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Strategy and Public Affairs for Real Estate

Populism, Politics and the Economic Context

As we try to make sense of the political tremors that have shaken the Western post-war order in the past 18 months, we could do worse than recall the words of Bill Clinton, 42nd US President, "it's the economy stupid."

The resurgence of populism, nationalism, protectionism – Brexit; the election of Donald Trump; the rise of the AfD in Germany; secessionism in Catalonia. All have their roots in the 2008 Great Recession. It is a salutary reminder that when faced with long periods of economic anxiety, voters from Birmingham to Berlin will find it tempting to seek refuge in those who offer easy solutions to complex problems.

The Great Recession of 2008 – Long-term impacts on the UK Economy

- Even in the UK which avoided the calamitous collapse suffered by the Greek and Spanish economies, the recession had massive economic, political and social consequences which are still unwinding.
- Productivity has stalled since 2008 (Forecast Evaluation Report, 2017 – Office for Budget Responsibility); while wage growth remains at record lows.
- As for the political pendulum, it seems permanently stuck in the middle of its once traditional swing. Coalitions or weak, minority governments seem to be the new normal.
- Moreover, a decade of austerity fueled a near breakup of the three centuries old Anglo-Scottish Union and fed much of the economic discontent that underpinned the Brexit campaign.

The Unlikeliest Heroes

In 2008 it was in large part Central Banks that pulled the global economy back from the debt-ridden brink that investment bankers and their customers had driven it towards.

But now the Fed, the ECB, the BoE and their peers have a new problem. Prescribing the usual economist's medicine of printing money (QE) and loosening monetary policy (lowering interest rates) to encourage the modern economy into growth, is proving less and less effective.

As outgoing Fed Chairwoman Janet Yellen said in September: "Our framework for understanding inflation dynamics could be mis-specified in some fundamental way." For a central banker this admission is the equivalent of a full throated primal scream.

The relationship between inflation and employment – for 30 years the formula used to measure the stage of the economic cycle and known as the "Phillip's curve' – has decoupled. This means that forecasting is now about as accurate as casting runes.
It means too that monetary policy – a key central banking lever – has lost one of its primary functions.

Economists are in a spin. Alongside this loss of confidence, they are faced with the reality that a decade of QE and ultra-cheap lending means that debt is now higher than it was even before the 2008 crash.

Should monetary policy be tightened or not? The Bank for International Settlements (BIS), the central banks' bank and one of the few organisations to have correctly predicted the 2008, thinks yes. The BoE agrees and has just raised interest rates for the first time in a decade. The Fed is not so sure.

Brexit – An Update

While the economists fret, Britain continues to negotiate its withdrawal from the European Union. No one pretends the process is moving at pace. Indeed both sides seem to accept that progress has been minimal. This is causing increasing anxiety to UK domiciled businesses which require as much certainty as possible in order to plan ahead.

The City of London has already had notice that it may be in danger of losing some big players: in recent weeks Citigroup, Morgan Stanley, Nomura and Standard Chartered have all been increasing the scale of their operations in Frankfurt. *

Sterling remains historically low, down 9% against the dollar since the 2016 referendum, 12% against the Euro**. This decline increases inflation (currently 3%) *and* the cost of living – "a 10 per cent fall in the value of sterling relative to the euro increases UK prices by 3.8 per cent" says Alan Tuckett, Bank of England economist.

UK/EU Trade – Not a Marriage of Equals

- While a cheap pound should help manufacturing exporters, given that Britain mainly exports services it helps the overall economy less than it might. This fact above all is worth considering when it comes to the debate about the wisdom of accepting a "no deal" and reverting to WTO trading terms.
- They will benefit the partner that exports *traded goods* by guaranteeing low tariffs but not the party that exports *services*. The UK primarily exports services *not* goods, so would not benefit from WTO low tariff rules.
- Plus, the partnership is unequal. The EU relies on the UK for only 15% of its trade while the UK depends on the EU for 47% of its.

Both the Conservative Government and HM Opposition are riven by dissent on the type of Brexit deal Britain should be trying to achieve. By virtue of being in opposition Labour are able to disguise this better than the Government which seems to suffer almost daily revelations of new disagreements between Cabinet Remainers vs Brexiteers.

The beleagured Prime Minister recently returned from an EU political summit with little to show for it but an embarrassing press leak from a dinner with Mr Junker. One can only hope that the food was good.

