

WEEKLY ECONOMIC UPDATE

19th September 2010

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Summary

The latest UK labour market, retail sales and housing market data were all softer, pointing to weaker economic growth in the third quarter. However, manufacturing output growth is firm and businesses remain relatively upbeat about their prospects going forward. At the same time, consumer price inflation remains elevated, mainly due to supply side pressures rather than domestic demand.

Economy

Interest rates

At its September meeting, the Bank of England's MPC left the base interest rate unchanged at 0.5% and made no changes to the stock of assets acquired under its quantitative easing programme. The Bank maintains its wait-and-see approach, arguing that although UK growth was firm in the first half of 2010 and inflation is still elevated, tight credit conditions and significant cuts in public spending could limit growth in the latter half of this year.

Manufacturing activity

Manufacturing output in July rose by 0.3% on June and up 5% year-on-year. However, activity remains a long way off pre-crisis levels, with output still more than 10% below the pre-recession peak.

Manufacturing survey

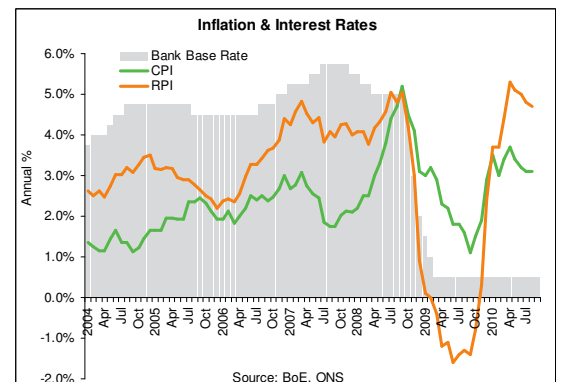
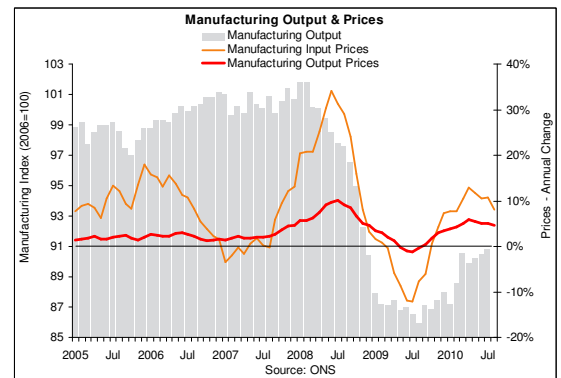
The CBI's latest industrial trends survey for September shows that more firms saw orders at "below normal" levels than in August. Manufacturers have this year benefited from stronger domestic and export demand, improved competitiveness from the weaker pound, and inventory re-stocking. However, manufacturers are likely to see slower growth in the remainder of 2010 as inventory adjustment comes to an end, fiscal cuts are implemented and global growth slows. Nevertheless, UK manufacturers still expect output to grow solidly in the next three months. Price pressures in the manufacturing sector intensified in August for the second consecutive month.

Input and output prices

Manufacturing input prices fell by 0.5% in August and the annual input price inflation slowed to 8.1% from double-digit growth in the preceding five months. Manufacturing output price growth was flat in August, but prices remain up 4.7% on a year ago.

Consumer price inflation

Consumer price inflation remained at 3.1% in August, unchanged from July. Retail price inflation, which includes mortgage interest



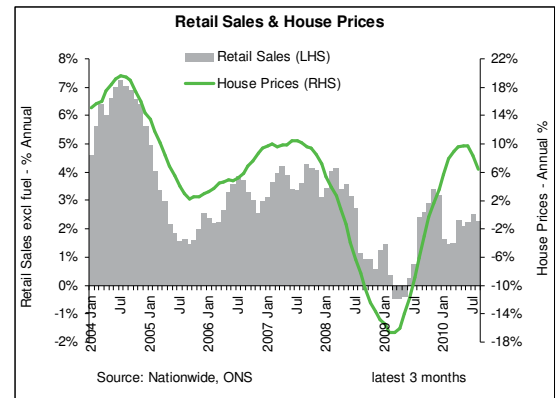
payments and housing costs declined marginally to an annual 4.7% from 4.8% in July. Whilst inflation has fallen back in recent months, it remains stubbornly high in the UK, particularly compared with the Eurozone and the US. CPI inflation is expected to ease in the remainder of this year as domestic price pressures appear contained by excess capacity, a gradual recovery, wage moderation and the recent strengthening in the Pound. However this is being partially offset by supply side pressures, i.e. a sharp rise in global food prices. With VAT to hike in January 2010 this could mean that CPI inflation stays above its 2%-target for a longer period.

