

Weekly Economic Update

28th March 2010

Summary
PAGE 1

Statistics
Economy
Consumer Price
Inflation
Retail sales
Retailers' survey
Commodity Prices
PAGE 1

Exchange Rates
Looking Ahead
PAGE 2

Focus on...Budget 2010 – A Pre-election Budget
PAGE 3

Market Watch
PAGE 7

Summary

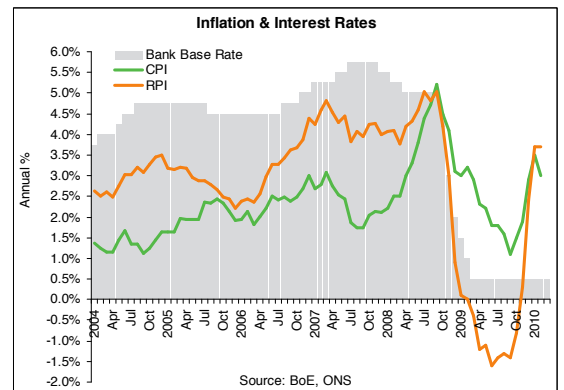
The 2010 Budget offered the Chancellor, Alistair Darling, a final opportunity to set out his vision for the UK economy and public finances prior to the General Election. Whilst economic growth is expected to recover modestly this year, forecasts for 2011 and beyond remain far to optimistic. Large public spending cuts will be needed to bring the public finances back onto a sustainable path. Much of the reduction will be on the capital investment side, which will hit the UK construction industry.

Statistics

Economy

Consumer Price Inflation

CPI inflation eased to 3% in February, down from 3.5% in January, raising expectations that general inflation in the UK economy has now peaked. Retail price inflation stood at 3.7% in February, unchanged from January. Consumer price inflation has risen above its 2% target due to the restoration of the VAT rate to 17.5% from 15%, and higher energy bills. However, inflation is expected to fall sharply in the near term, due to considerable spare capacity in the UK economy. Also the pass-through from Sterling depreciation is likely to put less upward pressure on inflation.



Retail Sales

The value of seasonally adjusted retail sales (including automotive fuel) rose by 4.9% in February compared to a year ago, up from 2% growth in January. Retail sales volumes rose by 3.5% in February year-on-year, compared to a 0.8% fall in the preceding month.

Retailers' survey

The CBI's Distributive Trades Survey reveals that retail sales in March increased for the 2nd consecutive months. However, the pace of growth appears to have slowed, with a balance of 13% of retailers reporting that sales volumes in March were higher compared to a year ago, down from 23% in February's survey. Looking ahead, sales growth is expected to continue at a similar pace through Easter

Commodity Prices

Crude oil prices stagnated last week, with a barrel of Brent at \$79.2. Base metals also held relatively stable, with copper unchanged at \$7,490/ tonne and aluminium down 1% at \$2,200/ tonne. In contrast, nickel prices hit their highest level since June 2008, rising to \$23,650, as a sharp increase in stainless steel production is fuelling demand.

Commodity Prices (26th March 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	79.2	0%	2%	50%
Copper (\$/tonne)	7,490	0%	6%	84%
Aluminium (\$/tonne)	2,200	-1%	7%	56%
Nickel (\$/tonne)	23,650	4%	15%	142%
Global Steel Price (Index 04/1994=100)	174.6	0%	7%	24%

Source: FT, LME, Cruspi

Exchange Rates

Sterling lost 1% versus the Dollar last week, falling to £/\$1.4874, but held stable against the Euro at £/€1.111. In the EU, governments finally agreed on a support package for Greece, bringing the IMF and bilateral loans into the equation. Loans will only be provided in the case that Greece finds itself unable to raise enough funds in the markets to refinance its debts.

Looking ahead

Bank of England **lending data** is likely to show that **mortgage approvals for house purchases** edged up only slightly in February after falling to an eight-month low in January. Consumer **net lending** is expected to have risen modestly. The Nationwide is likely to reveal that **house prices** were broadly flat in March after falling 1% month-on-month in February, as despite low interest rates the general economic backdrop remains fragile. Some support for housing market activity and prices is likely to come from the government's 2010 Budget announcement of a stamp duty holiday for the next two years for first-time buyers on properties costing up to £250,000. The GfK/NOP **consumer confidence index** is expected to have risen modestly in February. The **manufacturing purchasing managers' index** is expected to show that sector activity expanded in March at a similar rate to February.

