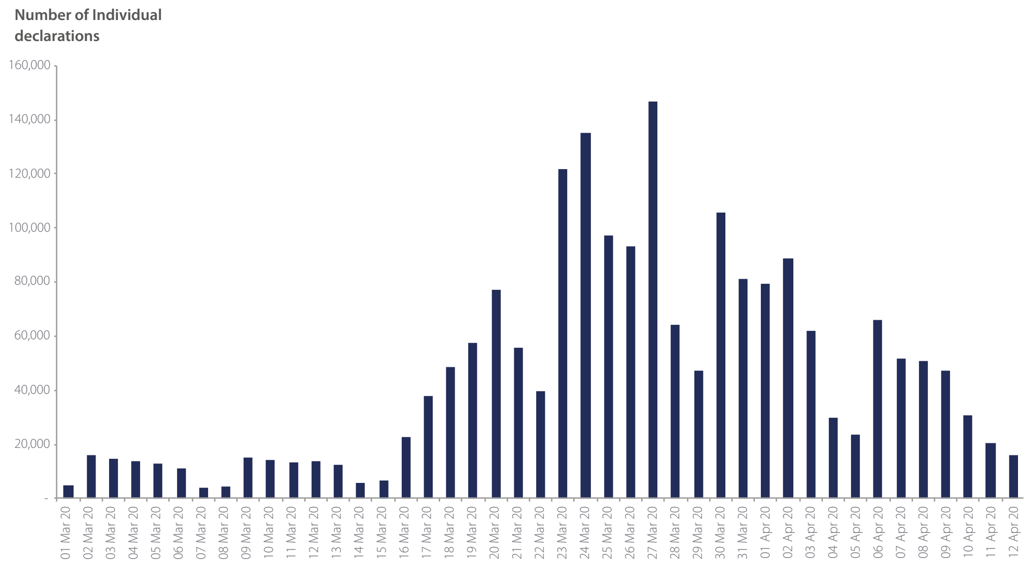
BANK RATE **0.1%**

GLOBAL ECONOMIC GROWTH



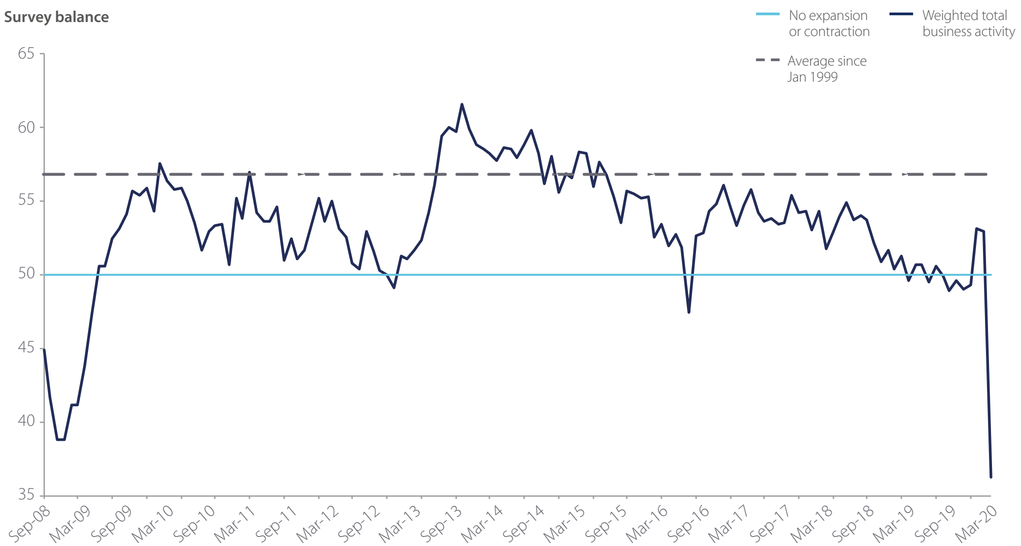
Source: IMF

INDIVIDUAL UNIVERSAL CREDIT DECLARATIONS (PROVISIONAL)



