

UK Economic Outlook

REPORT

Q3 2024



Outlook Summary



- Headline inflation has reached the Bank's 2% target, but we are expecting some volatility for the remainder of the year due to persistent wage and services inflation. Once these domestic pressures ease, we anticipate inflation should stabilise.



- The Bank of England continues to follow a data-led approach and we expect the first rate cut in August. Still reflecting stronger-than-expected growth and labour market performance, we only forecast one further cut by year end. Though minimal, falling rates will help improve consumer and business confidence and reduce debt costs.



- Unemployment is increasing, but labour markets remain tight. While we don't expect a significant rise in unemployment, we think that conditions are sufficient to reduce wage inflation.



- The outlook for growth is steadily improving. Positive signals like falling inflation, real income growth, house price stabilisation, and strong business and consumer survey responses are all indicative of an improving growth outlook for the UK.



- There are still risks around the trajectory of inflation. If wage growth doesn't decline as expected, it may postpone cuts in interest rates, which could dampen the growth outlook.

CBRE Forecasts

	2022	2023	2024 (F)	2025 (F)
GDP Growth (%)	4.5	0.1	1.0	2.0
CPI	9.1	7.3	2.5	2.6
Unemployment (%)	3.9	4.0	4.3	4.0
Base Rate (%)	2.8	5.25	4.8*	3.8
10-year gilt	3.5	4.2	4.0	3.7

*Q4 2024 (F)

This report is based on the latest data available at the time of publication, July 2024.

Inflation has reached 2%, but will it stay there?

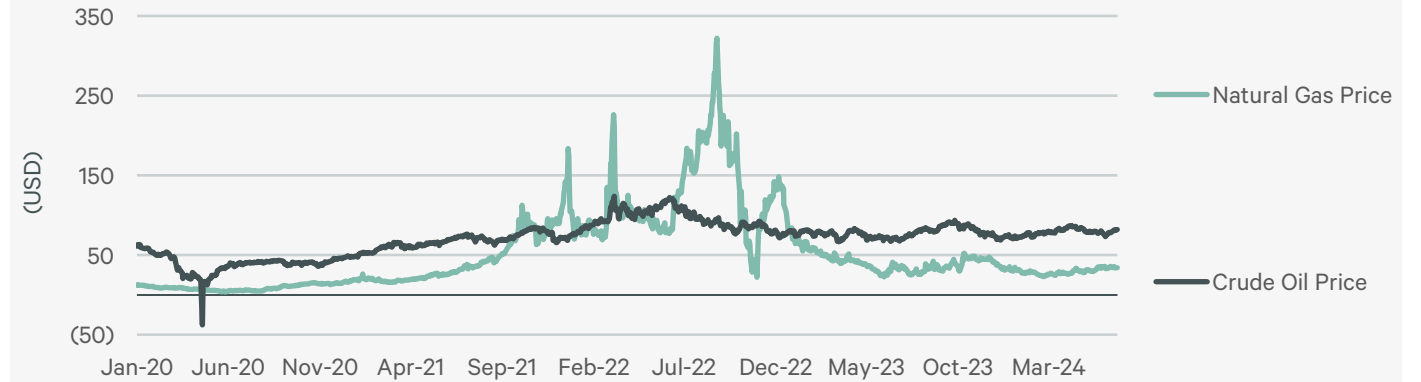
Inflation has continued its steady decline in 2024, reaching the Bank’s 2% target in May. However, we anticipate strong wage growth and a seasonal increase in energy prices, which will create volatility in the headline figure towards the end of the year.

The energy price shocks of 2022 were a large driver of UK inflation over that period. However, these have almost all but abated, and while gas prices are currently 180% higher than pre-2020 prices, they are much lower than the August 2022 peak. This has contributed heavily to falling inflation over the last 18 months and, despite a seasonal rise in energy prices, will not be a concern going forward. In addition, the post-pandemic supply chain problems have been resolved and are no longer influencing inflation.

Despite moderately rising unemployment, labour markets remain uncharacteristically tight for a period of low growth. The latest data shows unemployment nudged up to 4.4%, and while there was a further fall in vacancies, levels remain above pre-pandemic averages. Still, despite the economic weakness, [redundancies remain muted](#), and inactivity continues to increase. This is exacerbating the shortage of labour supply, evidenced by the above-average number of unfilled vacancies.

