FUTURE

ECONOMIC & REAL ESTATE BRIEFING

OCTOBER 2025 | UNITED KINGDOM

RESEARCH & INSIGHTS

BNP PARIBAS REAL ESTATE

Real Estate for a changing world

ECONOMY

By Sam Hall, Real Estate Economist

1.3% BNPP FORECAST FOR UK ANNUAL REAL GDP GROWTH IN 2025

3.8% BNPP FORECAST FOR HEADLINE CPI INFLATION BY END OF 2025

4.6% BNPP FORECAST FOR 10Y GILT YIELD BY END OF 2025

Source: BNP Paribas, BNP Paribas Real Estate. Data and forecasts as at 26.09.2025.

"Survey data suggests businesses are finding it increasingly difficult to pass rising costs through to prices. This supports our view that inflation will gradually pare back after peaking in September."– Sam Hall

Jobs market past peak recalibration; growth risks linger: The UK labour market is showing signs it is past the peak recalibration to policy-driven increases in labour costs. April's rise in employer National Insurance Contributions and National Living Wage reduced labour demand, which led to several months of falling employment and job postings. Recent data suggests this downward trend is easing; vacancies rose in July for the first time in over a year and job losses have slowed (figure 1).

Survey data from the Bank of England (BoE) paints a similar picture, with fewer CFOs planning to offset higher costs by cutting jobs or wages. Instead, more are absorbing costs through reduced profit margins. This is a welcome sign for the BoE, as difficulties raising prices points to lower inflation. The downside, however, is that weaker profitability usually signals softer demand. This reinforces our view that GDP growth in Q3 will undershoot the BoE's 0.4% q/q projections.

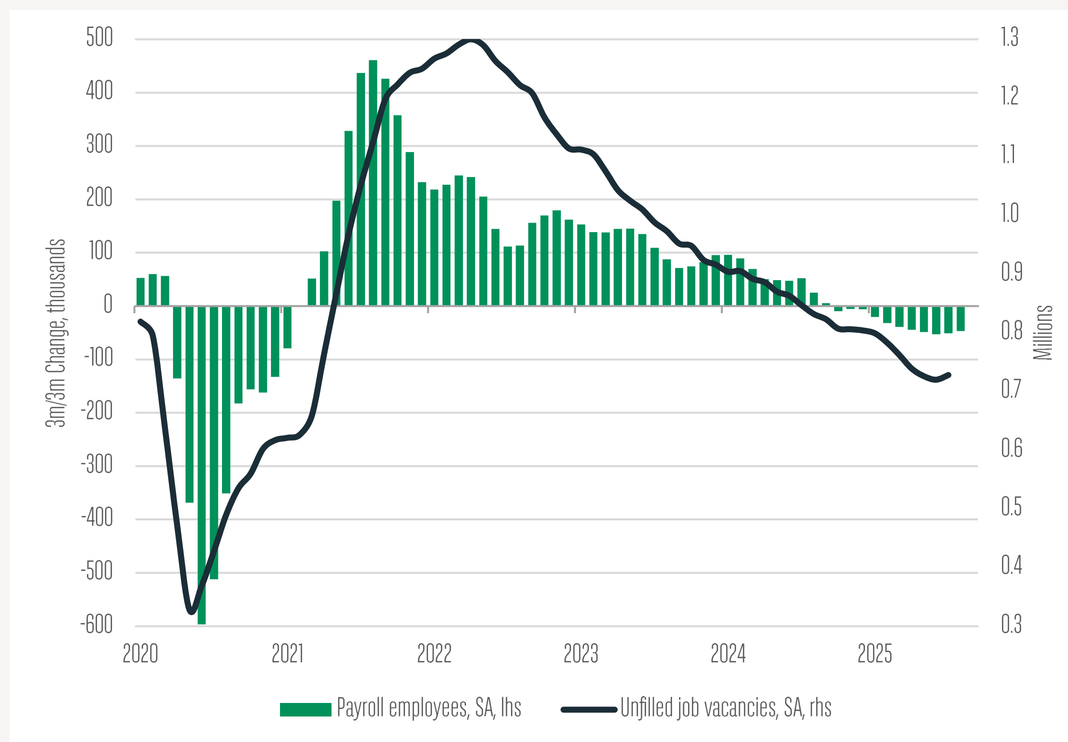
Meanwhile September's PMI data showed business sentiment remained resilient. However, this could be tested at the Autumn Budget, as further fiscal consolidation to meet government rules is likely to dampen demand. A potential silver lining is that tighter fiscal policy could allow another BoE rate cut in December.

