

# WEEKLY ECONOMIC UPDATE

20<sup>th</sup> September 2009

## Summary

Last week marked the 1<sup>st</sup> anniversary of one of the most dramatic events in recent financial history - the collapse of Lehman Brothers, which triggered a financial firestorm and the sharpest global economic slowdown for many decades. Since then, substantial fiscal stimulus packages and monetary interventions by many governments have brought the crisis under control to a point where signs of stabilisation are now visible. Global economic data were stronger last week, but the same cannot be said of the UK in particular with regards to the labour market and public finances.

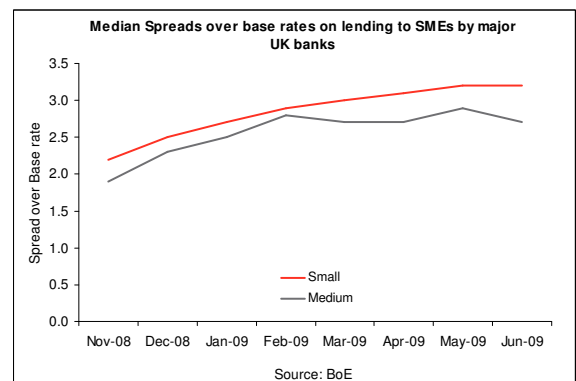
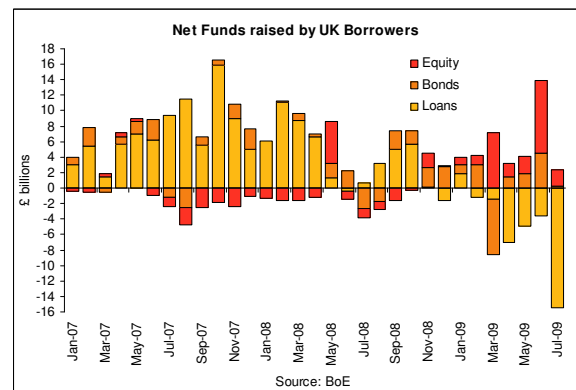
## Statistics

### Bank of England

- Bank of England governor Mervin King reiterated in his testimony to the Treasury Select Committee that the outlook for the UK economy remains clouded. There are signs that the UK economy was growing again, but the “strength and sustainability” of the recovery are still “highly uncertain”, as the state of the banking system, levels of debt and the global economy are all drags on growth. On the inflation end, the governor said that inflation was “likely to be volatile” over the next 6 months, initially falling further below the 2% target, but then rising above it due to the reversal of last year’s VAT cut.

- The Bank of England’s **Trends in Lending** report shows that credit conditions remain tight for many businesses:

- Data for July show the weakest flow of total net lending to UK businesses since the series began in 1998. Major UK lenders indicated that lending to businesses fell further in August. Some lenders report that where companies have used the proceeds of capital market issuance to pay back bank debt, they have often kept the size of their facilities unchanged. For large companies, some banks report a slight lengthening in the tenor of loans offered, as banks’ longer-term financing costs have edged down. Banks also report that in some instances greater competition has reduced spreads. Financing remains more constrained for smaller companies. Looking ahead, major UK lenders expect net lending to remain depressed. This is either because companies are expected to use the proceeds of issuance to pay back loans, or because companies borrow by issuing bonds rather than by seeking new bank loans. Some lenders indicate that, despite upward pressure on retail funding costs, a further easing in longer-term wholesale funding costs or greater competition may lead to some further compression of spreads over Libor or Bank Rate.

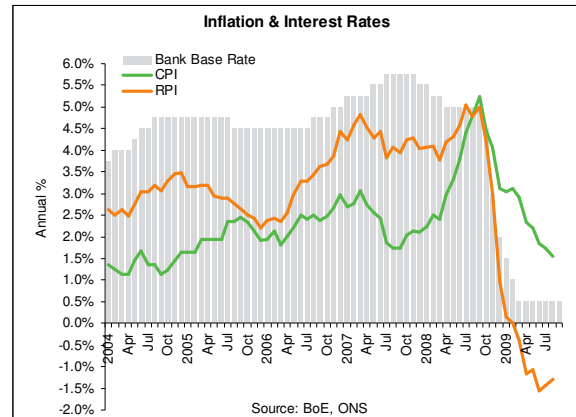


### Economy

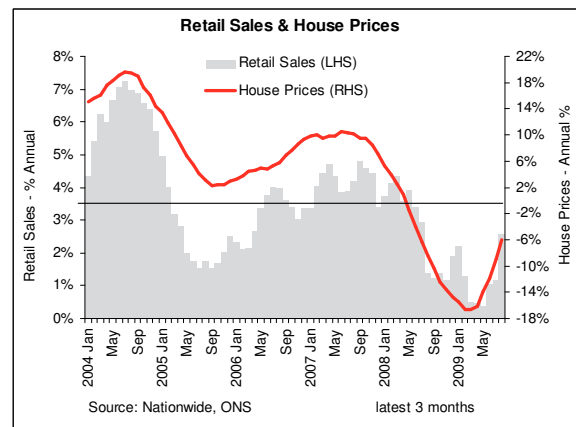
- The UK **job market** continues to deteriorate. The number of unemployed people rose to 2.47 million in the three months to July, or 7.9% of the labour force. The claimant count rose to 1.61 million in August,

the highest level since 1995. Despite signs that the UK economy may return to growth later this year, unemployment – as a lagging indicator – is likely to continue to rise for a prolonged period. **Average earnings** growth slowed further in July. Excluding bonuses, average earnings for the whole economy rose by 1.7% in July; this compares to 4% earnings growth last year.