Retailer survey

The British Retail Consortium reports that total retail sales in August were 2.8% higher than a year ago, while like-for-like sales were up by 1%. Total sales were slightly stronger than in July, but consumers limited spending on “big-ticket” items. The BRC suggests that year-on-year growth rates were flattered by very weak sales in August last year.

Retail sales

In contrast to the relatively upbeat industry surveys, official data show that retail sales (excl. fuel) fell by 0.5% in August compared to July, though sales volumes remained up 1.8% on a year ago. In the three months to August, retail sales were 1.6% higher compared to the preceding three months and up 2.3% compared to the same period last year.

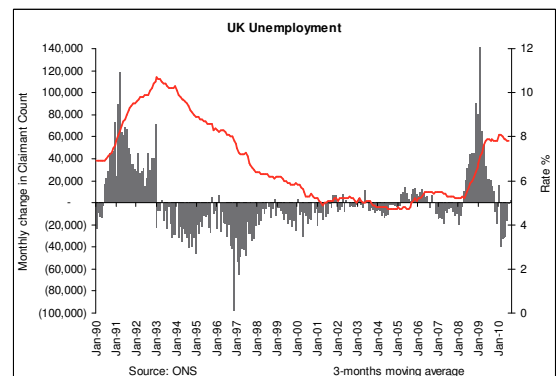


Housing market

Housing market activity continued to slow in August, according to the latest RICS housing market survey. The supply-demand balance moved further in favour of buyers, putting downward pressure on house prices. Consequently, the majority of those surveyed reported falling rather than rising house prices. Prices fell across all regions apart from Scotland. New buyer enquiries continued to fall, while property transactions remain steady - albeit at relatively low levels. The balance of newly agreed sales fell to the lowest reading since August 2008. However, despite a further drop in buyer enquiries, future sales expectations have begun to pick up in August. According to the RICS, lower house prices could begin to tempt more buyers back to the market over the coming months.

Labour market

Latest news from the labour market is mixed. Unemployment fell by 8,000 in the 3 months to July compared to the preceding three months, while the number of people employed rose by 286,000 over the same period. The increase in employment was once again mainly driven by a rise part-time work. The number of benefit claimants increased slightly in August to 1.47 million. This is the first monthly increase since January 2010. Average earnings growth remains modest, with earnings (excl. bonuses) up 1.8% in July, compared to 1.6% in June.



Commodities

Oil prices declined 1% last week to \$77.7/ barrel of Brent. Opec stated that it was comfortable with oil prices moving in the \$70-\$80 a barrel range, suggesting that the cartel is set to keep production levels unchanged when it meets in October in Vienna. Base metals prices rose last week, with copper, aluminium and Nickel all up by 3%. In contrast, the global steel price index recorded a 1% decline.

Commodity Prices (17th Sep 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	77.7	-1%	0%	8%
Copper (\$/tonne)	7,756	3%	6%	23%
Aluminium (\$/tonne)	2,156	3%	1%	13%
Nickel (\$/tonne)	23,425	3%	7%	34%
Global Steel Price (Index 04/1994=100)	180.5	-1%	3%	13%

Source: FT, LME, Cruppi

Exchange rates

The Dollar rose against the Yen last week after Japanese authorities intervened in currency markets to halt the Yen's rise. Sterling recovered from losses earlier in the week to rise 2% against the Dollar to £/\$1.564. At the same time the Pound fell 1% against the Euro to £/€1.199.

Construction

Construction forecast

The Construction Products Association published its latest forecasts for the UK construction industry. Highlights:

