The Ripple Effect

Bear: Morning Bull. Where are your running shorts? Have you forgotten it's London Marathon day.

Bull: You'll have to count me out this year I am afraid, Bear. My poor legs haven't yet recovered from the Landmarks Half Marathon. Although to give me credit, I was dressed as 10 Downing Street and running into a 40mph headwind.

Bear: I'm disappointed, Bull. I overheard some of your chat with Russ Cook (aka the Hardest Geezer) in the office last week and you made it sound like you did marathons for fun!

Bull: Not at my age, Bear. The joints don't allow it. Although, I do have to bow down in admiration to someone who has just run the length of Africa and is prepared to run another marathon just two weeks later. As a warm-down!

Bear: Absolutely. He's clearly on a mission to inspire a whole generation of runners. Not to mention the money he's raised for charity.

Bull: I just wonder how many people have read his story, popped on their trainers, and headed out to the local park for a couple of circuits. It's hard to find excuses not to force yourself out for a 5km jog, when he's just completed a 16,000 km odyssey.

Bear: I agree. His story was one of the few positive headlines I've seen recently. The rest of the news cycle feels like it gets more depressing and alarming by the day.

Bull: You're not worrying about the turmoil in the Middle East again are you, Bear? I don't want to downplay the horrors of what is happening in Gaza or the tit-for-tat blows now being traded between Israel and Iraq but there have been explosive tensions on and off in that region for decades. And besides, we are here to discuss the property investment market, not geo-politics.

Bear: But that's the problem, Bull. Like it or not, global political instability has an impact here in the UK. And a full-blown regional conflict in the Middle East could cause all sorts of unforeseen ripple effects. The current Iran-Israel hostilities have already crossed some serious red lines.

Bull: Wow. You do know how to bring a conversation down to earth with a bump. Just look around you for a second. The Spring blossom is out. The 44th edition of the London Marathon is underway. Inflation is back under control. CBRE's prime yields have stabilised. And the UK property market is showing tentative green shoots of a recovery. Life looks good from where I'm standing.

Bear: Gosh. You can be so blinkered sometimes, Bull. Do you remember last week's conversation about the St Bride's World Cities Index when we bemoaned the fact that London has been de-throned by the Big Apple for the first time.

Bull: Yes. But I am not sure why that's relevant.

Bear: Because property investors operate across borders, Bull. The international political and macro-economic backdrop frames what happens here in the UK. The global backdrop is one of low growth, high interest rates, sticky inflation, and an increasing number of escalating regional conflicts. The focus over the last few weeks has been on the Middle East, but we mustn't forget that Russia's full-scale invasion of Ukraine is now in its third year.

The IMF has lowered its global growth forecasts

IMF global growth forecast for 5 years ahead (%)

Source: IMF

Bull: Blimey. I'm glad you weren't surveyed as part of the UN World Happiness Index. I am not sure the UK would have been awarded a ranking at all!

Bear: Stop being facetious, Bull. The point I am trying to make is that while the unprecedented escalation in tensions in the Middle East might feel far removed from our local London boozer, the global financial markets are jittery.

Bull: How do you mean?

Bear: Well, just look at what happened on Friday morning when Israel launched reprisal attacks on Iran. Oil futures for Brent crude, the international oil benchmark, shot up over 4% in a matter of minutes. And gold prices briefly came close to a record high before settling just below $2,400 an ounce. Goodness knows what will happen if there is an all-out regional war.

Bull: Well, it's probably not going to help with the cost of petrol for starters.

Bear: It could get a lot more expensive all round, Bull. As you well know, a sustained rise in oil prices risks further fuelling of inflation. Remember, Iran is the seventh largest oil producer in the world, and the third-largest member of OPEC.

Bull: Ah.

Bear: And any escalation in the conflict could cause supply chain issues. The Strait of Hormuz between Oman and Iran is a crucial shipping route. Approximately 20% of the world's total oil supply passes through it and members of OPEC- Saudi Arabia, Iran, the UAE, Kuwait and Iraq - send most of the oil they export through the strait.

Bull: Well, I did notice that the stock market wasn't very happy on Friday morning either. The FTSE 100 share index turned decidedly red in early trading before it rallied again. There is certainly heightened volatility.

Bear: Exactly, Bull. What I am trying to press home to you is that these global events have a direct bearing on the UK economy and, ultimately the underlying performance of UK property. And I am seeing plenty of potential global financial headwinds.