The key impact of the labour market tightness has been on wages; the latest data shows a 5.8% annual increase in average regular weekly earnings. This is over 200bps above the long-term average. As a result, upward inflationary pressure remains, and while headline inflation has fallen 670bps, services inflation has only fallen 140bps, largely due to wage growth. Without a sufficient softening in wage growth, it’s unlikely inflation will stabilise to a level that would allow the Bank of England to embark on significant interest rate cuts.

Figure 1: Energy markets have stabilised when compared to 2022 peaks



Source: CBRE Research, ONS

Figure 2: Wages remain persistently above long-run average levels due to tight labour markets



Source: CBRE Research

How is the interest rate outlook evolving?

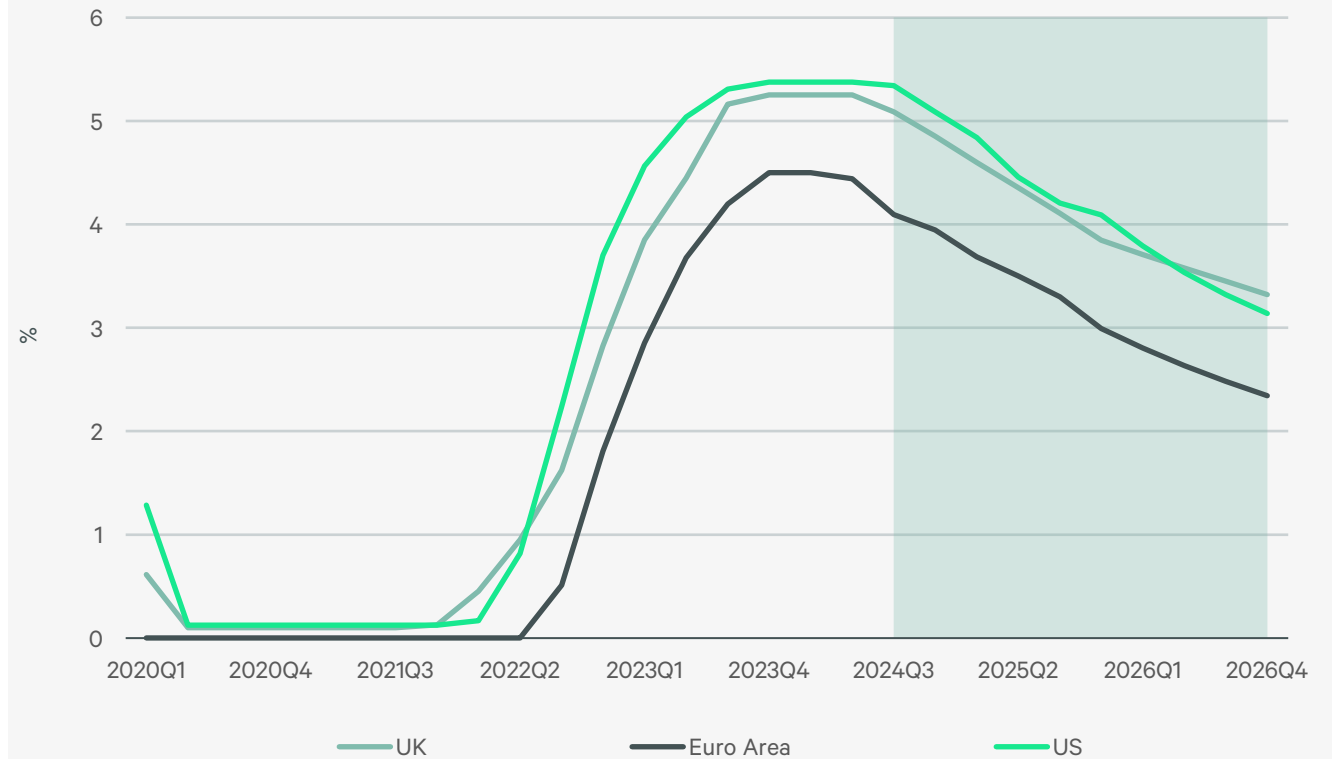
Our forecasts now suggest just two interest rate cuts this year. This is due to a combination of stubborn wage growth and stronger-than-expected economic growth. However, we are now broadly in sync with major economies globally, so other considerations such as currency risk will need to be considered.

Despite inflation reaching the Bank's target, the MPC voted 7-2 to keep rates at 5.25% in June, emphasising their aim to ensure inflationary stability over the medium-term. This was in line with market expectations after services inflation and wage growth fell more slowly than the Bank anticipated in March.