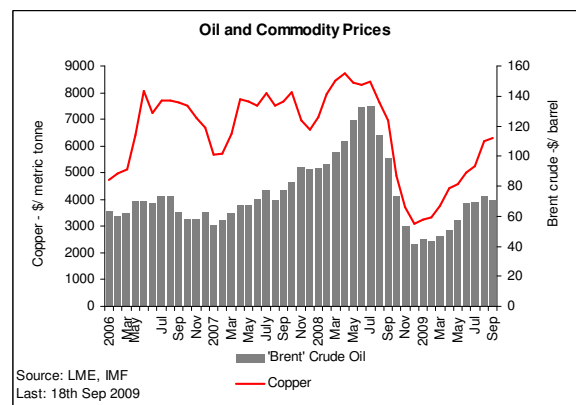
- **Consumer price inflation** eased to 1.6% in August from 1.8% in July, but inflation is still proving stickier than expected. The largest downward pressure came from gas and electricity prices, but this has been partially offset by higher fuel prices. The **retail price index**, which includes mortgage interest payments and housing costs, showed a decline of 1.3% in August, compared to a 1.4% fall in July. So far the Bank of England expects inflation to ease substantially over the next two years, but does not anticipate deflation and recent data back this view.



- **Retail sales** in August were unchanged compared to July, confirming recent industry surveys that strong sales in June and July were not sustained by retailers. In the three months to August, retail sales were 1.2% higher compared to the preceding three months and up 2.6% compared to the same period last year. With unemployment at decade-high, consumers are cautious about spending, especially on big-ticket items. Households are likely to continue to feel the downturn even after economic growth returns, so that trading conditions for retailers look set to remain difficult.



- The UK's **public finances** continue to worsen, with the recession causing a record deficit for August. Public sector net borrowing hit £16.1bn, compared to £9.9bn this month last year. The deterioration in public finances has been due to a sharp fall in revenues (total tax receipts are down 11% so far this financial year) rather than higher spending. Even if the economy is showing some signs of a recovery, the underlying deficit caused by lower tax revenues will take a long time to return to pre-recession levels. There is also the risk that the economy will not perform as well as the government forecasts in the years ahead, putting public finances under even higher pressure.



- **Oil prices** rose again above the \$70-mark last week, as oil inventories declined by more than expected. A barrel of Brent crude cost \$71.16 on Friday. **Copper** prices stagnated at \$6,300 last week, amid signs that slower Chinese imports may dent demand. In contrast, **aluminium** prices rose 5% last week to \$1,913.

- The **Sterling** lost ground last week due to concerns about UK banking system and the belief that interest rates will remain low in the near future. The Sterling slipped 2% to £/\$1.6274 against the Dollar and down 3% against the Euro to £/€1.1054.

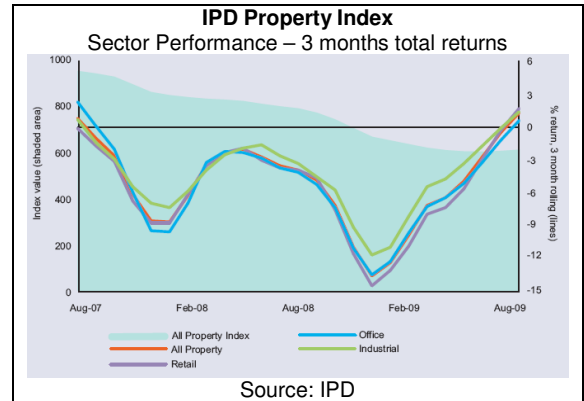
### Construction

- UK **commercial property** recorded its first monthly capital growth after 26 months of declines, climbing 0.2% in August, according to the IPD. The industrial sector saw the largest monthly change in values - from a 0.24% fall in July to a 0.26% rise in August. Retail property values grew 0.37% during the month. The value of offices was relatively unchanged in August. Overall the 25-month peak-to-trough capital

- decline totals 44.2%. Rents and occupancy levels continue to decline. Overall rents for office, retail and industrial properties fell 0.5% on average in August, somewhat less than during the previous month. The vacancy rate in August at 12.3% rose to a new record high, led by a 1.2% rise in the vacancy rate of industrial property to 18.2%. Initial yields for all property sectors contracted to 7.86% on average, due to yield compression for both the retail and industrial sectors to 7.53% and 8.18%.