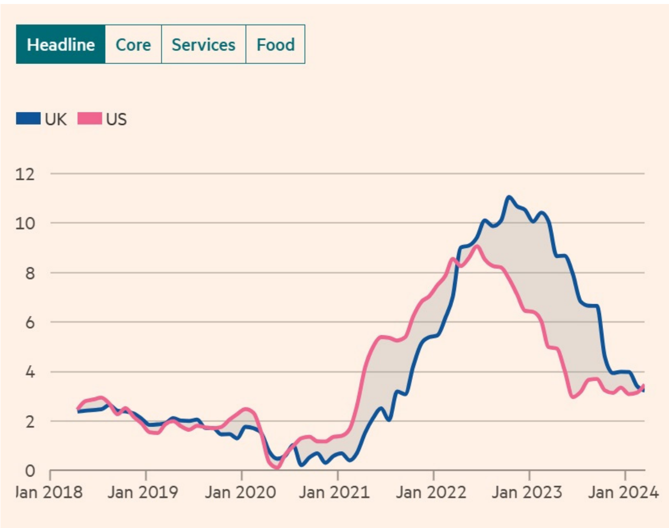
Bull: I've got your message loud and clear, Bear. The UK's economic fortunes are inextricably intertwined with events abroad. However, if we are going to take a balanced approach here, then I think it is also worth focusing on the domestic situation too.

Bear: I seriously hope you are referring to the UK economy, rather than Arsenal and Liverpool's fast diminishing hopes of catching Man City in the title race.

Bull: I'll pretend I didn't hear that, Bear. If you'd taken the trouble to read what Andrew Bailey said last week in Washington, he was actually pretty upbeat. We are now in the midst of a "pronounced period" of disinflation with inflation at a two-and-a-half-year low of 3.2%. I'll take that as a positive for the UK, especially as US inflation is proving stickier.

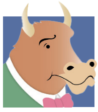
Headline inflation in the UK dropped below that of the US in March 2024

Annual percentage change on Consumer Price Index (%)



Source: LSEG, Financial Times

Bear: I'll grant you that one, Bull. Although, in case it has escaped your notice, the inflation rate is still above the Bank of England's 2% target. And it didn't decrease as much in March as forecasters had expected.



Bull: You are a hard man to please sometimes, Bear. The fact is that on the domestic front there are now reasons to be optimistic. Real wages are rising, inflation is falling, and the recent cuts in national insurance, combined with the increase in the living wage, should help to boost household income and spending. Average earnings increased 5.6% in the three months to February. That's got to help.

Bear: There are some positive signs in there, Bull. However, your little synopsis conveniently overlooks the fact that the unemployment rate in the UK edged up 0.3% in the three months to February, and the rate of economic inactivity in the UK workforce is still troubling. Did you know that the UK is the only country in the G7 where economic inactivity remains higher than it was before the coronavirus pandemic?

Bull: I didn't. Although only this week, Rishi announced a raft of measures to tackle our "Sick Note Culture". Maybe it has just taken us longer to get back on our feet.

Bear: That's one way of spinning it, Bull. But if you look closely at the employment data, rising redundancies and falling job levels are sure signs of a stagnant, rather than a buoyant economy.

Bull: Okay, Bear. Enough of the tit-for-tat. We know that the main stimulus for capital growth in the UK property market will be driven by a downward movement in interest rates. If you're so convinced that the jobs market is weakening, then labour shortages and wage growth should ease. Surely at that point, it's only a matter of time before the Bank of England starts to cut interest rates from its current 16-year high of 5.25%.

Bear: If only it was that simple, Bull. The policy makers on the MPC are navigating some very choppy waters. And their recent record has been far from perfect. Has the inflationary dragon really been slain? Will there be further inflationary shocks to the system? The Bank has a myriad of factors to consider before they start cutting interest rates.

Bull: Stop, Bear! You're giving me a headache. This may be a period of increasing global financial volatility, but surely in that situation the UK and London property market provides a genuine safe haven status. We've always advocated investing in property for the long term and there is a reason that London remains no.2 on the St Bride's World Cities Index. Where better to ride out a storm, especially as, unlike anywhere else, we have just about fully marked down our assets to their real market values?

Bear: Now that's a sentiment I can agree with, Bull. In times of turbulence there is always something comforting about investing in good old "bricks and mortar", if you'll excuse the expression.

Bull: Right, I need to stretch my legs and clear my head of all those economic statistics. I might even go for a run.

Bear: That's the spirit, Bull. I knew some of that Hardest Geezer inspiration would eventually rub off on you. I'd join you of course, but Mrs Bear has just messaged to say our roast lunch is almost ready. And her Sunday spreads are legendary.