Economic outlook

MARCH 2018

Spring forward

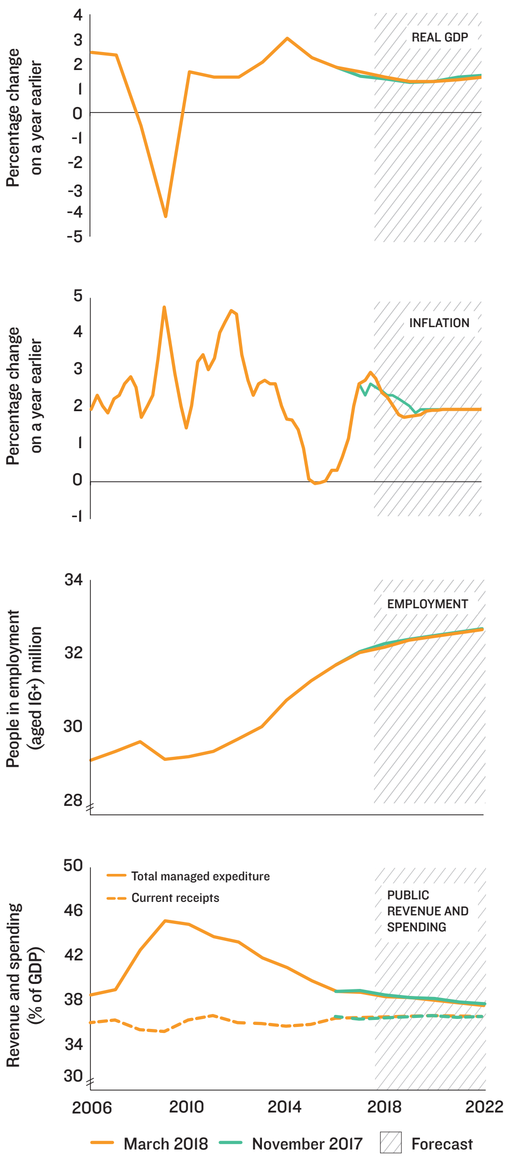
In his first slimmed-down Spring Statement, the Chancellor focused on positive economic headlines rather than policy announcements or spending commitments.

Despite the Brexit-related uncertainties that continue to affect the economy, the upward revisions on GDP growth in the Office for Budget Responsibility's latest forecast provided good news for the Government. The UK economy is now expected to grow by 1.5% in 2018 – revised up from 1.4% in November 2017 – 1.3% in 2019 and 2020 before picking up to 1.4% in 2021.

On the basis of these buoyant forecasts, the Chancellor delivered a Statement that, as anticipated, was not as rich of new policy and fiscal announcements as its recent predecessors. Instead, the Statement signalled a number of areas on which the Government is going to consult ahead of the Autumn Budget later this year, but also a continued focus on housing delivery. This follows last week's launch of the Draft National Planning Policy Framework (page 2). Moreover, the Chancellor also indicated that if this positive economic news continues, there may be flexibility for Government investment in the Autumn Budget later this year.

Additional topics covered include the rise of inflation and the impact this could have on the economy and construction (page 3) and the Government's policies to boost housebuilding – the Letwin Review and showing the latest housebuilding forecasts (page 4).

Figure 1: Macroeconomic indicators



SourceOBR; Lichfields analysis

THE STATEMENT IN FIGURES:

1.5% UK GDP growth in 2018, revised upwards from 1.4% in November 2017

1.4% forecast average annual UK GDP growth for 2018-2022

500K increase in people in employment between 2017 and 2022

300K annual housing target by mid-2020s

2021 date for the next business rate revaluation

£1.7BN funding to London to build 27,000 affordable homes by 2022

44 areas involved in bids into the £4.1 bn Housing Infrastructure Fund

At the heart of our plan for building an economy that works for everyone is our commitment to tackle the challenges in our housing market.

Chancellor of the Exchequer, The Rt Hon Philip Hammond MP

Latest policy announcements

Well-designed places: the draft NPPF's 'golden thread'

The draft National Planning Policy Framework (NPPF) has a whole chapter dedicated to 'achieving well-designed places', plus numerous housing-related design references throughout – both direct and implied. Initial reactions to the consultation have nonetheless focused on quantitative aspects of new housing delivery. This could change, following today's publication of Sir Oliver Letwin MP's 'preliminary update' on his independent review of build out rates and how to 'close the gap' between permissions and completions. He reports that the design and 'style' of new homes being granted planning permission help determine absorption rates, which in turn drive build out. His 'update' links to the 'golden thread' of design that stitches the draft NPPF's policies for boosting housing delivery together - from identifying housing land and establishing design principles in development plans, to optimising density in the right location, to design quality being key in the evolution and assessment of individual proposals.