- **Construction output** is expected to rise by 1% this year, after an 11.5% decline in 2009. Output is expected to fall back by 1% in 2011, as economic growth remains sluggish and the flow of public works slows. A stronger recovery in the private sector is expected to lift sector growth in the subsequent years. The key risks to the forecasts are on the downside, due to the uncertainty regarding the economy and the return of private sector growth, as well as the timing of public sector cuts.
- **Public housing** work has increased markedly since the 2nd half of 2009. Further strong growth is expected this year. However, under the new Government's deficit reduction plan, funding for new social housing provision has been cut. The Homes and Communities Agency's budget, the National Affordable Housing Programme, Kickstart Round 2 and the Housing Market Renewal programme have all been affected. The CPA estimates that on average less than 25,400 units will be delivered annually between 2010 and 2014 - significantly less than the 45,000 units per annum target set by the previous government.
- **Private housing** activity has picked up since the latter half of 2009, as the Kickstart programme has begun to underpin sector work. Kickstart is providing funding to unblock stalled mixed-tenure housing developments. Levels of house building are still at historically low levels, but annual growth is anticipated throughout the forecast period.
- **Infrastructure activity** has increased by more than 30% between 2007 and 2009, and work is expected to remain strong. Further growth in the years to 2014 is anticipated to leave sector output in 2014 almost 50% higher than five years earlier, with growth driven in particular by the regulated sectors of rail and electricity.
- **Public non-residential** work, the majority of which education and health, has increased sharply last year, on the back of the government stimulus programme. However, work is set to peak this year and sharp falls are anticipated post-2010. By 2014 sector output is expected to have nearly halved from the 2010 peak. However, at just over £6 billion output will remain higher than the average level over the past 30 years and will broadly return to 2007's level.
- **Industrial** construction fell sharply over the past two years, with 2009 output the lowest since 1983. A further decline is expected this year, before work is likely to rebound from 2011 – albeit from a low base. Distribution and logistics development around major ports projects, such as London Gateway, should support the sector in the medium term.
- **Commercial** construction work fell sharpest last year, due to a drop in offices, retail and entertainment related work. Demand appears to be stabilising and growth in the commercial sector is anticipated to occur from 2011, yet even in 2014, following four consecutive years of significant growth, the sector is expected to still be below the level seen in 2006 and 15% lower than peak level of output in 2008.

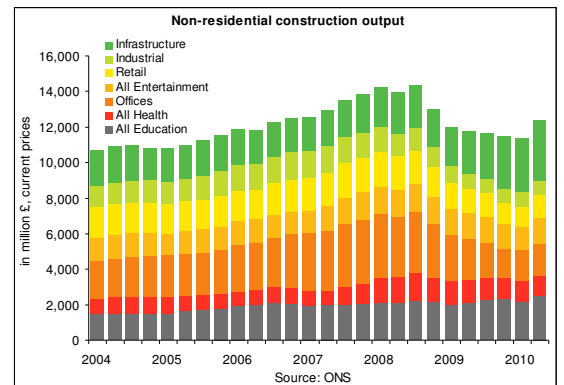
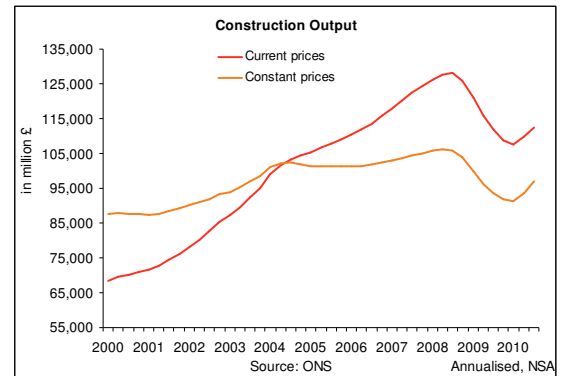
CPA - Construction Output - Forecast						
	2009	2010f	2011f	2012f	2013f	2014f
in £m, constant 2005 prices						
<i>Annual % change</i>						
Private New Housing	10,848	12,367	13,232	13,894	14,311	14,597
	-24%	14%	7%	5%	3%	2%
Public New Housing	2,854	3,425	3,014	2,592	2,385	2,242
	7%	20%	-12%	-14%	-8%	-6%
Commercial Total	22,903	20,584	20,846	22,294	24,064	25,172
	-23%	-10%	1%	7%	8%	5%
<i>of which...Offices</i>	6,992	5,873	6,226	7,782	8,950	9,397
	-34%	-16%	6%	25%	15%	5%
...Retail	4,935	4,442	4,664	4,897	5,387	5,925
	-21%	-10%	5%	5%	10%	10%
Industrial	3,039	3,013	3,408	3,751	4,125	4,460
	-31%	-1%	13%	10%	10%	8%
Infrastructure	6,552	7,590	7,890	8,408	9,096	9,733
	16%	16%	4%	7%	8%	7%
<i>of which...Water & Sewerage</i>	1,487	1,636	1,718	1,769	1,681	1,513
	12%	10%	5%	3%	-5%	-10%
...Rail	1,298	1,584	1,901	2,566	3,182	3,564
	42%	22%	20%	35%	24%	12%
...Electricity	719	805	902	1,127	1,522	1,902
	-3%	12%	12%	25%	35%	25%
Public Non-housing	9,854	11,416	10,253	8,287	6,887	6,073
	34%	16%	-10%	-19%	-17%	-12%
<i>of which...Education (Excl PFI)</i>	5,198	6,342	5,707	4,680	3,931	3,381
	32%	22%	-10%	-18%	-16%	-14%
...Health	1,666	1,732	1,524	1,311	1,088	979
	36%	4%	-12%	-14%	-17%	-10%
Total New Work	56,050	58,393	58,642	59,226	60,868	62,276
	-12%	4%	0%	1%	3%	2%
Total Repair and Maintenance	35,796	34,641	33,626	33,867	34,103	34,919
	-10%	-3%	-3%	1%	1%	2%
Total Output	91,846	93,034	92,268	93,093	94,971	97,195
	-11%	1%	-1%	1%	2%	2%

