

# WEEKLY ECONOMIC UPDATE

28<sup>th</sup> June 2009

## Summary

Signs of stabilisation continue to emerge, but there are still questions over their breadth and depth. Latest data from the UK point to weakening retail sales, while the Bank of England's governor Mervin King stressed that whilst the UK may be over the worst, substantial challenges remain.

## Statistics

The **OECD's Economic Outlook** published last week painted a cautious picture of global recovery prospects. According to the report, the global recession is close to bottoming out – following the deepest decline in more than 60 years - but recovery prospects are weak. Whilst strong policy responses helped to prevent an even worse economic outcome, the world economy should not expect to get back to business as usual once the recession ends. The wounds inflicted by the crisis will take a long time to heal. The OECD warns that governments will now have to devise a clear and credible plan and timeline for phasing out the emergency measures. When the recovery is sufficiently strong, fiscal consolidation will be needed to avoid damaging long-term growth prospects, which will mean spending cut and higher taxes.

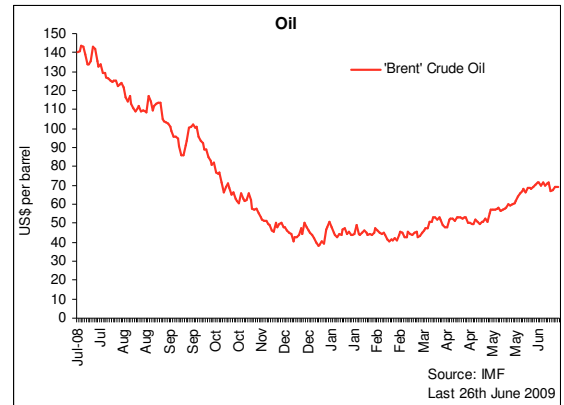
For the UK, the OECD's 2009 forecast is weaker (-4.3%) than in its last outlook in March, when it predicted GDP to shrink by 3.7%, but it is somewhat more upbeat about 2010, seeing output stagnating rather than contracting by 0.2%. Near-term prospects aside, the report draws attention to the longer-term outlook, arguing that the pace at which advanced economies, including the UK will be able to grow over the next decade has been hit, which will limit the potential for a fall in unemployment without inflation and a swift recovery of sharply deteriorating public finances. For the advanced economies, the OECD estimates that annual potential output growth was 2.1% before the crisis; this will fall back to 1.4% in 2009 and 2010 and recover to only 1.7% between 2011 and 2017.

The OECD believes that Britain's fiscal position is far weaker than many of its peers, following many years of government's spending splurge. The fiscal deficit next year is forecast to jump to 14% of GDP - higher than anywhere else in the OECD. This figure could even climb higher if more money had to be poured into the financial system. To preserve fiscal stability, the UK government will have to "develop a concrete and comprehensive plan to ensure that debt is on a declining path once recovery takes hold". In the 2009 Budget the government already outlined that net capital investment will be cut by half from £44bn this year to £22bn a year by 2013/14. Much of this will have severe implications for public construction spend. The OECD report reiterates that it could take much longer than currently forecast for public finances to be brought back in order, which means that spending cuts could turn out even higher.

## Economy

- The latest CBI **Distributive Trade survey** shows that retail sales in June fell again, with the decline similar to that in May. More positively, a relatively large minority of 31% of retailers surveyed report that their sales volumes rose in June compared to a year earlier. Sales for the time of year are still said to be poor and are expected to remain below par in July. Within the sector, grocers continue to see firm year-on-year growth. Durable household goods, hardware, china & DIY and clothing sales remain weak.
- The upward trend of the **Pound** has faded last week amid mixed economic data and concerns expressed by Mervin King about how quickly the UK economy would rebound from the recession and the magnitude of the fiscal deficit. Against the Euro, the Pound lost 1% to £/€1.17. The Pound was relatively unchanged against the Dollar at £/\$1.65. The **Dollar** came under pressure as China once again indicated that it might diversify some of its foreign exchange reserves away from the Dollar and made a renewed call for a "super-sovereign" reserve currency.

- **Commodity prices** have rallied since February 2009, amid hopes of a quicker than expected economic recovery this year. However, the “green shoots” observed so far are merely a signal of stabilisation of activity at low levels, rather than a return to firm growth. Thus, commodities price rises are not justified on market fundamentals (real demand and production), but have mainly been driven by technical factors, i.e. investment demand, stock building at low prices, etc. **Oil** prices early last week dropped towards \$66 per barrel of “Brent”, before recovering later on amid violence in Nigeria. “Brent” crude closed the week at \$69.51 per barrel. **Copper** prices stagnated at \$5,027/ tonne, while **aluminium** prices edged back 1% at \$1,621/ tonne.



### Looking ahead

- Data released this week should provide signals whether the UK economy is stabilising. Revised **national accounts** data for the 1<sup>st</sup> quarter could show that GDP fell by more than previously reported, mainly due to a sharper than previously estimated drop in construction output. The GfK/NOP **consumer confidence** index is expected to show a modest improvement in sentiment in June on hopes that the UK economy may now be through the worst of the current downturn. The Nationwide is likely to report that the annual decline in **house prices** is continuing to ease, though it is likely to remain in double-digit figures. The Bank of England is expected to report an up-tick in **mortgage approvals** for house purchases in May, but from a very low level. The **manufacturing purchasing managers' index** is likely to show that the pace of decline in the sector moderated further in June. Similarly, the rate of contraction is expected to have eased in the **construction sector**, after the deep fall during the 1<sup>st</sup> quarter. There are some signs that housebuilding may be picking up – albeit from a virtual stand-still. However with other parts of the sector, i.e. commercial in deep trouble, concerns over the sector’s fortunes remain. The **services PMI** is likely to show a further slight increase in June after returning modest growth last month.

