UK ECONOMIC AND INVESTMENT BRIEFING
JANUARY 2018

Economic

- UK growth forecasts for this year are clustered around 1.5%. BNP Paribas expects growth of 1.2% for 2018.
- Encouragingly, markets have responded positively to the breakthrough agreement agreed last year and business and consumer confidence indicators may follow suit over the next month or so. In this context there is some upside risk to the forecasts.

Investment

- At year-end, 2017 appears to have confounded most expectations in terms of investment activity; with full-year transaction volumes of £64bn.
- Overall, overseas buyers acquired £31bn of UK commercial property in 2017. Asian buyers dominated the market; acquiring over £13bn of assets and accounting for 42% of foreign investment.
- The MSCI IPD UK Monthly Property Index recorded a 12-month total return of 11.2% for All Property. Industrial property saw a total return of 21.2%, as investors bid strongly for a limited stock of assets.

Labour productivity, or economic output per hour worked, grew by

0.9%

BNP Paribas expects UK growth for this year to reach

1.2%

UK GDP in Q4 was

0.5%

For full year 2017, UK-wide investment volumes hit

£64bn

Industrial investment in 2017 reached

£10.9bn

Overseas investors accounted for 49% of investment

49%

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UK ECONOMIC UPDATE

Looking back at 2017

Last year was dominated by Brexit negotiations, with a breakthrough agreement being made on 8 December.

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Brexit negotiations weighed on growth

GDP grew by 0.5% in the fourth quarter of 2017 compared to 0.4% in the previous quarter. Services, once again, accounted for the majority of growth, increasing by 0.6%. The estimate puts growth for the whole of 2017 at 1.8%.

Moving ahead in 2018

UK growth forecasts for this year are clustered around 1.5%. BNP Paribas expects growth of around 1.2% year-on-year.

The UK economy will continue to be effected by the uncertainty over the outcome of the Brexit negotiations. However, it is worth noting that the annual average masks the shorter-term growth dynamics. Quarterly growth is likely to be on an upward trajectory throughout the year as it reflects the easing of the headwinds facing the consumer with inflation slowing and wages accelerating.

The recent progress on the Brexit negotiations should provide some comfort to businesses as concerns of a 'cliff edge' Brexit have reduced somewhat. However, "nothing is agreed until everything is agreed" so businesses looking for clarity earlier in the year could be waiting until later this year for any concrete details.

Encouragingly, markets have responded positively to the breakthrough agreed last year and business and consumer confidence indicators may follow suit over the next month or so. In this context there is some upside risk to the forecasts.

The Bank of England (BoE) is not expected to deliver another rate hike until Q4 2018 given the weakness in activity.

The Bank, like the Office for Budget Responsibility, is worried about weak productivity, and hence supply in the economy. It estimates that the new 'speed limit' (an economy's potential or trend rate of growth which depends on the supply of workers and their productivity) for UK growth is 1.5% – exactly where it is now. So, demand does not have to pick up for the BoE to consider it appropriate to tighten further.

Latest figures show UK productivity increasing at its fastest rate in more than six years. Labour productivity grew by 0.9% in the three months to September 2017. This was largely due to a number of factors: stronger growth in factory output, weaker jobs growth, a falling number of people entering the workforce and fewer hours worked. When fewer people work fewer hours but economic output holds steady, efficiency levels naturally rise.

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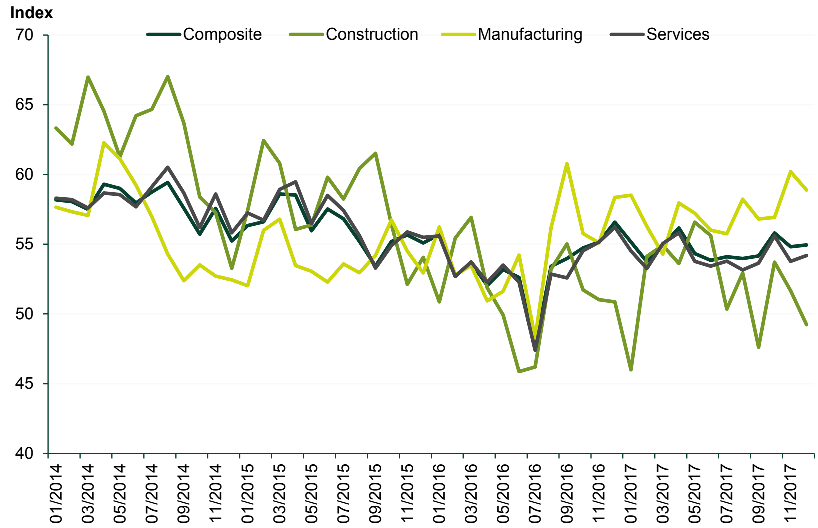
PURCHASING MANAGERS INDICES



Source: Macrobond

UK ECONOMIC UPDATE

Despite the third quarter increase being the largest seen since the second quarter of 2011 it is still well below the pre-financial crisis trend rate for the UK of about 2% a year. Productivity in the third quarter was 16.6% below its pre-downturn trend.