Source: Construction Products Association

Construction output

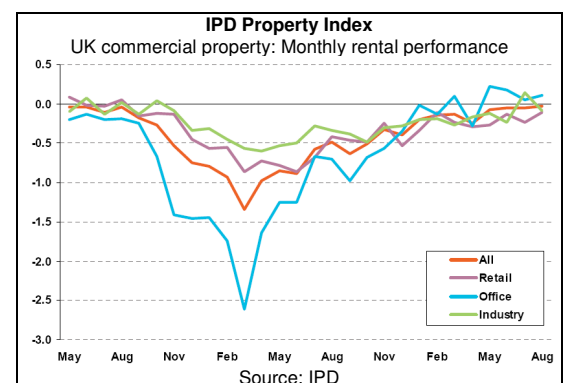
Construction output continued to grow in July, with total work valued at £10.49bn, up from £10.31bn in June.

- **Public housing** output totalled £1.2bn in Q2, up 15% on Q1 2010 and 60% higher year-on-year. Public housing work totalled £423m in July, a further increase in the June figure of £423m.
- **Private housing** work in Q2, at £3.66bn, rose 24% on Q1 and up 10% compared to a year ago. Private housing work totalled £1.29bn in July, compared to £1.31bn in June.
- **Public non-residential work** totalled £3.45bn in Q2, 12% higher compared to the first quarter of this year, and more than 40% up year-on-year. At £1.22bn, public non-residential work in July was slightly higher than in June (£1.2bn).
- **Industrial** work was valued at £0.8bn in Q2 2010, up 11% on Q1 and 15% higher year-on-year. Industrial output in July (£304m) was slightly lower than in June (£315m).
- There were £5.92bn worth of commercial projects in Q2, 7% more than during Q1 2010. **Commercial** work rose further in July to £2.22bn, from £2.09bn in June.
- **Infrastructure** work stood at £3.43bn in Q2, up 6% on the preceding three months and a third higher compared to last year. In July, infrastructure work totalled £1.08bn, slightly lower than the £1.19bn of work recorded in June. There was a sharp revision in the infrastructure figures. Last month the ONS said that the volume of infrastructure output (in 2005 prices) in the 12 months to June was £7.65bn, but this was revised up to £10.67bn in the latest figures. The revision to the figures in cash terms (value of work) was less severe – from £11.93bn to £11.86bn, which suggests that the volume figures suffered from a deflator problem (price falls in the sector were less severe than previously estimated).
- All **repair and maintenance** work totalled £10.74bn, 7% up on the first three months of this year. R&M work also continued to increase in July, to £3,946m, up from £3,799m in June.



Commercial property returns

Commercial property capital growth slowed further in August, rising by just 0.1% on July. Together with a 0.6% income return, this delivered a monthly total return of 0.7%. Total year-to-date capital growth now stands at 6.2%. The industrial sector saw its first capital depreciation since the recovery, while retail and offices rose by 0.1% and 0.2% respectively. Similarly, after a 0.1% rental growth in the industrial sector in July, rents declined by the same amount in August. Retail rents continued to decline in August, and are now down 9.3% since September 2008. In contrast, office rents rose for the fourth consecutive month.



Looking ahead

The minutes of the September meeting of the Bank of England's MPC will give insight as to whether the bank is becoming more worried about slowing UK growth or persisting high inflation. Public finances data for August are likely to show a modest improvement, given higher tax receipts, though public borrowing and debt will remain at a high level.