CIL indexation: amending the rules

Taking inflation into account in applying community infrastructure levy (CIL) charging rates to individual developments has caused ever-increasing uncertainty from when levy rules came into force in 2010. Past regulation amendments have addressed some of the issues. But the BCIS All-In Tender Price Index (for which there is a charge) still causes problems in calculating CIL, as does indexation itself.

If the CIL rules are changed, as currently being consulted on, to use different indices for residential development (based on several options relating to house price indexation), and for other development (based on the CPI, or some other yet-to-be-suggested data), calculating CIL liability on a mixed use scheme will become even more complicated. Other indexing problems are being ironed out more effectively, especially where planning permission has been granted before a charging schedule has come into force, and s73 permissions have been granted afterwards.

Letwin review update: is 'absorption rate' the key?

The 'preliminary update' from the Independent Review of Build Out commissioned at last year's Autumn Budget, led by Sir Oliver Letwin MP, has been published.

The interim findings specifically focus on why major housebuilders 'take as long as they do' to build homes on large sites. The Update underlines how a 'web of commercial and industrial constraints' has been highlighted as holding back large site build out, including: the limited availability of skilled labour; limited supplies of building materials; difficulties in land remediation; and provision of local transport infrastructure.

However, Sir Oliver Letwin is not 'persuaded' that these are the primary determinants, rather pointing to the 'absorption rate' (i.e. the rate at which homes can be sold), as the 'fundamental driver'. He acknowledges that this rate is largely determined by the type (including 'size, design, context and tenure') and pricing of new homes, and the limited opportunities for other housebuilders to enter large sites putting large housebuilders 'in a position to exercise control over these key drivers of sales rates'.

Accordingly, Sir Oliver Letwin raises further questions to be investigated in the coming months, relating to: how the absorption rate would be affected if large sites were to be 'packaged' in ways that foster the delivery of different products; what would happen to absorption rates if the reliance on large sites were to be reduced; and what implications a different absorption rate would have on the current business models of major housebuilders.

Finally, the Update concludes that he will also 'investigate what effect faster build out rates would be likely have on the 'land banks' held by major builders'. The results of his analytical work are expected by the end of June in the form of a Draft Analysis; recommendations in a final report will be produced in time for the Autumn Budget.

Inflated concerns

The latest forecasts from the OBR suggest that inflation, as measured by the Consumer Price Index (CPI), would slow to around 2.4% in 2018. CPI has remained at around 3% since August 2017. The OBR and the Bank of England agree that CPI stands above the 2% target almost entirely due to higher import prices.

This is particularly relevant when inflation is compared to wages. **Following two years of positive real wage growth in 2015 and 2016, higher inflation has caused a decrease in real wages in 2017 that may continue in 2018 (Figure 2)**. However, the OBR expects CPI to fall back to the 2% target in the next 12 months and real wages to start growing again from early 2019.

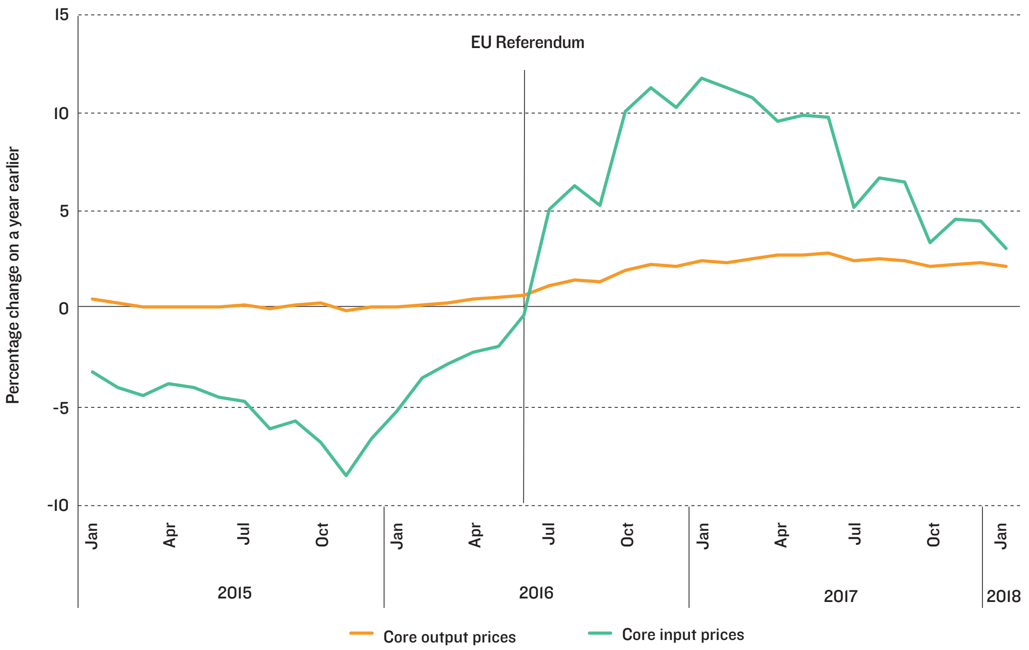
Other measures of inflation capture how recent changes in prices have affected UK businesses (Figure 3). The differences in the magnitude of change between core input and core output prices is explained, on the one hand, by how businesses decide to set their prices and, on the other hand, by how these metrics are built. The core input prices measures the cost of materials and fuels (both imported and domestic) for UK manufacturers, while the core output price is a measure of the amount received by UK producers for the goods they sell in their domestic markets.