Sluggish productivity growth was one of the main reasons for the sharp downgrade in economic growth unveiled by the Chancellor during the Autumn Budget. Previous economic downturns have typically seen productivity fall, before bouncing back relatively quickly to the trend rate of growth. This has certainly not been the case in the years following the 2008 financial crisis, amid rising employment.

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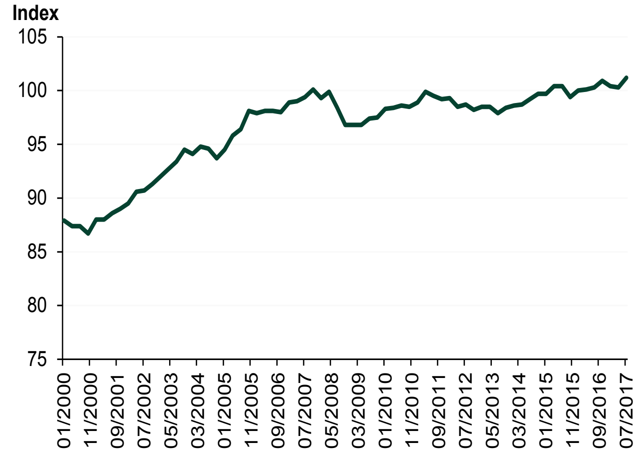
Major government bond yields hit multi-month highs recently as investors reevaluated the likelihood of QE by the world's major central banks. Speculation that the Bank of Japan (BOJ) could start to withdraw its stimulus this year put upward pressure on bond yields across the board. With the focus largely on the Federal Reserve and the ECB, not many paid attention to the BOJ assuming the BOJ would maintain its bond-buying. The change in the BOJ stance caused a reevaluation of risk in bond markets.

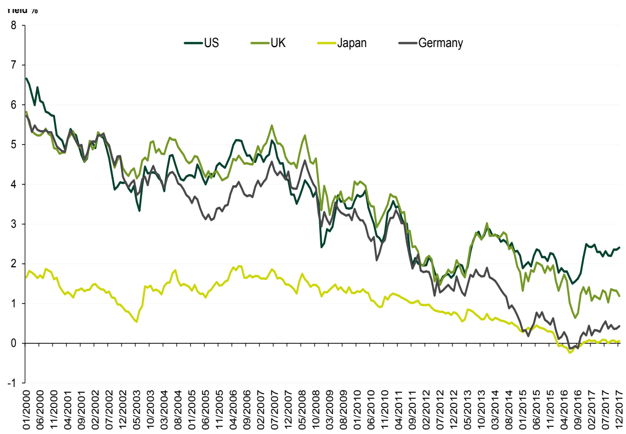
While yields have begun to rise in the US and Germany, the UK is clearly lagging. Gilt yields remain near historic lows as the political and economic outlook continues to weigh against the Bank of England's desire to continue raising interest rates.

LABOUR PRODUCTIVITY, OUTPUT PER HOUR, TOTAL ECONOMY (Constant prices)



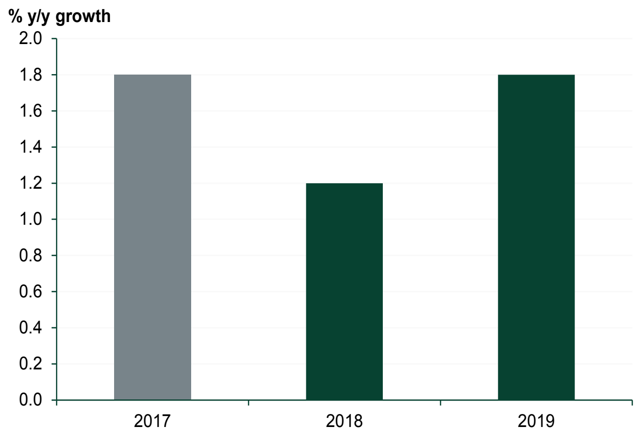
Source: Macrobond

GOVERNMENT BENCHMARK 10 YR BOND YIELDS (End of Period)



