

Weekly Economic Update

10th January 2010

Summary

Now that the euphoria of the New Year and a fond farewell to the Noughties is behind us, Davis Langdon's Construction Economics team provides an insight into ten key factors which will determine progress in the economy and demand for construction over the next twelve months ([Link: 10 Key Issues for 2010](#)).

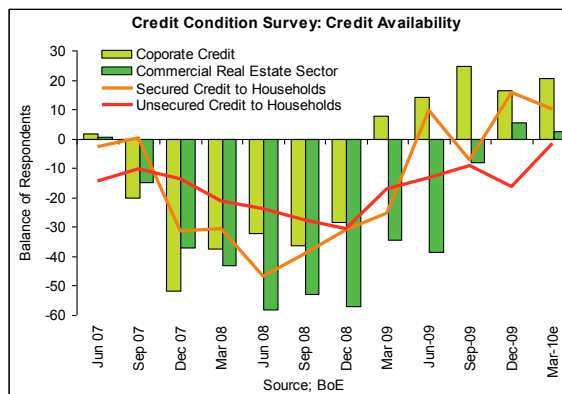
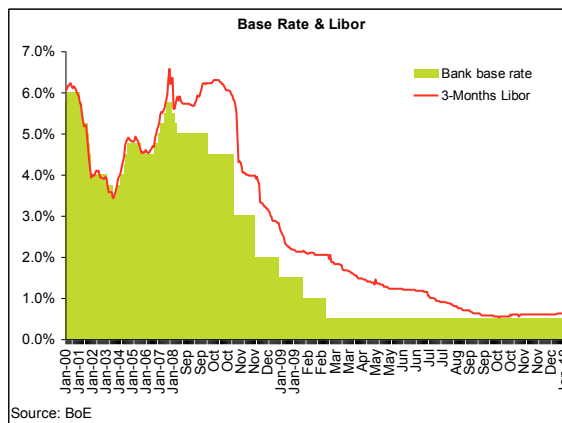
Construction in the UK and many other places is unlikely to have a positive 2010, but **foundations are now being set for improved prospects for the future**. Actions taken during 2009 and 2010 to improve credit conditions, continuing need to invest in social and physical infrastructure and the limited supply of most private sector property assets promise the return of demand in the foreseeable future. Property and construction's future will however be characterised by **much less money**, so investment will need to be focused on maximising efficiency, by for example, unlocking value from existing assets, or by achieving better outcomes with less resource. Amongst the gloom, organisations that are **comfortable with uncertainty, ready for recovery** and are **able to deal with opportunity** will thrive in the 'new normal'.

UK economic data last week were on the positive side on the whole, with improvement in the manufacturing and services PMI surveys and a further rise in house prices.

Statistics

Bank of England

- o The Bank of England's Monetary Policy Committee kept **interest rates** on hold at 0.5% during its January meeting. It also voted to continue with its **quantitative easing programme (QE)** totalling £200 billion until the completion of the programme next month.
- o **Credit conditions** continued to ease gradually during the 4th quarter of 2009 on the back of improvements in the economic outlook and house prices, according to the Bank of England's **Credit Condition Survey**.
 - o Availability of **secured credit to households** increased modestly in the 4th quarter, but **unsecured credit** continued to fall.
 - o Credit availability for **corporates** increased in Q4 2009, but by less than had been expected. Lenders also reported a slight increase in credit availability to the **commercial real estate sector** for the first time since the survey began in the 2nd quarter of 2007. Increased competition from capital markets - an alternative source of finance to larger firms - was one factor behind improved credit availability. Credit availability was expected to improve further in 2010. **Demand for credit from businesses** fell again, due to continued weakness in appetite for capital investment and weakness in M&A activity. Some lenders report that credit demand from the **commercial real estate sector** was positive for a 2nd consecutive quarter. **Default rates and losses given default** on corporate credit continued to increase and are

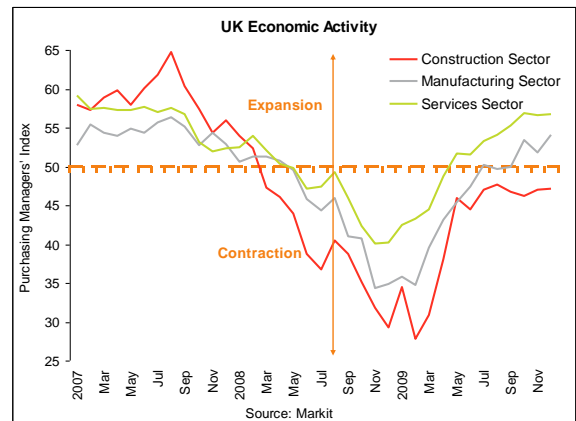


expected to rise further. **Spreads and fees** reduced slightly in Q4 2009, with further easing of price terms expected in the current quarter. Non-price terms remained broadly unchanged.