Figure 2: UK Median Pay and Consumer Price Index

Source: ONS, Lichfields analysis

The impact of the sterling depreciation following the EU Referendum is clearly visible in the uptick in core input prices from June 2016, albeit output prices have taken longer to pick up. The subsequent increase in the price of imported materials such as bricks, bathroom fittings and doors has hit some (mostly housebuilders and businesses relying on imports) while boosting business for domestic producers, relatively favoured by the pound weakening.

Figure 3: Core input and core output prices



Source: ONS, Lichfields analysis

I am pleased to report that the OBR expect inflation, which is currently above target at 3% to fall back to target over the next 12 months.

Chancellor of the Exchequer, The Rt Hon Philip Hammond MP

Homes under the hammer

Despite continued fiscal caution, one key area of public investment is housing. The Chancellor reiterated his desire to build 300,000 homes each year by the mid-2020s and highlighted two important funding allocations: London will receive £1.7 billion to build 26,000 affordable homes in the capital by 2021/22; and the agreement with the West Midlands to build 215,000 new homes by 2030/31 stimulated by the Land Remediation Fund.

The OBR provided forecasts for housebuilding that will both please and disappoint the Government. Forecasts suggest house prices will be 32% higher in 2022 than in 2015 stemming from a deceleration in growth to below 3% per year from next year (Figure 4). Residential property transactions are forecast to increase year-on-year but only by between 0.5% in 2018 and 2.4% in 2022 indicating that the market may slow (Figure 5).

Importantly, the OBR has forecast that net additional dwellings – the measure by which the government will mostly closely watch to see any boost in housebuilding – will plateau. In 2018, 246,000 net additional dwellings are forecast which slows to 239,000 in 2022 (Figure 6).

The government will, therefore, closely monitor the findings from the Letwin Review (as set out on page 2) to see his recommendations for boosting housing supply which will work alongside the proposed changes to the National Planning Policy Framework, published earlier this month.

Boosting housebuilding is not an easy task, particularly within an environment of political uncertainty – the Government does not have much time to lay the foundations to build 300,000 homes per year next decade.

Figure 4: Index of house price forecasts (100 = January 2015)

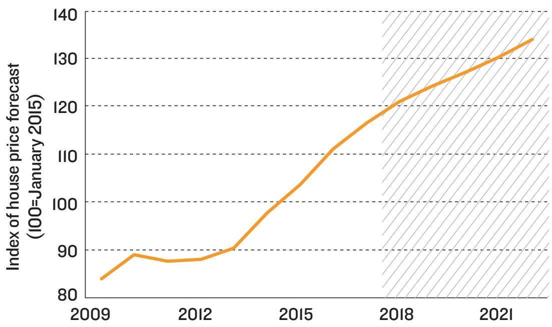


Figure 5: Residential property transactions

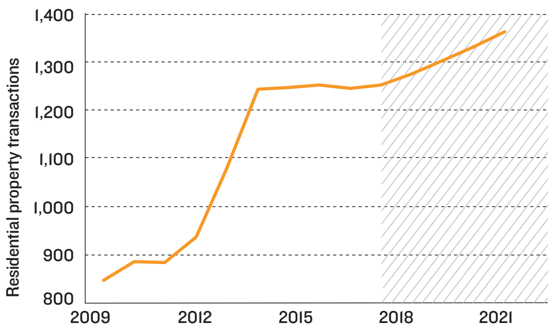
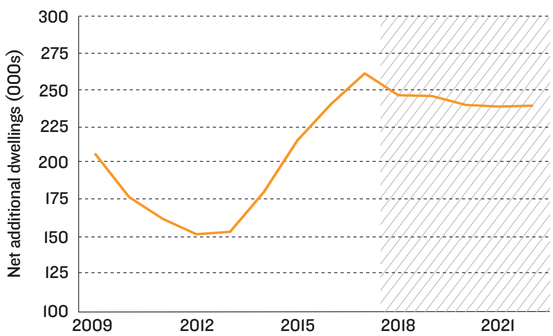


Figure 6: Net additional dwellings



Source: OBR; Lichfields analysis

We are concluding housing deals with ambitious authorities who have agreed to deliver above their Local Housing Need.

Chancellor of the Exchequer, The Rt Hon Philip Hammond MP

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