Why gilt yields remain high despite interest rate cuts: 10-year gilt yields are a key benchmark for the UK economy and real estate markets because they influence government borrowing costs, wider financing conditions and act as a 'risk-free' reference rate for real estate investments. While the BoE's rate cuts attract attention, gilt yields are shaped more by investors' expectations of where interest rates will be over the life of the bond, rather than current rates.

This helps to explain why 10-year gilt yields remain close to the highs last seen in 2008, despite three BoE rate cuts this year (figure 2). These cuts were largely anticipated and already priced into gilt yields. For long-term yields to fall, investors would need to shift their expectations towards a lower path for future interest rates, which would require a reduction in structural inflationary pressures.

Other factors are also keeping 10-year gilt yields elevated. Demand for gilts has weakened, as pension funds and the BoE have scaled back purchases, with the latter reducing its holdings through 'Quantitative Tightening' (QT)(figure 3). At the same time, government borrowing has grown sharply since the pandemic, forcing the Treasury to offer higher yields to attract buyers. UK yields are further influenced by high borrowing costs in the US and Europe.

FIGURE 1. Labour market slowdown eases



Sources: ONS, Macrobond

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ECONOMY

"UK gilt yields are highly sensitive to global factors. High borrowing costs in the US and Europe are a key reason why long-term borrowing costs in the UK are at multi-year highs." – Samuel Duah

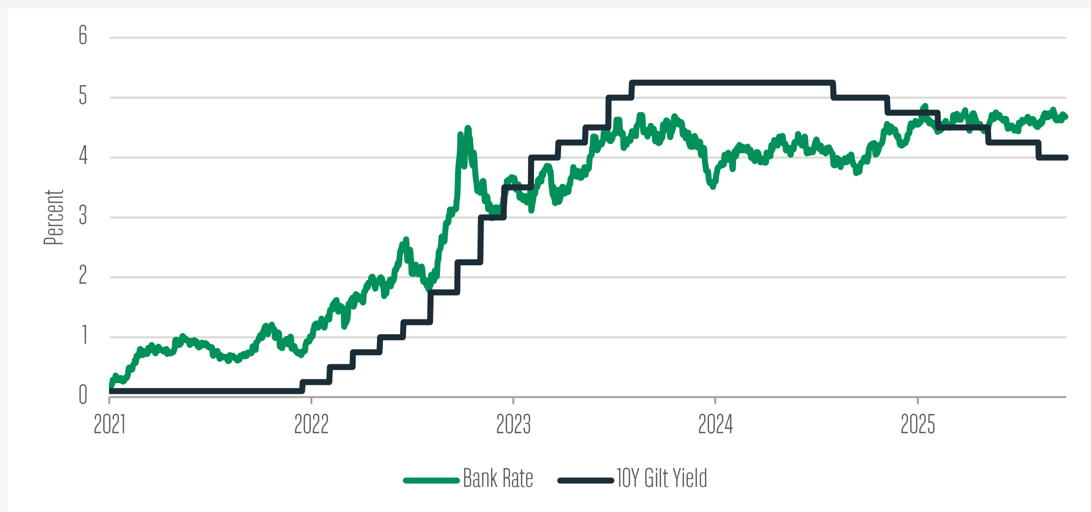
Finally, concerns about the UK's debt, particularly after the 2022 mini-budget, likely means that investors are demanding extra compensation for risk.

Economic impact of Quantitative Tightening: At the BoE's September meeting, it kept its base rate unchanged at 4.00%, but made a more notable shift in its bond-selling programme, QT. The scale of planned QT for 2025-26 was cut from £100bn to £70bn, which will reduce the supply of bonds flowing into the market.

The BoE is currently realising losses on its sales, as bonds are worth less than when they were purchased. These losses are passed on to the Treasury, adding to the government's deficit. By slowing the pace of QT, the BoE is easing that burden. It has also chosen to focus more on selling shorter-dated bonds rather than longer maturities. Similarly, the Debt Management Office is expected to continue to skew new bond issuance towards shorter dated bonds. Both of these factors should support long-term prices and take upward pressure off yields.