Labour is gradually shifting its position so that it better matches the many younger, pro-European voters whose support it wants to hang onto. The party's stance is by no means clear but seems now to favour leaving the EU but remaining in the Single Market and Customs Union at least for the

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duration of any transitional period. Presumably the lack of clarity in its position is a tactic designed to stop its many older, traditional Brexit leaning supporters from noticing this policy shift for as long as possible.

With the clock running down and amid increasing talk of a "no deal", the Government is now debating the 471 tabled amendments to the EU Withdrawal Bill , several of which it is not entirely confident of defeating. It requires the support of those 10 DUP MPs and 15 so called "Tory Mutineers".

The Good News

Despite some signs of "Brexodus" from the Square Mile, London's housing market is in good overall health. It remains a solid investment. Key factors in this include:

- Structural housing deficit – domestic & international demand remains very strong – population estimated to be 10 million by 2030
- Critical infrastructure & ongoing transport investment such as Crossrail 2 & the Bakerloo tube extension
- Cultural offer remains best in the world
- Education – schools and universities remain a huge overseas draw
- London remains the economic powerhouse of the UK
- Despite Brexit uncertainty, London is likely to remain a financial mega-hub for the foreseeable future
- Rule of law/minimal corruption – London remains safe haven for overseas investors
- Government is making noises about speeding up the purchasing process in England and Wales

Party Conferences

Depending on the party, conference season came and went with either a self-congratulatory whoop of delight (Labour) or with a fatal cough and the clatter of a collapsing backdrop (Conservatives).

Of the two main parties, Labour members went home the happier. They remain weirdly delighted by their 60 seat election loss.

Jeremy Corbyn is probably at the peak of his popularity within the wider party, still riding high after a surprisingly good general election performance. His front bench has been thoroughly purged of dissent along with obvious star quality. The toxic divisions which exist within Labour when it comes to Brexit were papered over by the effective if authoritarian method of simply refusing to table a debate about the biggest issue facing the UK since the Second World War.

Labour's Conference Housing offer

- Introducing a power to control rents
- Taxing undeveloped land held by developers
- Guaranteeing rights to return for tenants in regeneration schemes
- Requiring councils to ballot residents before starting large regeneration schemes

By contrast, the Conservative's mancunian get-together ended up an altogether less cheery enterprise. Overshadowed at the start by Boris Johnson's latest maneuvers, it ended – amid splutters and shambolic stage management – with a painfully public re-examination of Theresa May's prognosis as PM.

Though most of her colleagues privately agree that she must not be in charge by the time of the next general election, their inability to agree who *should* be and their determination that there won't in any event be another GE for a very long time, mean that Mrs May might well cling on in no.10 for far longer than even she had anticipated on the morning of June 9th.

New Conservative Policies

Cogniscent of the need to win back support among younger voters (a recent YouGov poll estimated that Tory membership among the under 60s to be just 19%) the Conservatives unveiled 3 key policies that are designed to appeal to the young.

- Freeze on student tuition fees
- Pensions review – extending auto-enrollment coverage to under 22 year olds
- Property – an additional £10Bn of funding towards Help to Buy (due to end in 2021) – this had the immediate effect of putting up value of housebuilding stocks by 2.6%. Plus the promise of £2 billion more into affordable housing – the last received more headlines than the first as it marked the first time for many years that a Conservative government will have directly funded social rented housing.

To put this into context, this additional subsidy will raise Government spending to £9 Billion p.a and deliver 25,000 new homes over the next 5 years. Government's own estimates say that 250,000 new homes are needed per annum for the foreseeable future to meet demand.

The Budget – What can we expect on November 22nd?

- On Oct 22nd *** Secretary of State for Communities & Local Government Sajid Javid suggested that he was lobbying the Chancellor to "use record low interest rates" to borrow £50 billion in the Budget to build houses. The Chancellor pushed back against this during Treasury Questions on Oct 24th. Saying this was not Government policy he added, "I would however agree with him that increasing activity in the construction sector is a very good way of creating jobs."

- Stamp duty – On Oct 16th the Evening Standard reported that the Chancellor is planning to reduce Stamp Duty for first time buyers in his November budget, in an attempt to win back much needed support among younger voters.

- Land Registry figures show that on an averagely priced London property (£484,362 in August 2017), a first-time buyer would be liable to pay £14,218 in SDLT, a very significant sum.

* (FT October 19, 2017) ** (Morgan Stanley) *** Andrew Marr Show

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