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Inflation Continues to Suppress the Full Potential of the UK Property Market

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Persistent inflation remains a central barrier to the UK property market's full recovery, despite an improving economic outlook and stronger transactional activity. With the Bank of England's next interest rate decision scheduled for 7 August, there is cautious optimism that a reduction in the Bank Rate could support renewed market momentum, though stubborn inflation may delay such relief.

Current inflation, measured by the Consumer Prices Index (CPI), stands at 3.4%, notably above the Bank of England's target of 2%. This "sticky" rate is curbing the likelihood of significant interest rate cuts in the immediate term. Without a clear downward trend in inflation, policymakers are expected to maintain a cautious approach.

However, analysts at Capital Economics, a respected independent economic research consultancy, forecast that lower interest rates are inevitable. The reasoning stems in part from the impact of recent government policy changes, particularly those increasing employer costs. These include higher **National Insurance Contributions (NICs)** and an increased **National Minimum Wage (NMW)**. According to Capital Economics:

"The falls in employment triggered by the Chancellor's rises in National Insurance Contributions for employers and the minimum wage have increased our confidence that it is only a matter of time before wage growth and CPI inflation slow to rates consistent with the 2.0% inflation target."

The firm projects the **Bank Rate**, currently at 4.25%, will fall to 3.00% in 2025, below the 3.50% level currently expected by financial markets. This more significant drop in interest rates would likely feed through to mortgage rates, supporting stronger housing activity and improving affordability for buyers.

From a housing market standpoint, the research suggests modest growth over the coming year, with average house prices expected to rise by only 2.0% by the fourth quarter of 2025. However, further into the medium term, house price growth is projected to accelerate, with a 5.0% rise forecast in 2026, followed by 3.5% in 2027.

This anticipated recovery comes after a period of relatively weak performance in the housing sector, which saw prices stagnate or soften in certain areas. While some parts of the country, notably London, continue to experience limited growth, overall nominal prices are trending upward. However, when adjusted for inflation, real growth remains subdued.

Despite these challenges, transactional activity is showing signs of recovery. Compared to last year, sales volumes have increased, suggesting a degree of resilience in buyer demand. Recent data from property price indices point to a market gradually regaining momentum, with both prices and activity expected to improve further in the second half of 2025.

Although inflation remains a drag on progress, the broader economic signals suggest the UK property market is slowly turning a corner. Sustained interest rate reductions, if realised, could provide the necessary boost for long-term recovery.