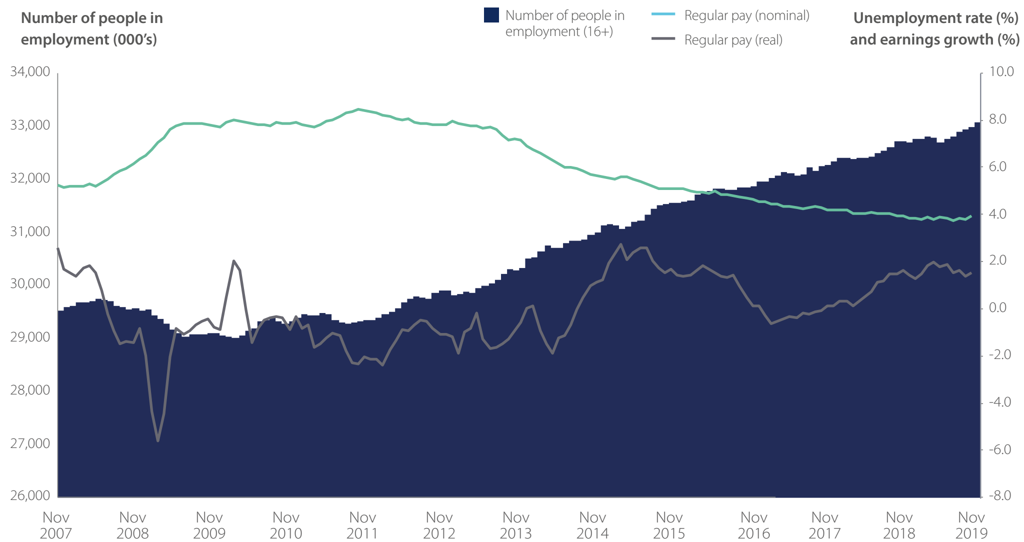
Source: ONS

PURCHASING MANAGERS' SURVEY



Source: Markit & CIPS

EMPLOYMENT AND AVERAGE WEEKLY EARNINGS ANNUAL GROWTH RATES



Source: Experian, HM treasury consensus

Occupier market

Central London office take-up totalled 2.4 million sq ft in Q1 2020, a 5.5% decrease on Q4 2019. The already constrained pipeline has suffered a short-term delay, with no major completions occurring in Q1 2020 as several significant developments have postponed their completion dates amid Covid-19 site closures.

Total take-up across the Big Nine office markets reached 2.0 million sq ft in Q1 2020 as pent-up demand was released in both the city centre and out-of-town markets across the UK cities. This reflects the healthy state of the Big Nine office market prior to the Covid-19 crisis, with demand from a diverse range of sectors and constrained supply supporting rental growth during the quarter.

Covid-19 will exacerbate the structural challenges faced by the retail market, despite the exceptional measures to mitigate impacts. The Centre for Retail Research (CRR) estimated over 143,000 jobs were lost in 2019 as a result of more than 16,000 stores closing. Unfortunately 2020 is likely to be substantially worse for the retail market as the CRR suggests that over 20,000 stores may not reopen when government restrictions have been lifted. Reflecting the difficult conditions, average retail rental values fell by -4.7% in 2019, down from -2.6% in 2018 (MSCI Monthly Index). Many retailers have withheld their rent payments, citing government-enforced store closures, and they are unlikely to produce next quarter's rent in June if lockdown restrictions are maintained.

Demand for industrial property continued to rise, albeit at a slower pace last year. The outbreak of the crisis saw a number of supermarkets and discounters set significant requirements for logistical facilities across the UK to cope with the additional demand from Covid-19. This has now subsided slightly, with activity normalising. However, looking forward, supply chain disruptions from Covid-19 could impact the industrial and warehouse sectors.

Longer term, the sector continues to be underpinned by the growth in e-commerce which could be further accelerated by trends adopted during the lockdown.

