

FUTURE

ECONOMIC & REAL ESTATE BRIEFING

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RESEARCH & INSIGHTS



**BNP PARIBAS
REAL ESTATE**

Real Estate for a changing world

ECONOMY

By Samuel Duah, Head of Real Estate Economics

“Q1 GDP was stronger than expected, but the underlying picture is less reassuring, with momentum already showing signs of fading. We expect the economy to expand only modestly in 2026.”

GDP: strong Q1, but momentum fading: The UK economy entered Q2 with a more complicated message than the headline data alone suggests. Q1 GDP was stronger than expected, supported by domestic demand and services, with all major sectors contributing positively. On the surface, that points to a degree of resilience. However, recent years have shown a recurring pattern of apparent first-quarter strength giving way to weaker momentum later in the year, raising the possibility that post-pandemic seasonal distortions are still flattering the data early in the year. Going forward, higher energy prices, tighter financial conditions and persistent political uncertainty are likely to weigh on household finances and business investment decisions over the coming quarters. Indeed, recent retail sales and survey data suggest growth has slowed significantly since Q1. We therefore continue to expect the economy to record anaemic growth through the remainder of the year, leaving the economy expanding only modestly in 2026 (0.7% y/y).

Jobs growth continues to weaken: The labour market is also beginning to look less supportive. April’s sharp payroll decline may yet be revised higher, but even the revised March data showed the largest monthly decline since late 2020. Unemployment has edged up again, vacancies have fallen to a post-pandemic low,

and job-to-job flows remain structurally weak, pointing to a labour market that is losing dynamism rather than simply normalising from previously tight conditions.

The weakness is not evenly distributed. Retail and leisure-related unemployment has risen materially, while unemployment among workers previously employed in predominantly office-based sectors has fallen (figure 1). Indeed, jobs growth in the financial sector has continued to pick up strongly this year, suggesting the consumer-facing economy is weakening faster than the higher-value office employment base.

Inflation: near-term relief, renewed pressure ahead: April’s inflation data provided some relief, with headline CPI, core inflation and services inflation all lower than expected. The fall was helped by lower energy bills, softer food inflation and favourable effects in volatile or annually set categories. However, this is unlikely to mark the end of the inflation problem. Energy bill pressures are expected to increase in July when the price cap increases. Moreover, fertiliser prices have risen sharply since the start of the year, and large increases in producer price inflation point to renewed cost pressure building through supply chains (figure 2). The key issue now is how much of these cost pressures will be passed through into final prices.

0.7% BNP Paribas forecast for UK GDP growth in 2026 (previous forecast: 1.0%).

3.4% BNP Paribas forecast for UK annual average inflation in 2026.

+75% Year-to-date rise in Middle East fertiliser prices (in GBP terms).

Source: ONS, BNP Paribas, CME Group, forecasts as of 29.05.2026.

FIGURE 1. UK unemployment rate by industry grouped into real estate sectors*



Source: ONS, Macrobond. *Office = Financial & Insurance, Professional Service, ICT, Admin & Support, Public Admin & Defense. Industrial = Transport & Storage, Manufacturing, Construction. Retail = Accommodation & Food and Wholesale, Retail & Repair of Motor Vehicles. As at 27.05.2026.

ECONOMY



“The latest economic data weakens the case for rate hikes, but Bank of England policymakers are unlikely to take too much comfort when energy, food and supply-chain pressures are building. The most likely path is therefore one of caution.”

