

Economics & Real Estate

Q2 2017

Uncertainty chipping away at economic growth

Economic Highlights

- The final estimate of GDP for Q1 2017 confirmed quarterly growth at 0.2%, the weakest expansion since Q1 2016, when output also grew by just 0.2%. PWC's nowcasting model estimates that Q2 GDP growth is likely to come in at just 0.3%.
- Consumer price inflation (CPI) increased by 2.6% in the year to June; the coming months, however, are expected to see import cost pressures linked to sterling's decline push inflation up to around 3%.
- The latest employment statistics for the three months to May 2017 show an increase in employment of 175,000 when compared against the three months to February. Unemployment fell by 64,000 to 1.5 million, with the unemployment rate falling marginally to 4.5%.
- Brexit update: much commentary (not ours) in the aftermath of the recent election focused on the increased likelihood of a 'Soft Brexit' as a result of Theresa May's 'defeat'. However, given the Labour Party is also *sort of* committed to leaving the Single market and Customs Union, whilst retaining the "exact same benefits", it would appear both parties are in favour of having and eating cake. Thus the picture remains completely unclear.

Sector Highlights

- Office – the UK Services PMI fell in June, reaching 53.4 compared to 53.8 in May. The index has now signalled output expansion for 11 consecutive months. (Markit/CIPS)
- Industrial – the UK Manufacturing PMI fell to a three-month low of 54.3 in June. However, the second quarter's average PMI reading of 55.9 was the best registered for three years. (Markit/CIPS)
- Retail – retail sales volumes in June rose 0.6% versus the previous month. Whilst the three months to June saw sales increase 1.5% versus the previous three months. Given sales fell 1.4% in the first quarter of 2017, the trend is broadly flat. (ONS)
- Construction – the UK Construction PMI recording a reading of 54.8 in June, down on the previous month's 56.0. (Markit/CIPS)
- UK house prices fell 0.1% in Q2 2017, with the annual growth rate falling to just 2.8%. London house prices declined 2% in the second quarter, with annual growth standing at just 1.3%. (Nationwide)

The OECD's Economic Outlook, June 2017, forecasts UK GDP growth of 1.6% in 2017 and 1.0% in 2018.



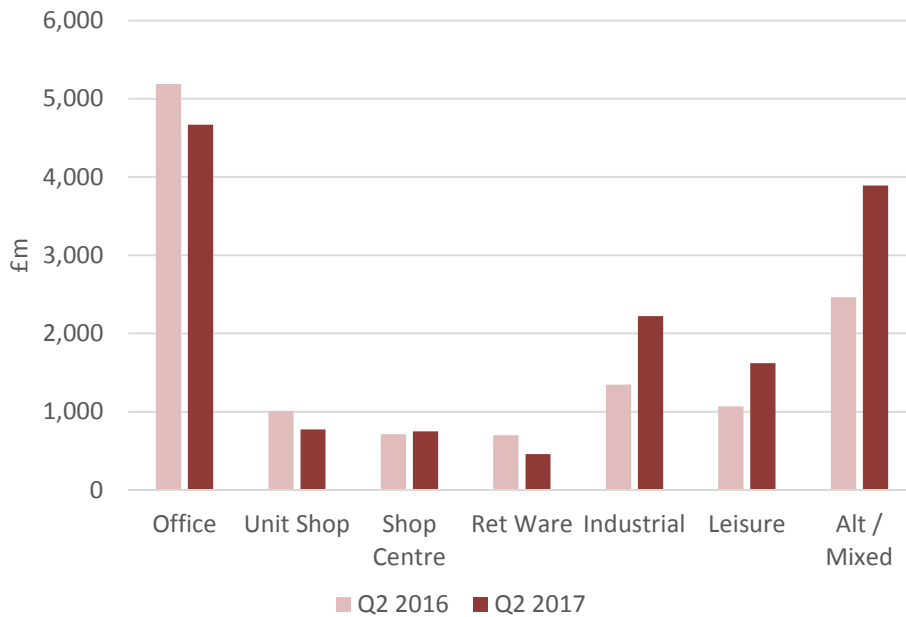
Consumer spending continues to be a key driver of growth; the quarterly household savings ratio fell sharply, to 1.7%, in Q1 2017.



According to the average of independent forecasters' views compiled by HM Treasury for June, UK CPI is expected to be 3.0% in Q4 2017. Above the Bank of England's 2.0% target.



Investment Activity



Source: Property Data as at 18 July 2017

Q2 2017 saw investment volumes of £14.4bn, 15% up on the same quarter last year (£12.5bn).

Overseas investors accounted for 48% of the market in the second quarter, and 48% in the 12-months to the end of Q2 2017.



Prime Yields

	Sector	Prime Yield*	Direction (next six months)
Industrial	Logistics (15 years)	5.00%	Tightening
	Industrial Estate - Greater London	4.50%	Stable
	Industrial Estate – National	6.00%	Stable
Office	City	4.00%	Stable
	West End	3.50%	Stable
	South East	5.25%	Stable
	Provincial	5.25%	Stable
Retail	High Street - Regional Centre	4.00%	Stable
	Out of Town (open A1)	5.00%	Stable
	Shopping Centre	4.50%	Stable
Alts	Healthcare	4.25%	Tightening
	Hotels	4.25%	Tightening
	Student	4.75%	Stable

*The achievable yield for a freehold, prime investment; fully let and rack-rented to tenant/s of strong financial credibility on lease terms typical of prime property in that segment. Alts = Alternatives

Prime yields in Q2 2017 remain steady: stock remains limited and investors continue to focus their efforts on the lower end of the risk spectrum, with lease length a significant factor in decision-making.

Looking forward, we do not expect much further tightening; however, prime, long-let healthcare, hotel and logistics assets will likely see some yield compression given strong demand.



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