Nevertheless, the slowdown in the global economy and reduced consumer demand has weighed on the sector to some extent. Average all UK property rental growth decreased marginally by 0.3% in the 12 months to March 2020 (MSCI Monthly Index). This is heavily skewed by retail property, where rents have been in decline since June 2018, now at-5.3% for March, the largest contraction since May 2010. While the office and industrial sectors have reported a slight decline in growth rate for March, they remain robust despite the Covid crisis at 1.8% and 2.9% respectively.

Outlook

Longer term, the changes that businesses, government and individuals will implement during the Covid-19 crisis will accelerate some trends already evident in the market, including deglobalisation of supply chains, a shift towards online retail and flexible working practices in the service

KEY STATS

ANNUAL ROLLING VALUE OF NEW CONSTRUCTION ORDERS

£9.2 billion

Q1 TAKE-UP LEVELS

CENTRAL LONDON OFFICES

2.4m sq ft

'BIG NINE' REGIONAL OFFICES

2.0m sq ft

ANNUALISED AVERAGE RENTAL GROWTH

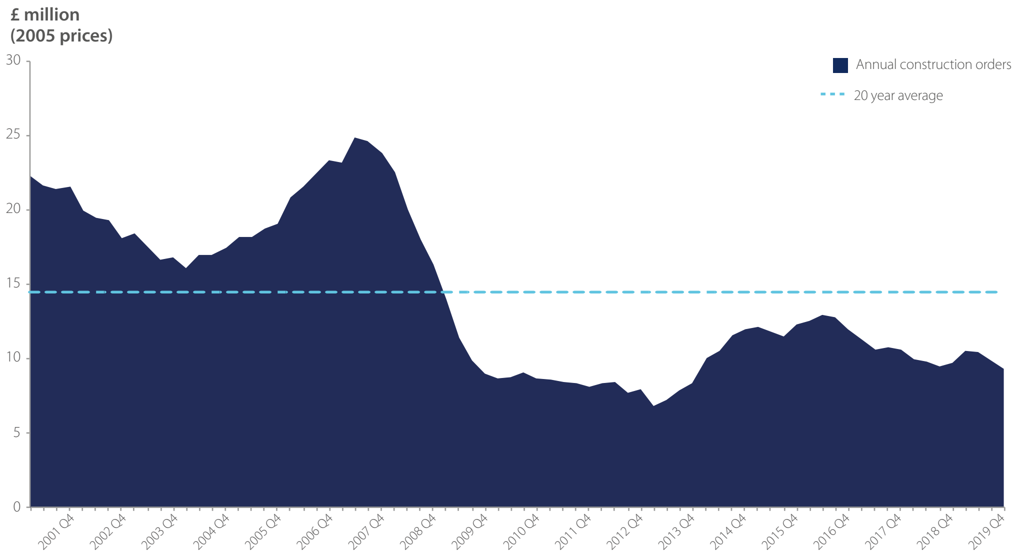
ALL-PROPERTY **-0.30%**

OFFICES **1.83%**

RETAIL **-5.28%**