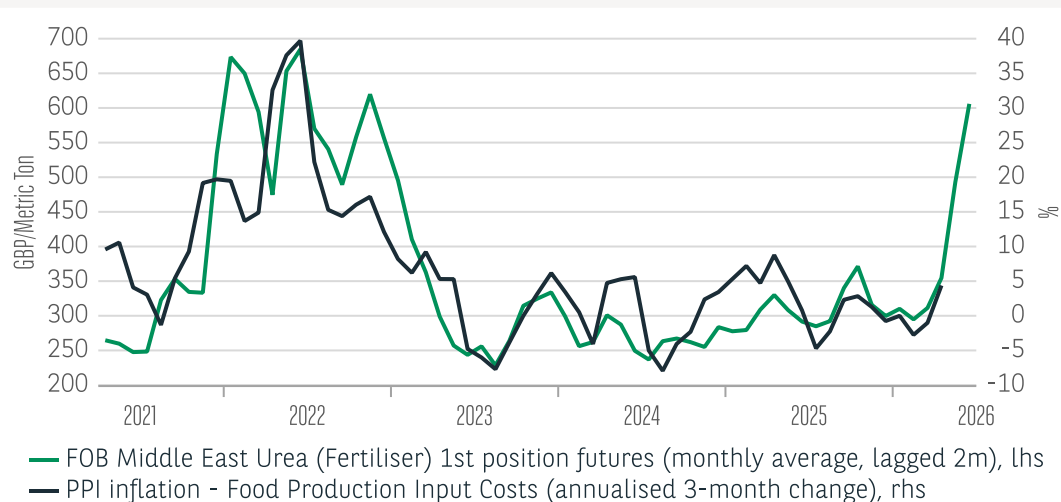
The UK economy looks more fragile than it did ahead of the previous inflation shock, which should limit the peak in inflation, but the risk of second-round effects, such as wage or services inflation increases, remains very real.

Monetary policy: near-term pause, but hawkish bias remains: This leaves the Bank of England facing an uncomfortable trade-off. Markets have reduced expectations for rate hikes after the softer inflation and labour market data, but they are still pricing in further tightening over the coming year (figure 3). The latest data weakens the case for rate hikes, but policymakers are unlikely to take too much comfort when energy, food and

supply-chain pressures are building.

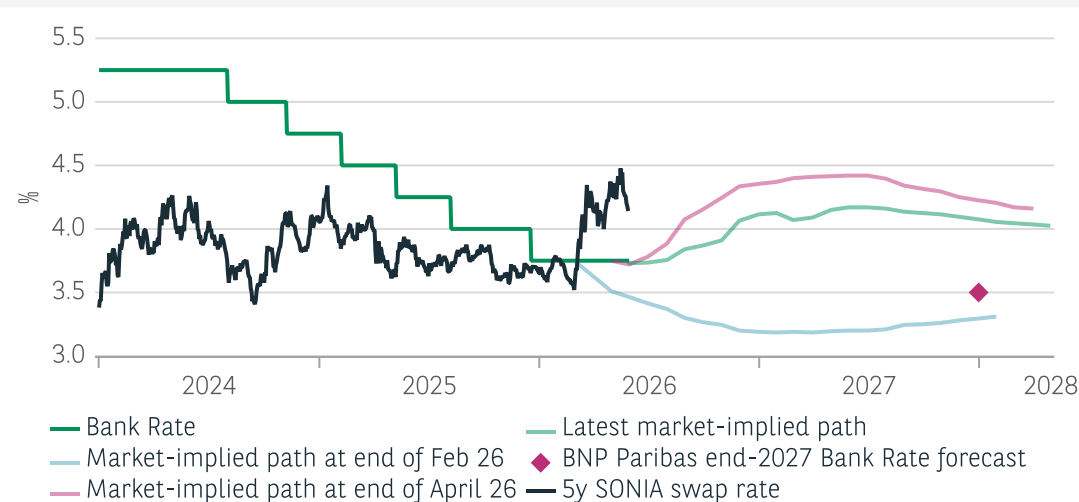
The most likely path is therefore one of caution: waiting for more evidence on the extent of inflation pass-through before making a change. For real estate, the key point is that the direction of interest-rate expectations remains finely balanced. If growth concerns begin to outweigh inflation worries, markets may ultimately price a less severe path for Bank Rate, easing swap rates and debt costs. Until then, the interest-rate backdrop remains a constraint on investor confidence and transaction activity.

FIGURE 2. Fertiliser prices and UK wholesale food inflation



Source: CME Group, ONS, Macrobond. As at 27.05.2026.