Market Watch

Investor confidence remained mixed last week, with stronger than expected Chinese trade offset by weak economic data from the US.

The FTSE 100 index surpassed the 5,600 mark for the first time since April, but ended the week barely above the 5,500-mark at 5,508.5 points. The real estate sector underperformed, falling 1.2% in the week to Friday, as latest data point to a renewed weakening in commercial capital values.

The Unite Group, St. Modwen Properties and Land Securities saw the heaviest losses, falling 8.1%, 5.4% and 4.5% respectively. In contrast, the Workspace Group jumped 9.1% in the week to Friday. Minerva, Capital Shopping Centres and Great Portland Estates also rose, up 3.3%, 1.3% and 1% respectively.

Performance amongst building contractors was mixed. Balfour Beatty and Kier saw solid gains, up 7.7% and 5.8% respectively.

In a trading statement, Kier said that it was benefiting from maintenance contracts left over

by the collapse of rival Connaught. Kier ended the year to June 30 with a net cash position of £175.2m, compared to £92.5m last year. Pre-tax profits doubled to £57.7m due to the absence of exceptional items reported last year. Underlying profits rose 10% to £58.4m on slightly lower revenues of £2.1bn. Earnings per share stood at 108.2p, compared to 44.1p last year.

Morgan Sindall also said that its Lovell division had reached agreement to acquire ongoing contracts and related assets of Connaught's social housing operation. Its share price fell 4.7% in the week to Friday.

Stock Market		Friday 17th September 2010			
Index	Index	Week	Month	Year	
FTSE100	5,508.5	▲ 0.1%	3.0%	6.7%	
EPRA/NAREIT UK	362.4	▼ -1.2%	4.0%	-10.6%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,120	▼ -3.2%	2.1%	-8.3%	
Hammerson	2,710	▼ -1.4%	3.6%	-10.7%	
Land Securities	4,780	▼ -4.5%	1.1%	-9.2%	
Capital & Counties	805	▼ -0.2%	11.4%		
Capital Shopping Centres	2,240	▲ 1.3%	9.5%		
Shaftesbury	968	▼ -1.6%	5.3%	14.6%	
Great Portland Est.	1,030	▲ 1.0%	4.8%	14.2%	
Derwent London	1,490	▼ -0.9%	5.6%	13.0%	
Segro	1,960	▼ -2.0%	-5.1%	-30.6%	
Quintain Estates & Development	204	▼ -2.5%	-6.6%	-65.1%	
St. Modwen Properties	326	▼ -5.4%	-4.2%	-30.1%	
Unite Group	308	▼ -8.1%	6.3%	-31.2%	
Workspace Group	242	▲ 9.1%	1.2%	-18.5%	
Minerva	150	▲ 3.3%	-4.4%	173.5%	
Average*		▼ -2.0%	2.9%	-9.9%	
Building Contractors					
Balfour Beatty	1,830	▲ 7.7%	3.3%	-17.5%	
Carillion	1,260	▲ 0.6%	4.8%	5.4%	
Morgan Sindall	292	▼ -4.7%	15.9%	-0.1%	
Kier Group	425	▲ 5.8%	11.6%	-11.1%	
Lend Lease Corp*	2,367	▼ -2.0%	3.8%	-29.8%	
Average		▲ 1.8%	4.9%	-16.3%	
Building material suppliers					
Wolseley	4,050	▲ 3.0%	6.8%	-4.8%	
SIG	576	▼ -1.5%	2.5%	-32.9%	
Marshalls	205	▲ 0.0%	19.5%	-23.0%	
Kingspan	773	▲ 0.3%	2.1%	-21.1%	
BSS	548	▼ -0.2%	0.1%	42.4%	
Average		▲ 1.9%	5.6%	-5.9%	
Housebuilders					
Persimmon	1,200	▼ -2.1%	15.3%	-23.2%	
Taylor Wimpey	985	▲ 2.0%	5.4%	-37.4%	
Barratt	985	▼ -1.6%	8.2%	-43.8%	
Bovis Homes	506	▼ -1.1%	7.4%	-25.2%	
Bellway	707	▲ 2.0%	7.6%	-36.1%	
Berkeley	1,090	▼ -1.9%	3.0%	-11.4%	
Average		▼ -0.6%	8.1%	-29.0%	

**Sector averages are weighted according to current market capitalisations