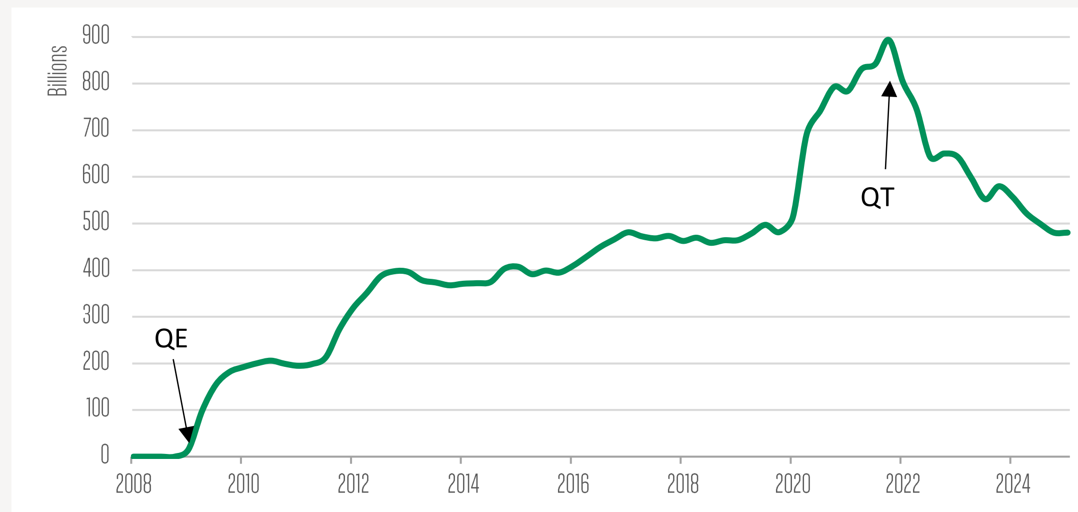
Overall, we expect 10-year gilt yields to remain close to 4.6% in the near term. The next major risk event to this view will be the Autumn Budget on 26 November as the Chancellor faces a trade-off between fiscal sustainability and economic growth.

FIGURE 2. 10Y Gilt yields remain high despite interest rate cuts



Sources: BoE, Macrobond.

FIGURE 3. Bank of England Gilt holdings



Sources: DMO, Macrobond

REAL ESTATE

By Charlie Tattersall, Senior Associate Director, Capital Markets Research

+9% OUR FORECASTED Y/Y INCREASE IN CENTRAL LONDON INVESTMENT VOLUME IN 2025.

+5.2% OUR FORECAST FOR PRIME LONDON CITY OFFICE 5Y ANNUALISED RENTAL GROWTH (2024-29

106,250 HOME COMPLETIONS IN ENGLAND IN THE YEAR TO Q2 2025, A TEN-YEAR LOW.

Source: BNP Paribas Real Estate, MHCLG. Data as at 26.09.2025.

"For the first time in three years, London office values are growing in real terms, highlighting renewed momentum in the commercial sector despite broader macro uncertainty."

Further encouraging signs of improving office sentiment: Despite high inflation, elevated bond yields and stretched equity valuations, the UK office investment market, especially London, is showing gradual improvement. The first half of 2025 saw a 31% rise in investment volume, followed by the usual summer slowdown in completions in Q3. However, recent increased investment supply signals renewed market momentum; our in-house data shows volume currently under offer (a clear indicator of future transaction volume) totals c. £2.5 billion. If completed before year-end, this could lead to the strongest Q4 transaction volume since 2021.

Yields for both prime and average offices remain stable, even as the risk premium over gilt yields narrows to historically low levels. This steady performance is supported by growing confidence in strong rental growth prospects, which is shoring up projected income returns that offset likely-limited future yield-driven capital growth. Crucially, capital values for the best buildings in the West End and City markets have begun to rise in real terms for the first time in over three years, suggesting that the worst impacts of inflation have passed.