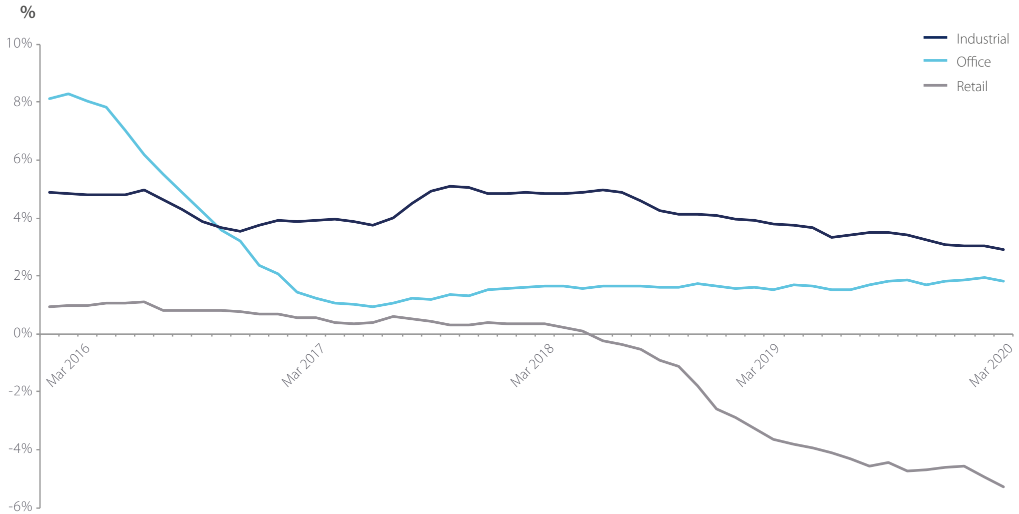
INDUSTRIAL **2.92%**

NEW CONSTRUCTION ORDERS (DEVELOPMENT ACTIVITY) RETAIL, OFFICE AND INDUSTRIAL



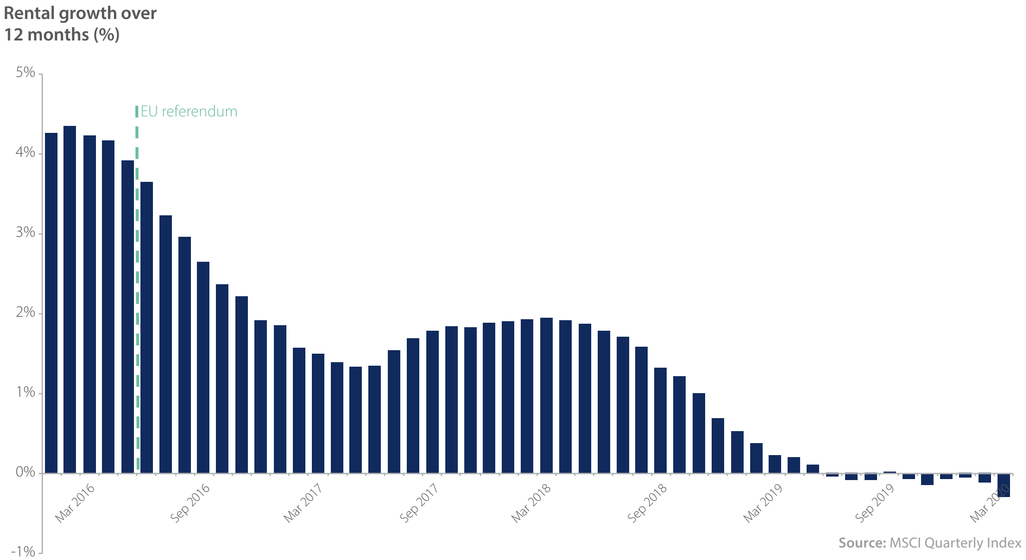
Source: ONS

AVERAGE ANNUAL RENTAL GROWTH



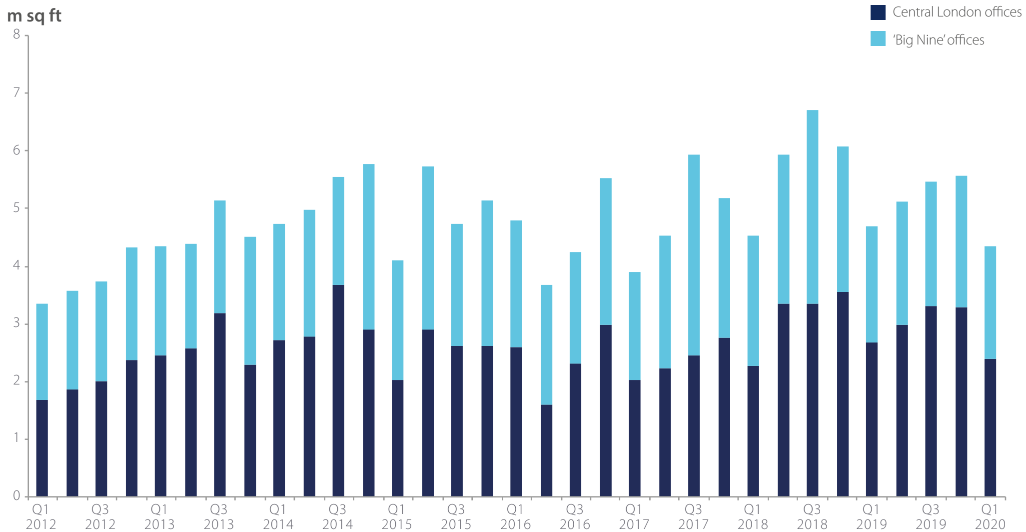
Source: MSCI Quarterly Index

AVERAGE ALL-PROPERTY ANNUAL RENTAL GROWTH



Source: MSCI Quarterly Index

QUARTERLY OFFICE TAKE-UP IN CENTRAL LONDON AND THE 'BIG NINE'



Source: Avison Young

Investment

The first quarter of the year saw £15.3 billion transacted across the investment market (Property Data). Despite being down on the 5 year quarterly average, this figure was marginally up on the same period in 2019. Overseas investors accounted for over 70% of the quarter's investment activity as UK institutional investment halved quarter-on-quarter.

While some deals which were already in their late stages have completed investment activity is likely to remain muted until the economic outlook is clearer, with buyers, vendors and lenders adopting a wait and see attitude. Hence lockdown restrictions are likely to have notable impacts on Q2 investment.

MSCI all-property equivalent yields have edged up to 6.1% as stress in the property sector increases. Consequently, all-property average capital value growth declined further to -5.0% in the year to March 2020, compared to 3.4% a year previously.

Outlook

Covid-19 will have significant impact on activity in the short term – particularly through the lack of valuation capacity as site visits are suspended, comparable evidence is limited and market uncertainty reigns. Whilst the economic outlook is bleak, there is significant appetite in the market and considerable amounts of capital to invest, primarily in the industrial and office sectors. Challenges in the retail sector will to remain in the year ahead and we expect capital values to deteriorate further as structural changes are sped up.

Q1 2020 VOLUMES BY REGIONS

- London **£5.5 billion**
- East of England **£629 million**
- East Midlands **£300 million**
- North East **£70 million**
- North West **£439 million**
- Scotland **£431 million**
- South East **£809 million**
- South West **£227 million**
- Wales **£153 million**
- West Midlands **£276 million**
- Yorks & Humber **£252 million**
- Northern Ireland **£30 million**