### Looking ahead

- This week will be a quiet week with few data coming out. The key release is the minutes of the last meeting of the Bank of England's Monetary Policy Committee, which will be watched for cues as to whether the quantitative easing programme will be extended further to boost lending to the economy.

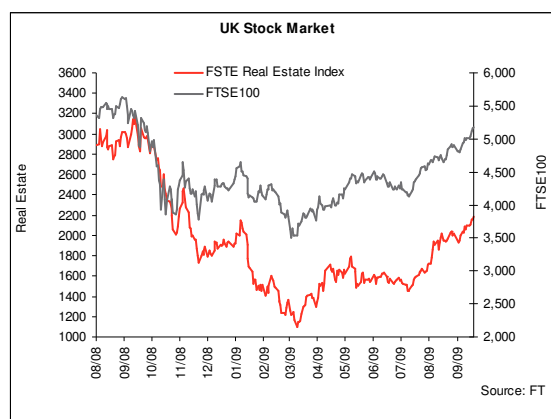


## Market Watch

Friday 18 <sup>th</sup> August 2009				
Share prices	Market Cap, £	Week	Month	Year
<b>FTSE100</b>		3.2%	10.4%	6.0%
<b>Real Estate</b>				
British Land	4.39bn	5.2%	9.3%	-12.3%
Hammerson	2.98bn	3.0%	11.8%	-31.1%
Land Securities	5.16bn	5.2%	13.1%	-37.7%
Liberty Intl.	3.22bn	4.2%	19.6%	-33.7%
Shaftesbury	844.2m	1.5%	0.2%	10.1%
Great Portland Est.	899.6m	1.4%	9.3%	8.5%
Derwent London	1.32bn	9.5%	15.5%	25.2%
Segro	2.79bn	4.2%	15.5%	-45.7%
Quintain Estates & Development	309.9m	5.0%	54.8%	31.5%
St. Modwen Properties	466.8m	-6.4%	-8.7%	-11.9%
TR Property Investment Trust	656.1m	4.1%	13.2%	16.5%
Unite Group	352.5m	16.2%	59.9%	23.7%
Workspace Group	269.4m	-1.0%	7.5%	-74.2%
Minerva	54.8m	9.5%	68.3%	-56.2%
<b>Average**</b>		<b>4.4%</b>	<b>13.7%</b>	<b>-22.1%</b>
<b>Contractors</b>				
Balfour Beatty	1.78bn	-2.0%	1.6%	3.9%
Carillion	1.19bn	-0.8%	3.3%	-7.4%
Morgan Sindall	291.3m	1.1%	12.7%	31.0%
Kier Group	475.3m	4.0%	36.3%	37.9%
Lend Lease Corp*	2.47bn	9.9%	16.2%	20.4%
<b>Average</b>		<b>3.6%</b>	<b>10.9%</b>	<b>12.2%</b>
<b>Material Suppliers</b>				
Wolseley	4.24bn	3.7%	5.5%	-8.3%
SIG	858.5m	1.8%	12.4%	-59.6%
Marshalls	258.6m	8.1%	21.6%	-6.2%
Kingspan	1.05n	13.6%	34.9%	-1.2%
BSS	383.7m	-2.3%	5.8%	6.4%
<b>Average</b>		<b>4.8%</b>	<b>11.5%</b>	<b>-12.8%</b>
<b>House Builders</b>				
Persimmon	1.56bn	-1.7%	5.2%	28.5%
Taylor Wimpey	1.50bn	-7.4%	7.0%	28.5%
Barratt	960.8m	-2.4%	25.5%	111.3%
Bovis Homes	675.7m	1.4%	-0.2%	3.6%
Bellway	1.1bn	4.4%	15.9%	43.7%
<b>Average</b>		<b>-1.8%</b>	<b>10.4%</b>	<b>42.2%</b>
*Lend Lease Corporation Limited is listed on the Australian and NZ stock exchange				
**Sector averages are weighted according to current market capitalisations				

Equity markets continue to rise, amid growing confidence in the global economic recovery and large amounts of liquidity in the financial system. However, at the same time there are increasing concerns that the equity rally might have got ahead of itself.

The **FTSE 100** rose 3% last week and most **property and construction stocks** posted solid gains. The FTSE Real Estate index outperformed the wider index last week, rising 4.5% in the week to Friday.



Among property stocks, Derwent London, Minerva and the Unite Group were the top performers last week. All big UK property firms also gained. The **Unite Group** is reported to be raising some £82m by issuing new equity to finance its London development portfolio for the next few years.

**Balfour Beatty** is reported to be buying US consulting and engineering group Parsons Brinckerhoff for \$626m (£380m), which would be the largest acquisition in the firm's history. The purchase, which would bolster Balfour Beatty's position in the US market, will be largely financed by a £353m rights issue.

The **Kier Group** reported annual pre-tax profit of £24.8m, down from last year's £63.4m, but said at the same time that there are signs that its markets are improving. Kier's share price rose 4% last week.