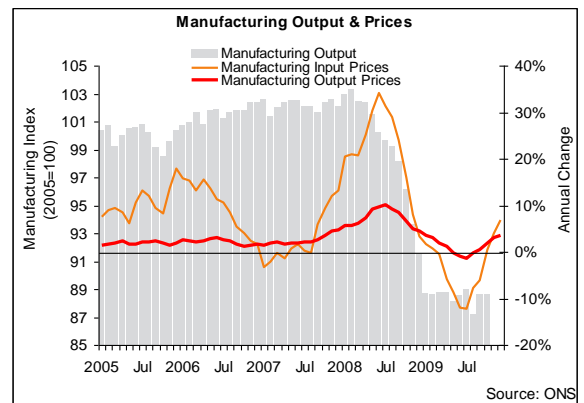
- On the back of firmer house prices and an uplift in household confidence, mortgage lending has ticked up modestly. **Mortgage approvals** totalled 60,518 in November, up 5% on the preceding month. Mortgage approvals more than doubled from their November 2008 lows, but remain low compared to historic standards. **Total net lending secured on dwellings** increased by £1.5bn, compared with a £1.1bn rise in October. In contrast, unsecured consumer credit fell for a 5th consecutive month, as households pay down debt and rebuild balance sheets.

Economy

- Operating conditions in the manufacturing sector are improving. The purchasing managers' index for the **manufacturing sector** jumped from 51.7 to 54.1 in December, the highest level in 2 years. Output of consumer and intermediate goods rose, but production fell further in the investment goods sector. New orders rose at the strongest pace for 29 months, with manufacturers linking higher levels of new work to improving market conditions and clients rebuilding stocks. The survey evidence suggests that domestic demand is currently improving, while UK exporters still hope to benefit from recently improved demand in important overseas markets, including the Eurozone and the US. The **service sector** PMI rose modestly from 56.6 to 56.8 in December. Whilst this points to stronger sector activity, the industry as a whole continued to shed jobs in December, although at the slowest pace since August 2008. The surveys underpin confidence that the UK economy returned to growth in the final quarter of 2009. However, as some economic stimulus measures are withdrawn in 2010, the strength and sustainability of the recent upturn remains uncertain.



- Manufacturing **output prices** rose 0.5% in December and were 3.5% up on a year ago. Manufacturing **input prices** rose 0.1% in December compared to November and were 6.9 higher year-on-year. This rise partly reflects an increase in the price of imported parts and equipment and fuels. The increase in pipeline inflation could contribute to an upward pressure to consumer and retail price inflation in the coming months.



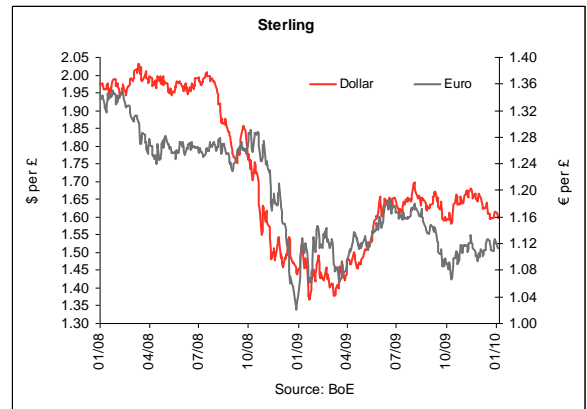
- House prices** in December rose by 0.4% compared to November, according to the Nationwide. At £162,103 the average UK house price in December was 5.9% higher compared to a year earlier. House prices are still 12.2% lower than their October 2007 peak, but have risen by 8.9% since their February 2009 low. During 2009, a low supply of property available for sale meant that an even small pick-up in demand was enough to exert upward pressure on house prices. Whether this trend will continue in 2010 is highly uncertain, given that unemployment is still rising and credit conditions are only easing gradually.

- After averaging \$75 per barrel in December 2009, the Brent crude **oil price** edged above the \$80-mark during the 1st week of this year. Stronger global manufacturing data and optimism about a sustained economic recovery is driving oil prices higher, though a stronger US Dollar has limited commodities' prices upward trend. **Copper, aluminium** and **nickel** prices also rose in the week to Friday.

Commodity Prices (8 th January 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	81.0	4%	4%	81%
Copper (\$/tonne)	7,593	3%	10%	124%
Aluminium (\$/tonne)	2,306	5%	10%	46%
Nickel (\$/tonne)	18,745	1%	18%	50%
Global Steel Price (Index 04/1994=100)	153.14	2%	2%	2%

Source: FT, LME, Cruspi

- The **Sterling** lost ground against the Dollar and the Euro since the start of this year, amid continuing concerns over the UK's fiscal position. Last week, a potential leadership challenge to Prime Minister Brown also added to the downward pressure. The £/\$ ended the week at 1.5974 and the £/€ stood at 1.1141.



Construction

- The **construction purchasing managers' index** for December rose marginally to 47.1 from 47, indicating that the sector is still contracting. This shows that activity in the UK construction sector is lagging behind the uplift in the manufacturing and services industries.