FIGURE 3. UK market interest rate expectations



Source: ONS, BNP Paribas. Inflation forecasts as of 31.03.2026.

REAL ESTATE

By Charlie Tattersall, Senior Associate Director, Capital Markets Research

“Unless energy prices fall materially and inflationary pressure reverses, new development activity is likely to remain constrained this year, reinforcing the gap between resilient occupational markets and weaker investment liquidity.”

More evidence of slowing development: The real estate implications of the current economic backdrop are increasingly divided. The construction sector is in the midst of a structural slowdown. New data from the Q1 GDP release points to a further deterioration in construction output across key commercial sectors and housing. Once adjusted for construction cost inflation, construction output is now at its weakest level for more than a decade (excluding the pandemic disruption of Q2 2020) (figure 4). Moreover, the latest construction PMI data suggests this weakness carried into Q2, with activity contracting as input costs rise. In practical terms, development viability remains under pressure from multiple directions: high interest rates, higher build costs, and uncertain exit pricing. In short, unless energy prices fall materially and inflationary pressure reverses, new development activity is likely to remain constrained through much of the year.

Leasing and investment: diverging sentiment: This is reinforcing the gap between occupational markets and investment liquidity. MSCI data show capital values recorded only anaemic growth in Q1, while the more timely monthly data points to a renewed negative yield impact in April across much of the market, although Central London offices were a notable exception. At the same time, rental growth remains comparatively

resilient, particularly for better-quality assets, where supply scarcity continues to support landlord pricing power. The result is a market where leasing fundamentals are doing much of the heavy lifting, but the investment market is still struggling to convert that occupational resilience into stronger liquidity.

REITs are sending the same message. Recent trading updates suggest leasing momentum has held up well despite the energy shock, with management teams reporting little evidence so far of a material hit to leasing. The narrative across the listed sector remains one of constrained prime supply and robust occupier demand driving prime office ERV to multi-decade highs. This is in line with our own data, showing that [prime central London rents grew 6.1% and 8.8% y/y in Q1 in the West End and City respectively](#). Despite this, the equity market reaction has been muted, with share prices continuing to reflect sensitivity to interest rates and doubts over investment liquidity. In short, leasing markets are still providing support, but capital markets are where the macro shock is having the most impact so far. Combined with indications that deal flow softened early in Q2, we take this as another signal that overall investment volume will remain relatively subdued this year (figure 5).

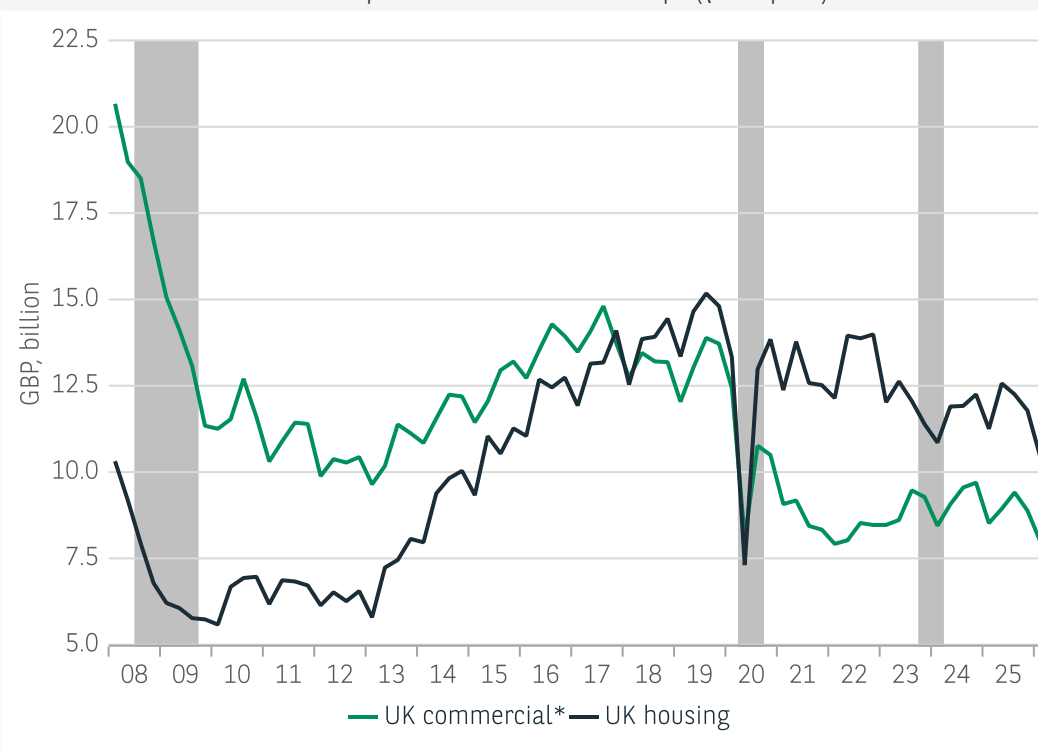
-6.2% Annual fall in UK commercial construction output in Q1 2026.*