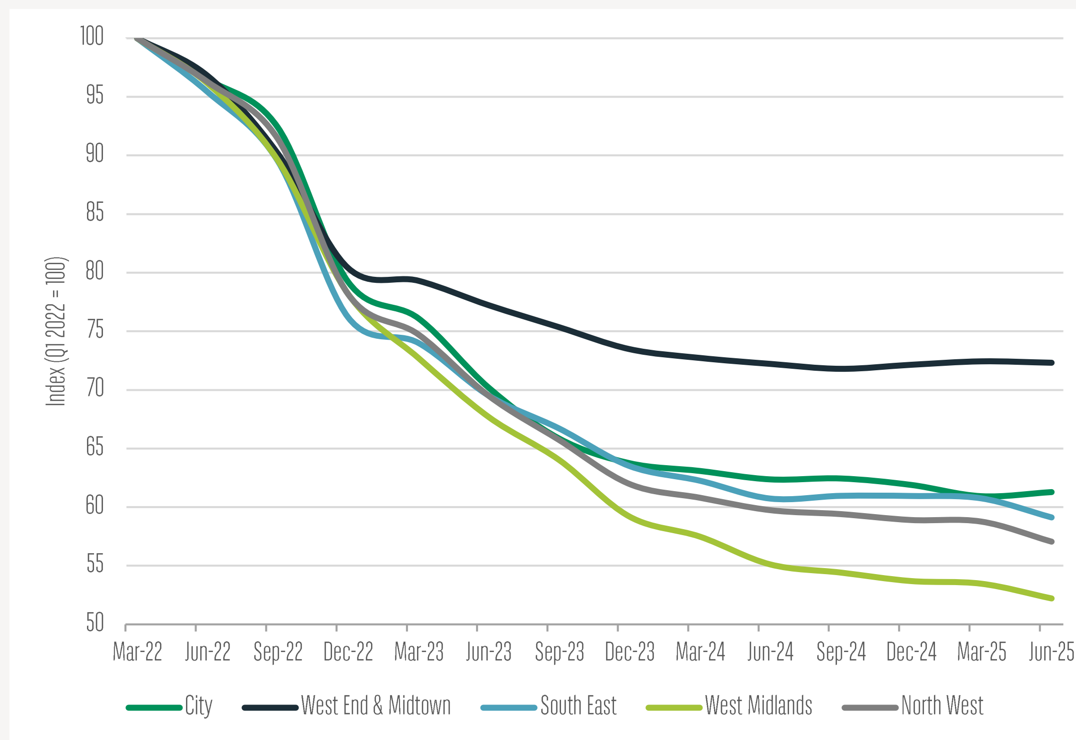
Debt costs remain a significant concern, but their negative impact is eroding. While risk-free rates remain high and are unlikely to drop sharply soon, the 5-year swap rate—a key benchmark for commercial lending—has been relatively stable, reflecting more entrenched market expectations that Bank Rate will fall to 3.50% in 2026. Alongside more competitive lending terms, these changes are making finance more attractive for leveraged buyers.

This is also beginning to fuel sentiment among office developers. Indeed, feedback from our brokerage teams is that we are at the start of an office supply response as viability improves, thanks to above-average rental growth, declining debt costs, and an acute lack of Grade A space. Recent data backs this up; while still down on historic levels, new figures from Glenigan show there was a 156% year-on-year increase in London office construction project starts in the three months to August.

Living sector showing maturity amidst short-term uncertainty: The residential sector, however, is facing obstacles that are hampering much-needed new home delivery. In the year to Q2 2025, only 106,250 new homes were completed in England—the lowest annual figure in ten years (figure 5). Consequently, private rental sector investment activity has declined, with transaction volumes down y/y at the half-year point, in contrast to the growth seen in commercial sectors.

Nevertheless, we expect investment to rebound once there is more policy clarity. Capital raising survey data

FIGURE 4. Prime London office asset values are growing again in real terms



Source: BNPPRE analysis of MSCI UK Quarterly Index. Data shows asset value growth since Q1 2022 in real terms for assets in the lowest equivalent yield quartile.

REAL ESTATE

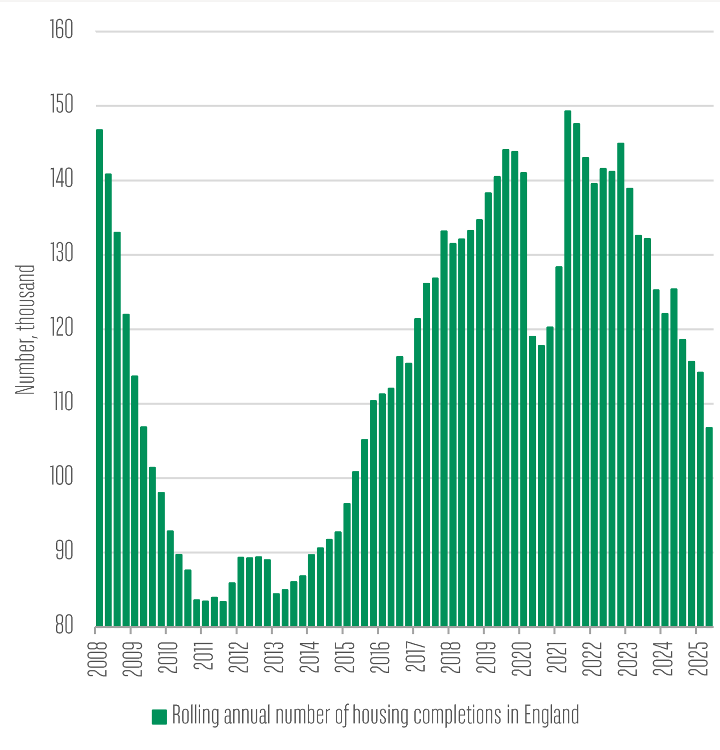
"Despite persistent policy and development challenges, strong demand and limited supply in London's residential market continue to underpin the long-term drivers of rental growth."

from INREV shows the residential sector accounted for almost half of the capital raised for European single-sector strategies last year. Moreover, the rising number of secondary trades of standing stock points to a rapidly maturing sector and helps price discovery. This will in turn help investor confidence and the underwriting of development exit yields.