KEY STATS

ANNUAL ROLLING INVESTMENT TRANSACTIONS VALUE

£56.1 billion

Q1 VOLUMES BY INVESTOR TYPE

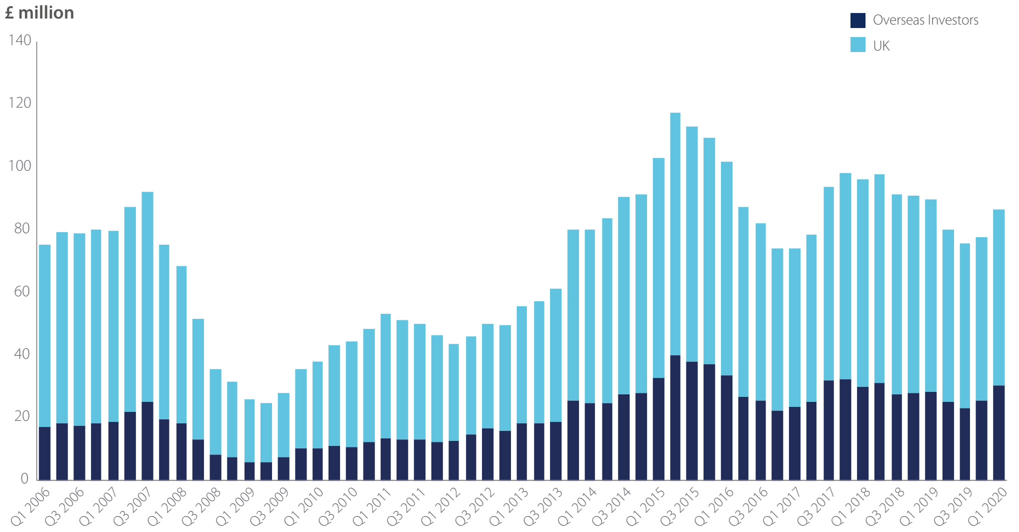
OVERSEAS INVESTOR	UK INSTITUTION	UK PROPERTY COMPANY
66%	**8%**	**14%**

ALL-PROPERTY EQUIVALENT YIELDS

6.1%

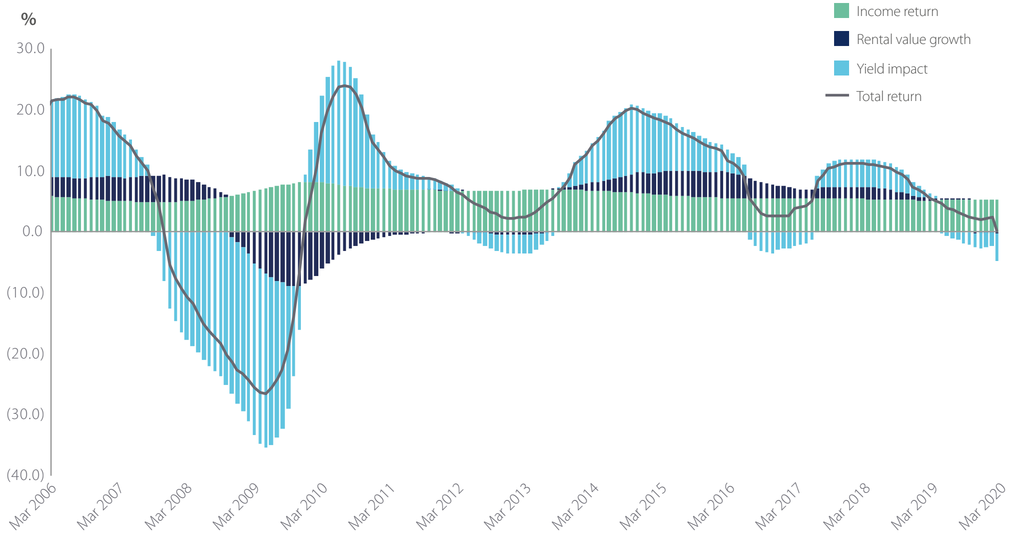
ANNUALISED ALL-PROPERTY TOTAL RETURN	ANNUALISED ALL-PROPERTY CAPITAL GROWTH
0.1%	**-5.0%**