However, in contrast to early 2023, the UK disinflationary process is no longer an outlier compared with other developed economies. In June, the ECB reduced its three main rates by 25bps, citing softening wage growth and positive core inflation signals. With our UK outlook showing a similar direction of travel, we expect the first Bank of England rate cut will occur in August. Like the UK, the US held rates in June amid stronger-than-anticipated economic growth and strong labour market signals. Long-term bonds have remained stable, fluctuating as markets' expectations of rate cuts have changed, largely in response to inflation data releases.

A final consideration for the Bank is around currency risk. Cutting the base rate out of sync with the US could lead to depreciation of the pound. The UK experienced the negative impacts of a depreciating currency following the mini budget, and the euro has depreciated slightly against the US dollar since its rate cut was announced. Currency depreciation can, among other things, lead to "imported inflation", which the Bank will be eager to avoid. However, the risk is minimal as the Fed is likely to cut interest rates in 2024, albeit slightly later than in Europe and the UK.

Figure 3: Cuts for the UK and US are still expected although less than we thought at the start of the year



Source: CBRE Forecasting

What does this mean for growth?

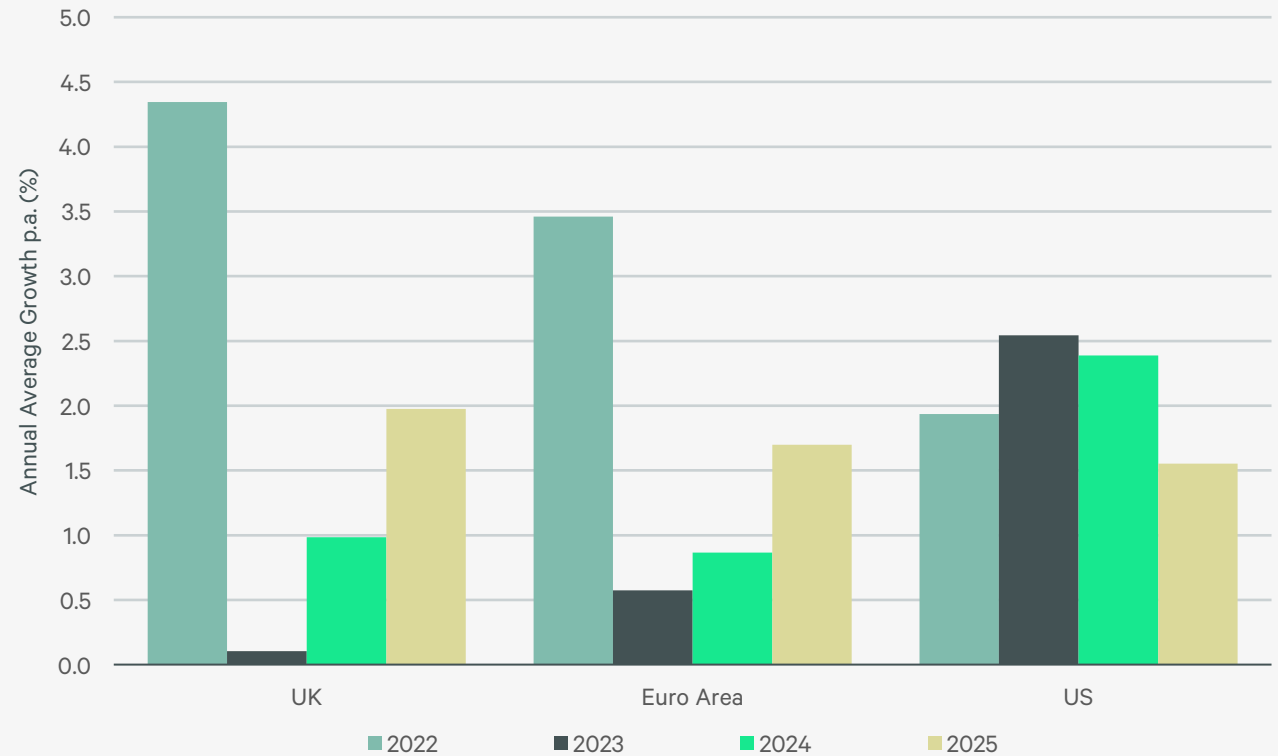
We expect to see economic growth improving over the course of the year, boosted by more normal levels of inflation, interest rate cuts, real income growth, and increasing business and consumer confidence. So, while we forecast below average annual growth of 1.0% for 2024 overall, the Q4-on-Q4 comparison will be higher at 2.0%.