Underlying demand drivers remain intact: Despite these significant barriers, long-term demographic and affordability trends continue to underpin the residential sector's medium-term growth potential. Home ownership costs remain prohibitive, even with easing mortgage rates and slower house price growth. While rental growth has outpaced wage increases since the pandemic, rental affordability for two people on the London median pay (more representative of a typical earner) is still higher than pre-pandemic levels.

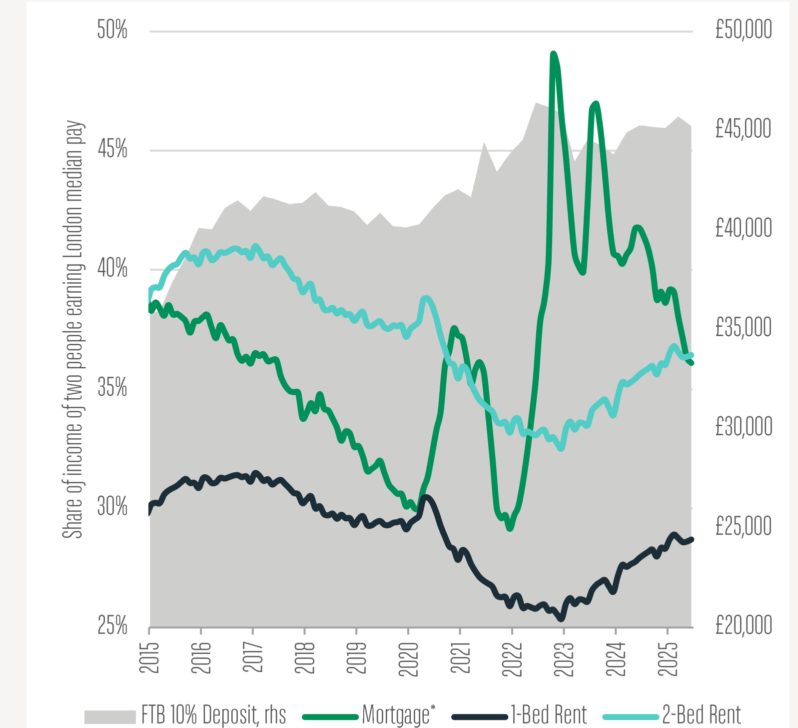
This persistent demand, combined with limited supply and continued challenges to home ownership, is conducive to medium-term growth in rental values. For investors, the sector's resilience—driven by solid demographic factors and the relative appeal of rental yields—provides a strong case for continued focus despite short-term headwinds. Carefully monitoring policy changes and adapting investment strategies will be essential for maximising returns in both the commercial and residential markets going forward.

FIGURE 5. Housing delivery is at a ten-year low



Source: MHCLG, Macrobond.

FIGURE 6. Relative to median wages, London housing affordability has eased recently, but remains prohibitive



Source: ONS, Nationwide, Bank of England, Macrobond. *Assumes 90% LTV, BoE average 2-year fixed rate and 30y term.

Amidst ongoing economic uncertainty and high bond yields, driven by speculation around the Autumn Budget and concerns over inflation and growth, the UK continues to prove its resilience. Despite ongoing structural headwinds, consumer spending is strengthening, and businesses are adapting to higher costs and taxes without widespread layoffs. Meanwhile, recent major data centre and AI investment announcements from US tech firms and real estate investors also highlight Britain's continued international appeal. It's also worth noting that, in the first half of the year, the UK led the G7 in growth, with the OECD also raising its GDP forecasts—clear signs of underlying economic potential.

This resilience is equally evident in UK commercial real estate markets. Our latest briefing reveals healthy fundamentals, particularly in Central London, where prime leasing activity is robust, values are rising in real terms, and development viability is improving. Optimism is beginning to spread to regional markets, supported by record-high yield spreads around increasing evidence of strong income growth.

For a closer look at the opportunities and risks in today's dynamic UK property market, we invite you to read our full report. Our expert team is on hand to discuss how these insights can help inform your investment and occupational strategy.

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