OCTOBER 2018

DESPITE BREXIT

Brexit dominates the headlines, but recent statistics point to an economy that is deaf to the political noise.

Headlines

Recent indicators point to a UK economy expanding despite Brexit

GDP grew by 0.7% in the three months to August, while pay growth beat expectations

This environment is supportive of rental growth, which is in evidence in some markets

Nevertheless, a hard Brexit caveat remains necessary, given the rollercoaster politics

Recent weeks have seen a run of figures released that are at odds with the expectation that Brexit should be casting a wet blanket across the UK economy. GDP growth in the three months to August was an impressive 0.7%, confirming that output has gathered momentum over the spring and summer. Unemployment remained at just 4.0% in August, while pay growth came in ahead of forecast at 3.1%, its highest level in nearly a decade.

A fall in inflation in September to 2.4% brightens the picture further. Weaker inflation means real terms pay growth for workers, and in turn higher retail spending, just as we move into the Christmas shopping season. This bodes well for a robust Q4 GDP figure.

Economic commentators are doubtless noticing the frequency with which they end sentences with the words “despite Brexit”. The strength of the indicators is not in-line with the view that the political uncertainty should be encouraging investors, businesses and consumers to rein back. What should we make of this?

Few relocations

Previously, the economy’s refusal to respond to the march towards Brexit was attributed to it being a distant event. The argument ran: we are still in the EU, wait until the UK is closer to leaving. After all, businesses cannot relocate operations quickly, and there is a certain logic that any job migration from the UK to the EU would happen gradually.

However, if we look at finance, an industry expected by some to be hard hit by Brexit, a Reuters study found that just 630 jobs have so far moved to Europe – the equivalent of 0.16% of London’s financial workforce. In a hard Brexit scenario, the same study estimates the figure could rise to 5,800, although according to ONS 6,000 new finance jobs were created in London between April and June of this year.

Far from losing momentum as we draw closer to Brexit, the monthly GDP figures point to a rebound for growth, after severe weather brought growth to a halt in March and April – see figure 1. In part, this is thanks to a strong performance from the information and communication

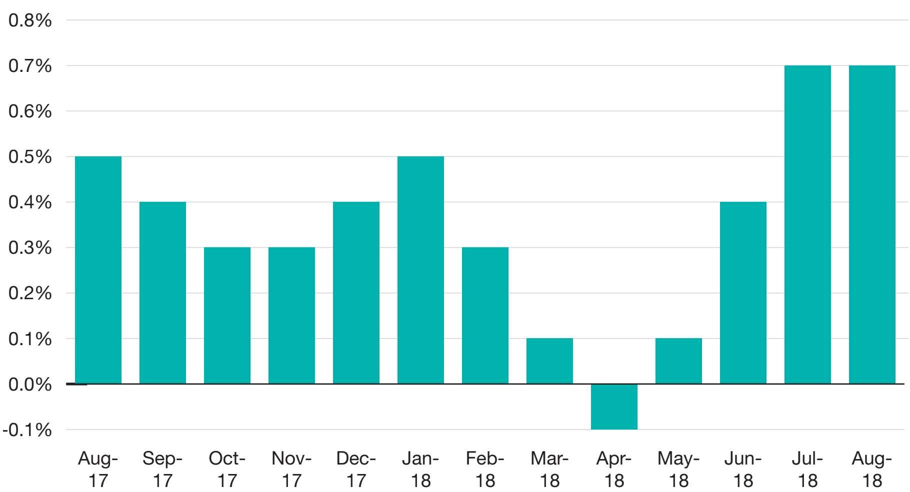
JAMES ROBERTS
Chief Economist

“If we look at finance, an industry expected by some to be hard hit by Brexit, a Reuters study found that just 630 jobs have so far moved to Europe – the equivalent of 0.16% of London’s financial workforce.”

Follow James at @KF_JamesRoberts

For the latest news, views and analysis on the world of property, visit Knight Frank’s blog www.knightfrank.co.uk/blog

FIGURE 1
UK GDP over the previous three months



Source: ONS

sector, for whom Brexit is less of an issue than industries like finance.

Life goes on

We believe the explanation for the resilience of the UK economy since the referendum can be explained in three words: life goes on. The technology and media revolution engulfing the UK is continuing irrespective of Brexit. In many industries, trade with the EU only makes up a minority of activity. Oliver Wyman estimate that for wholesale finance (i.e. the City), the domestic market and the rest of the world make up around 75% of business. This non-EU business still has to be carried out, and the same will be true after Brexit.

Firms continue to rebuild inventory, and replace the broken and obsolete; while consumers spend their real terms pay rises. Add all the above factors together for a country with a population of 66 million people, and we get an economy that can grow despite Brexit.

None of this rules out a hit for the economy in the event of a hard Brexit; however, the no deal scenario will not impact all regions and industries evenly. Tech industries have far less Brexit exposure than agriculture, for instance, and the impact around the country will vary. We should also be ready for the 'hit' to play out different to popular expectations. It is widely assumed that finance will struggle in the event of a hard Brexit, but institutions have contingency planned in consultation with regulators. Finance could prove to be one of the best prepared industries.

All this comes with the caveat that no deal remains just one of several possible outcomes. Nevertheless, the present situation is that there is a huge gap between the relatively positive economic statistics, and the hugely negative Brexit debate. Conditions in the property market are in-line with the economic figures, not the political storm.

Value add

For property, the resilience of growth in the UK is well timed. Prime yields are low, and some investors are struggling to make the sums work to buy at current levels. Expectations of higher interest rates are pushing property investors up the risk curve towards value add and development opportunities. This strategy becomes more attractive when rental growth is either occurring or anticipated.

This returns us to Brexit. At present, there are office markets around the UK that are achieving modest rental growth. IPD data suggests the same is true in parts of the industrial market. The drivers are a shortage of development, better than expected demand, and a desire to experiment with new locations and office formats. If the government were to announce a withdrawal agreement soon, clearing a path to the transition period, rental growth could spread to other parts of the market, increasing the logic for development and asset management.

"At present, there are office markets around the UK that are achieving modest rental growth. IPD data suggests the same is true in parts of the industrial market."

RECENT MARKET-LEADING RESEARCH PUBLICATIONS

China Outbound Real Estate Investment - Oct 2018

Active Capital 2018

The New Energy Economy 2018

Manchester Report - catching the new wave

Knight Frank Research Reports are available at **KnightFrank.com/Research**

COMMERCIAL RESEARCH

James Roberts
Chief Economist
+44 20 7861 1239
james.roberts@knightfrank.com