It was a strong start to the year, as the UK bounced back from the technical recession with growth of 0.7% in Q1. Strong services growth was supported by growth in production, despite construction contracting. The latest monthly data shows GDP increased by a further 0.4% in May. Household expenditure increased 0.4% in Q1, while retail sales remain volatile, growing 2.9% in May, yet have only increased 0.7% since the start of the year due to poor weather conditions impacting consumer activity. Furthermore, the household savings ratio increased in Q1, driven by increasing wages. This indicates households have strong spending capacity if they decide to ease their constraints.

Business and consumer confidence continues to improve. GfK's consumer confidence survey reached the joint highest score since November 2021 (-14), and PMIs are all in expansionary territory. We expect another uptick once the first interest rate cut is announced. In addition, in over 70% of cases, consumer confidence has increased following a general election. This would act as a catalyst for further improvement in overall activity and household consumption.

The key risk to the growth outlook is the path of inflation. If it is unexpectedly high, or more volatile than expected, the MPC could delay interest rate cuts and dampen growth. A further 'one to watch' will be the Labour Government's first budget in September.

Figure 4: Growth remains below long-run averages, but the outlook is positive




Source: CBRE Forecasting

What does this mean for commercial real estate?

- 1 Yield contraction is likely to be less sharp in 2024 than previously thought. This reflects our revised interest rate outlook, but we anticipate that capital value falls will turn by the end of the year. We expect the first interest rate cut in August, with a second later in the year, totalling a fall of 50bps by the end of 2024.
- 2 Stronger GDP growth and reduced interest rates should boost investor sentiment, but cash buyers will likely be the first to move.
- 3 Lower inflation is boosting real income growth, and this looks to be driving demand as both GDP output and household expenditure are improving. An improving household sector will particularly benefit the retail and logistics sectors as demand for goods increases. Interest rate cuts and a more positive outlook for house prices will benefit the residential market as mortgage rates come down, driving demand for houses, although this could cool the residential rental market. Prime offices continue to benefit from tight labour markets and strong office-based employment growth. There is a continuation of returning to the office, particularly in the services sector, which is driving the economy.
- 4 Labour have laid out plans for commercial property in its manifestos and you can read more about what this might mean for the sector in our [Mid Year Outlook](#) and [recent research](#).

Overview

	Recent Developments	Outlook	Risks
GDP	 The UK bounced back from its technical recession to register 0.7% GDP growth in Q1, driven largely by the services sector.	Growth is improving, with falling inflation, real income growth, and confidence at three-year highs. We expect more activity in the second half of the year and growth of 1.0% and 2.0% in 2024 and 2025, respectively.	Risks to inflation could delay the cutting of interest rates and dampen the growth outlook in the near-term.
Consumer trends	 Retail sales grew 2.9% in May but remain volatile, registering 0.7% growth since the start of 2024. Poor weather conditions have been affecting consumer activity.	Consumer confidence remains trending upward, and real income growth and increasing certainty will benefit consumption.	A weaker-than-expected rebound in consumption due to higher-than-expected savings flows could weaken the outlook. A protracted downturn in the housing market could affect consumer sentiment.
Labour market	 Unemployment increased to 4.4% as the labour market continues to unwind but remains tight with wages still growing strongly (5.8%).	Relatively, the labour market is still tight and our expected peak in unemployment at 4.4% is low. Further softening will see wage growth continue to fall.	Insolvencies have spiked and a continuation of the weak economic environment and low demand could lead to labour shedding, increasing unemployment.
Inflation	 Inflation fell to the Bank's 2% target in May which continues to be driven by goods, with services inflation remaining stubborn (5.7%).	With high energy prices removed from the year-on-year comparison and stubborn wage growth, we are expecting some volatility in the headline figure settling at the Bank's target later in 2025.	A slower-than-expected decline in inflation will keep interest rates higher for longer, slowing economic recovery. This risk could come from further fall out from the Middle East conflict, affecting energy prices or more stubborn than anticipated services inflation.
Policy conditions	 In June, the Bank of England voted (7-2) to keep the base rate held at 5.25%.	Base rates have peaked while bond movements remain tentative. We expect that inflation signals will lead the Bank to cut rates in August.	Shocks to inflation and stubborn core components of CPI are the main risks that could lead the Bank to postpone cutting rates and delaying an economic recovery.

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