ROLLING ANNUAL INVESTMENT TRANSACTION VOLUMES



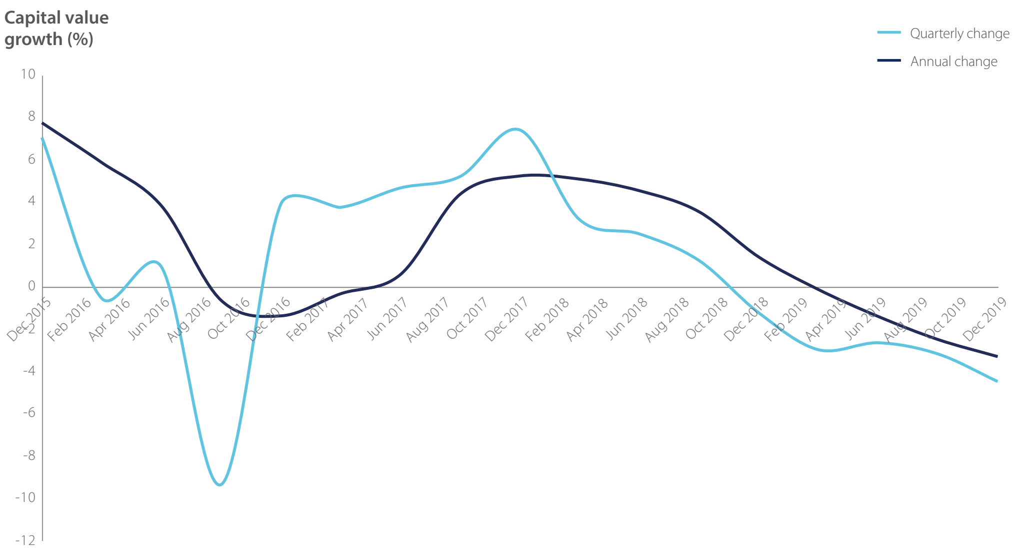
Source: Property Data

ALL PROPERTY ANNUAL TOTAL RETURN



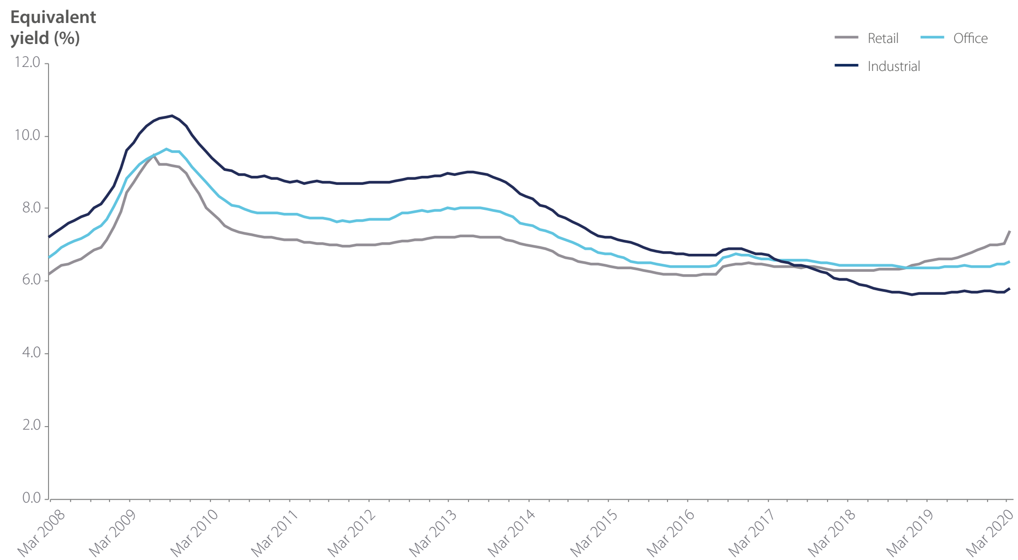
Source: MSCI Quarterly Index

ALL-PROPERTY AVERAGE CAPITAL VALUE GROWTH



Source: MSCI Quarterly Index

AVERAGE EQUIVALENT YIELDS



Source: MSCI Quarterly Index

Should you wish to discuss any details within this update please get in touch.

Daryl Perry
Director, Head of UK Research
020 7911 2340
daryl.perry@avisonyoung.com

Kiran Patel
Research Analyst
020 7911 2625
kiran.patel@avisonyoung.com

Visit us online
avisonyoung.co.uk/research

Avison Young
65 Gresham Street, London EC2V 7NQ

Avison Young is the trading name of Avison Young UK Limited. ©2020 Avison Young **Created: 04/20 Ref: 12090**

@AYUKviews

This report has been prepared by Avison Young for general information purposes only. Whilst Avison Young endeavours to ensure that the information in this report is correct it does not warrant completeness or accuracy. You should not rely on it without seeking professional advice. Avison Young assumes no responsibility for errors or omissions in this publication or other documents which are referenced by or linked to this report. To the maximum extent permitted by law and without limitation Avison Young excludes all representations, warranties and conditions relating to this report and the use of this report. All intellectual property rights are reserved and prior written permission is required from Avison Young to reproduce material contained in this report.