4.8% 10y Gilt yield at the end of May 2026 – down c. 20 bps from April.

+4.9% BNPPRE average prime UK logistics rental growth in the year to Q1 2026.

Source: Macrobond, ONS, BNP Paribas Real Estate, *when adjusted for non-housing construction cost inflation. Data as at 29.05.2026.

FIGURE 4. UK private sector new construction output (Q1 2026 prices)



Source: ONS, Macrobond. Commercial = offices, shops, industrial. Deflated using government construction material cost indices. Grey shaded areas = recessions.

REAL ESTATE

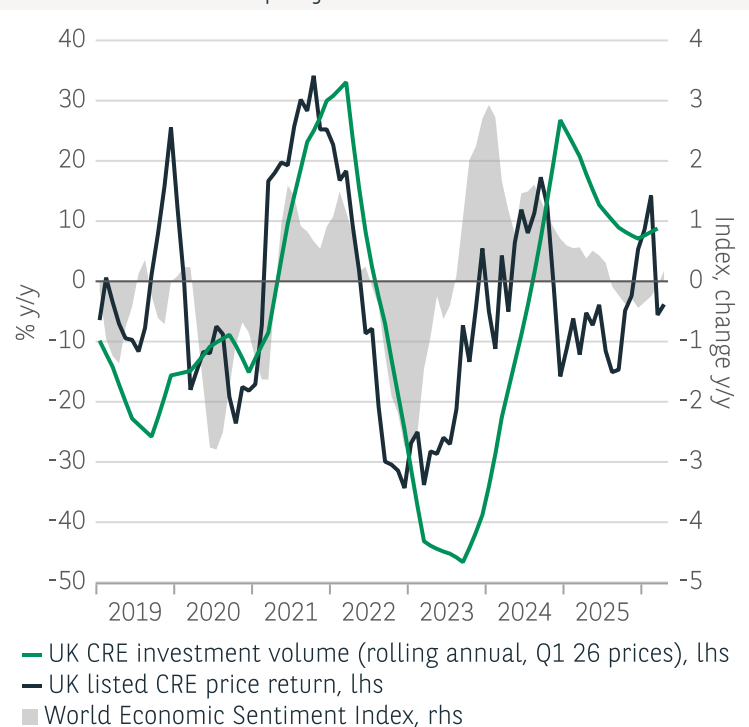


“Previous periods of supply-chain stress have encouraged occupiers to hold more inventory and bolster logistics networks, supporting demand for strategically-located warehouses and increasing upward pressure on rents.”

Is industrial rental growth about to take off again? One sector that may find renewed support from macro disruption is industrial & logistics, although the demand story is likely to be more nuanced than during the post-pandemic logistics boom. Recent manufacturing surveys point to worsening supplier delivery times, higher costs and rising inventories. Previous periods of supply-chain stress have encouraged occupiers to hold more inventory and bolster logistics networks, supporting demand for strategically-located warehouses and increasing upward pressure on rents (figure 6).