Source: Macrobond

UK GDP FORECASTS



Source: Macrobond/BNP Paribas

UK INVESTMENT UPDATE

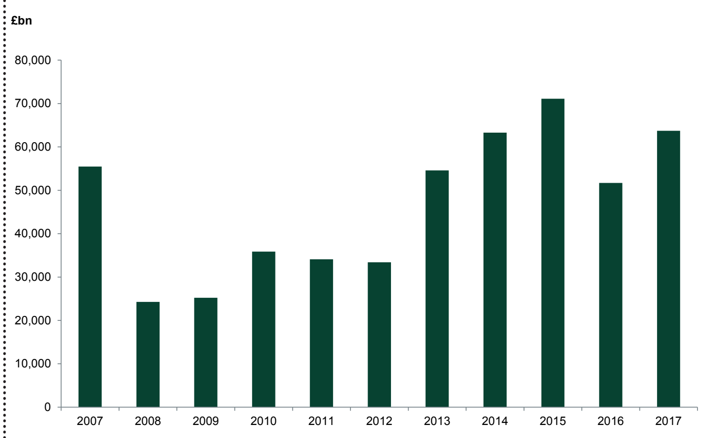
At year-end, 2017 appears to have confounded most expectations in terms of investment activity; with full-year transaction volumes of £64bn. A surprising result given the year's on-going political drama, suggesting the UK's underlying fundamentals remain attractive on a long-term basis even if investors have short-term concerns. A point well-illustrated by overseas investors' market share of 49% for the year, up from 42% in 2016 and just below 2015's 50% - a record.

Overall overseas buyers acquired £31bn of UK commercial property in 2017. However, what is particularly striking about last year is the extent to which Asian buyers dominated the market; acquiring over £13bn of assets, and accounting for 42% of foreign investment. They have now been the leading overseas buyer for two consecutive years, displacing the US buyers who had dominated activity in 2014 and 2015. Looking at net investment the figures become even more striking: overseas buyers were net investors to the tune of £12.5bn in 2017; with every other buyer segment a net seller.

In terms of sectors, the office sector remains the largest, accounting for 38% of investment volumes. Followed in second by alternative/mixed assets, this segment accounted for 25% of investment (for the third year running). Notably, however, the industrial sector continues to see investment increase; volumes reached £10.9bn in 2017 and accounted for 17% of transactions, overtaking retail investment volumes for the first time in recorded history (since 2000). Although it should be noted that we saw some major retail transactions in the listed sector, where substantial UK retail assets changed ownership; transactions that are not accounted for in these figures.

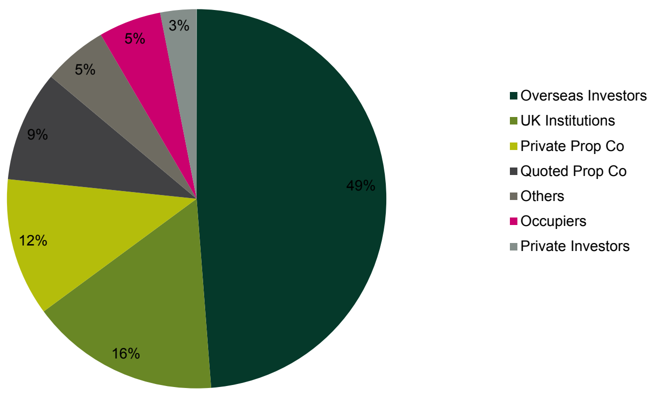
The strong weight of money targeted at UK property in 2017 also drove a level of investment performance for the year that was well-above consensus forecasts. The MSCI IPD UK Monthly Property Index recorded a 12-month total return of 11.2% for All Property. Industrial property saw a total return of 21.2% as investors bid strongly for a limited stock of assets.

UK COMMERCIAL PROPERTY INVESTMENT VOLUMES (£bn)



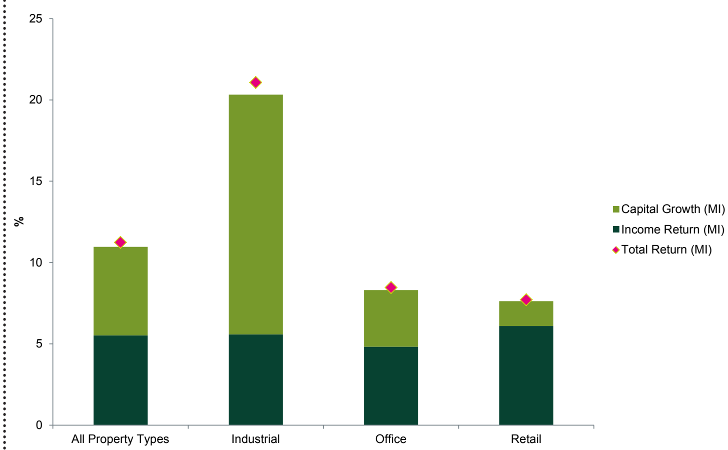
Source: Property Data, BNP Paribas. As at 22/01/2018

2017 INVESTOR BREAKDOWN



Source: Property Data, BNP Paribas. As at 22/01/2018

MSCI IPD UK MONTHLY PROPERTY INDEX, 12 MONTHS TO DEC 2017



Source: MSCI