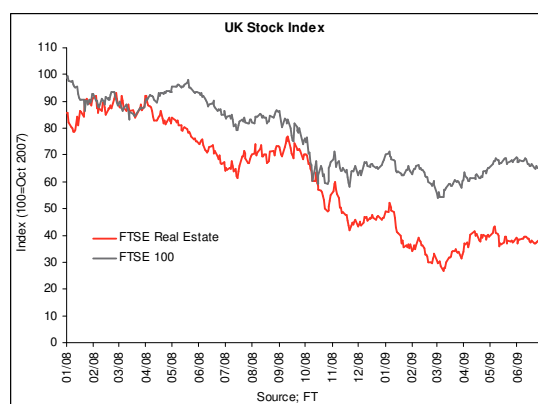
## Market Watch

Friday 26 <sup>th</sup> June 2009				
Share prices	Market Cap, £	Week	Month	Year
<b>FTSE100</b>		-2.4%	-3.9%	-23.2%
<b>Real Estate</b>				
British Land	3.32	-2.2%	-1.3%	-33.7%
Hammerson	2.16	-0.8%	7.9%	-48.0%
Land Securities	3.54	-4.0%	-4.8%	-57.9%
Liberty Intl.	2.24	-1.2%	13.4%	-49.7%
Shaftesbury	665.1	-0.5%	-4.0%	-4.3%
Brixton	107.3	-36.8%	-43.6%	-83.3%
Great Portland Est.	689.5	-3.5%	-8.9%	-15.4%
Derwent London	933.5	-0.5%	9.6%	-11.1%
Segro	1.42	11.1%	-4.8%	-64.9%
Quintain Estates & Development	66.0	-5.1%	-2.9%	-75.5%
St. Modwen Properties	359.7	2.6%	6.2%	-25.1%
TR Property Investment Trust	456.6	1.7%	-1.6%	-18.9%
Unite Group	162.7	3.4%	12.2%	-45.4%
Workspace Group	154.3	-6.4%	5.4%	-86.6%
Minerva	20.6	0.0%	-21.5%	-86.1%
<b>Average**</b>		<b>-1.0%</b>	<b>1.1%</b>	<b>-43.1%</b>
<b>Contractors</b>				
Balfour Beatty	1.49	-1.6%	-12.2%	-25.8%
Carillion	991.8	-2.1%	-8.0%	-21.5%
Morgan Sindall	301.5	4.5%	11.1%	-2.6%
Kier Group	346.5	-3.7%	-7.2%	-1.6%
Lend Lease Corp*	1.39	-1.8%	-0.1%	-28.4%
<b>Average</b>		<b>-1.5%</b>	<b>-5.6%</b>	<b>-22.3%</b>
<b>Material Suppliers</b>				
Wolseley	3.14	2.7%	-10.4%	-34.2%
SIG	545.0	3.7%	-21.5%	-79.0%
Marshalls	175.8	3.7%	-7.7%	-34.1%
Kingspan	580.3	-3.7%	-11.8%	-31.3%
BSS	321.2	-0.1%	-7.7%	-23.0%
<b>Average</b>		<b>1.9%</b>	<b>-11.6%</b>	<b>-38.2%</b>
<b>House Builders</b>				
Persimmon	1.05	-4.5%	-3.3%	15.2%
Taylor Wimpey	1.06	-2.2%	3.9%	-20.4%
Barratt	511.4	-3.9%	-11.5%	120.2%
Bovis Homes	440.5	-0.3%	-10.1%	11.0%
Bellway	715.2	-0.2%	-6.3%	40.3%
<b>Average</b>		<b>-2.5%</b>	<b>-3.8%</b>	<b>23.7%</b>

\*Lend Lease Corporation Limited is listed on the Australian and NZ stock exchange  
 \*\*Sector averages are weighted according to current market capitalisations

Major stock indices fell for the 2<sup>nd</sup> consecutive week. The **FTSE 100** recorded a 2.4% fall in the week to Friday, dragged down by commodity-related stocks. The **FTSE Real Estate** also fell, though the decline was more modest at -0.9%.

Some analysts are taking a more positive view on **UK commercial property stocks**. Credit Suisse is the most upbeat, arguing that the sector is benefiting from effective monetary, banking and fiscal policy measures implemented. It raised its rating on the sector from “market weight” to “overweight”, as the UK market is expected to bottom out earlier than other markets in Europe and the US. Citigroup also raised its expectations for the sector.



**Segro** outperformed the wider index last week, increasing by 11%. Early last week, **Brixton** appeared to have agreed to accept an offer from Segro valuing Brixton nearly 40% less than its £170m market capitalisation a week earlier. Segro said it could raise up to £250m through a share issue to pay for the acquisition, though there was no certainty that any offer will be made even if the pre-conditions are satisfied. Brixton shares slumped 37% in the week to Friday.

**Housebuilders** lost across the board. Despite recent more positive news from the housing market, housebuilding is expected to remain weak for a while. The industry has lost a lot of capacity over the last 2 years, which will prevent a sharp increase in units being built, despite a potential return of demand.