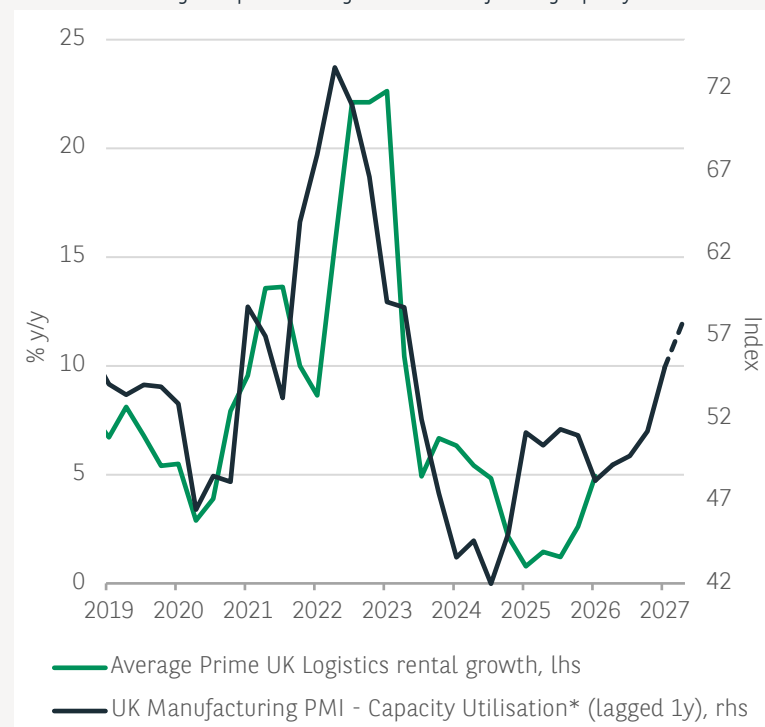
The latest data does not yet point to a repeat of the exceptional rental growth seen in 2021-22. The economy is weaker, occupiers are more cost-conscious, and supply has increased. However, the direction of travel is still supportive. A combination of precautionary stockholding, gradual e-commerce growth, reshoring or nearshoring strategies, and the need to strengthen defence and energy capacity should continue to drive demand for functional, well-connected industrial space. The key distinction is that demand may be less about rapid expansion and more about resilience in a more volatile trading environment. In a market where development activity is already becoming more constrained, that could help preserve rental growth even as wider economic growth slows.

FIGURE 5. UK REIT pricing and direct-market investment volume



Source: BNP Paribas Real Estate, MSCI, FTSE, Macrobond, Economic Policy Uncertainty. Deflated using construction cost inflation. Dated 27.05.2026.

FIGURE 6. Logistics prime rental growth and manufacturing capacity utilisation.



Source: BNP Paribas Real Estate, S&P Global. *Signals how current productive capacity and supply chains are being employed relative to demand.



The current market mood is more constructive than the headlines might suggest. At UKREiiF, the tone was realistic, but notably forward-looking. Investors, developers and occupiers recognise the challenges around politics, planning, financing and delivery, yet there is a clear desire to move ahead where the fundamentals are supportive.

This month's briefing reflects that more balanced picture. The economy is slowing after a stronger start to the year, and the interest-rate outlook remains challenging and volatile. For real estate, the clearest divide is between occupational markets, where demand for prime and functional space remains robust amid constrained development activity, and capital markets, where liquidity is still being held back by higher financing costs and policy uncertainty.

The Chancellor's support for commercial development and regeneration at UKREiiF shows a government keen to help reduce barriers to delivery, but the sector now needs rhetoric to be matched by practical, effective measures that address the serious issues currently restricting new supply across all sectors.

For investors, the market is evidently not easy, and transacting requires selectivity, patience, and an ability to provide greater certainty and speed when opportunities arise. But with repriced assets, resilient occupier demand and a deep structural need for modern space, the UK remains a compelling real estate market for capital today.



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