Construction firms continue to suffer from reduced client demand and falls in new business. As a result, contractors are competing aggressively to secure the relatively fewer new contracts in the market. The industry continued to shed jobs in December. Many construction companies reported that they were still restructuring their operations in line with lower workloads. On a brighter note, the residential sector is showing a gradual improvement in activity.

Looking ahead

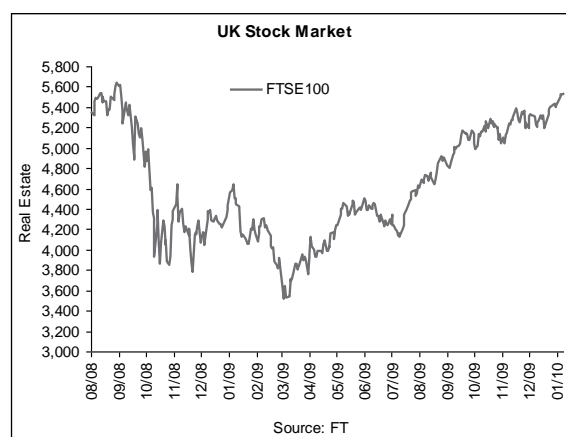
- This week's data should show some improvement in **UK economy** and **housing market**. The British Retail Consortium's **retail sales monitor** for December is expected to show a pick up in sales compared to November, amid reports of a swifter Christmas business. **Industrial and manufacturing output** is expected to have increased after disappointing in the previous month. **Construction new orders** should show some improvement in the residential sector. **Construction material costs** are likely to show a further fall, albeit at a slower pace.

Market Watch

Share prices	Friday 8 th January 2010			
	Market Cap, £mn	Week	Month	Year
FTSE100		2.2%	6.0%	22.8%
Real Estate				
British Land	3,960	-3.9%	4.1%	-5.5%
Hammerson	2,810	-5.9%	2.3%	-1.1%
Land Securities	5,020	-3.1%	1.1%	-25.5%
Liberty Intl.	3,080	-3.7%	7.8%	-0.5%
Shaftesbury	891.8	-0.2%	1.2%	40.4%
Great Portland Est.	891.1	-0.7%	2.1%	39.4%
Derwent London	1,320	-1.0%	2.0%	61.4%
Segro	2,530	-0.2%	7.0%	-30.3%
Quintain Estates & Development	347.2	11.3%	9.9%	339.1%
St. Modwen Properties	400.7	3.1%	-4.4%	61.0%
TR Property Investment Trust	594.2	3.7%	-1.3%	27.6%
Unite Group	472.6	-1.1%	12.0%	97.1%
Workspace Group	264.4	-1.1%	9.5%	-62.2%
Minerva	120.1	-1.0%	26.8%	292.1%
Average**		-2.4%	3.9%	6.3%
Contractors				
Balfour Beatty	1,920	7.1%	9.8%	-14.6%
Carillion	1,220	1.7%	5.4%	19.3%
Morgan Sindall	247.0	-4.6%	6.8%	-8.0%
Kier Group	396.0	3.3%	12.5%	11.9%
Lend Lease Corp*	2,475	-2.7%	8.1%	41.7%
Average		0.5%	8.3%	21.9%
Material Suppliers				
Wolseley	4,080	15.3%	18.9%	-14.0%
SIG	739.7	11.7%	13.5%	-29.9%
Marshalls	171.0	3.8%	3.8%	9.9%
Kingspan	1,034	16.3%	5.3%	117.7%
BSS	337.0	12.9%	7.6%	10.6%
Average		14.6%	14.9%	9.5%
House Builders				
Persimmon	1,480	4.6%	13.7%	67.7%
Taylor Wimpey	1,340	7.7%	19.6%	215.3%
Barratt	1,370	14.4%	24.3%	137.2%
Bovis Homes	593.8	2.6%	14.1%	0.3%
Bellway	997.7	1.0%	10.7%	36.5%
Berkeley	1,180	6.8%	4.1%	2.4%
Average		6.8%	14.9%	88.5%
*Lend Lease Corporation Limited is listed on the Australian and NZ stock exchange				
**Sector averages are weighted according to current market capitalisations				

2009 was a record breaking year on global asset markets, for perhaps all the wrong reasons. Equity markets rallied on the back of a sharp rise in liquidity and low interest rates, rather than evidence of a strong economic recovery – at least in the Western industrialised countries.

The increase in global equity prices, which began in March 2009 continued last week. The **FTSE 100** jumped above the 5,500-mark, for the first time since the beginning of September 2008.



UK **commercial property stocks** underperformed the wider index by a wide margin last year. This trend continued during the first week of this trading year, with the majority of property companies losing in the week to Friday. Hammerson, down 5.9% and British Land, down 3.9% were among the biggest losers. Liberty International edged back 3.7% and Land Securities declined by 3.1%. Quintain Estates & Developments bucked the trend, rising by a strong 11.3% in the week to Friday. TR Property Investment Trust and St. Modwen also gained, up 3.7% and 3.1% respectively.

Other construction related firms had a positive week, with the majority of contractors, building material suppliers and house builders gaining.