Focus on... Budget 2010 – a Pre-election Budget

Overview

The 2010 Budget offered the Chancellor, Alistair Darling, a last opportunity to set out his vision for the UK economy and public finances prior to the General Election.

Unsurprisingly, it was a highly political Budget, with the Chancellor seeking to draw a line under the financial and economic crisis, to focus on measures to secure the UK recovery. Overall, the poor state of the public finances did not allow for large vote-winning measures and tackling the large deficit has largely been left to whichever party is in government after the Election.

Within the limited measures announced there were some headline grabbing initiatives, including help for SME's, creation of a Green Investment Bank and a boost to housebuilding through the increased stamp duty threshold for first-time buyers. In total the measures were relatively small, amounting to some £2.5bn.

Big question marks remain over the reduction in public debt. The government announced its intention to halve public sector net borrowing over the course of the next four years, mainly through spending cuts. However, the projections are based on very optimistic forecasts for economic growth and the Chancellor offered no detail on the planned spending cuts.

As expected, the Chancellor confirmed that net public capital investment will be halved in the three years to 2012/13, which will have a significant impact on the construction industry. However, the prospects for UK construction in the years ahead will be determined by measures taken by the new government after the election, including the next Comprehensive Spending Review, which - assuming no hung parliament - should take place in the Autumn this year.

1. Economic Outlook

In what has been the deepest recession for over 60 years, UK GDP contracted by 5% in 2009. The UK economy is expected to strengthen this year, but with commodity price inflation re-surfacing, lending conditions still tight and subdued prospects for eurozone growth, the Chancellor warned that recovery will be fragile and it is important that public support is not withdrawn until a private sector recovery is well underway.

The Chancellor maintained projections for GDP growth in 2010 at 1-1.5%. Forecasts for 2011 were marginally downgraded to 3-3.5%. Growth is still predicted to accelerate to 3.5% in 2012. Whilst the 2010 growth rate is shared by many forecasters, projections for 2011 and beyond appear highly optimistic, with the consensus predicting growth around 1% lower at 2% in 2011.

Gross Domestic Product – Annual %	2008	2009	2010	2011	2012
Pre-Budget 2009		-4¾	1-1½	3¼ -3¾	3¼ -3¾
Budget 2010	½	-5	1-1½	3-3½	3¼ -3¾

The Chancellor is relying on broad economic expansion over the coming years to meet his forecasts. Consumer expenditure is predicted to recover from a 3% decline in 2009, to growth of 0 – 0.5% this year, accelerating to 2.25% - 2.75% in 2011 and 2.5 - 3% in 2012. The contribution made by private spending looks very optimistic given that the labour market is still fragile and real disposable earnings continue to fall.

Business investment is set to see another year of decline before rebounding sharply from 2011. The Treasury is also predicting a steady rebalancing of the UK over the coming years towards net exports, counting on a competitive boost from Sterling depreciation and a recovery in world trade. However, at the same time the Treasury has revised down its forecast for export growth in 2011, due to weaker projections for the eurozone, the UK's largest trading partner. Public spending is set to fall from this year, as the fiscal purses are tightened.

Gross fixed capital formation – Annual %	2008	2009	2010	2011	2012
Business	1¼	-19	-5¼ - -4¾	9¼ - 9¾	11½ - 12
Government	17¾	16½	-2½	-19	-8½

In the near term, CPI inflation is expected to remain above target, reflecting the impact of the VAT change. Fuel prices and sterling depreciation will have a positive but declining impact in

the medium term, while the degree of spare capacity in the economy should limit price increases. Consequently inflation is forecast to ease to around 2% by the 4th quarter of 2010 and 1.5% in the 4th quarter of 2011.

The government continues to rely on optimistic growth assumptions from next year to drive an improvement in the UK's fiscal position. The figures in the Budget imply that the Chancellor predicts trend growth to return to its pre-crisis average of 2.75% p.a. from the middle of 2010, using this growth rate as the basis for his borrowing projections. It remains to be seen whether this optimism is justified. Many analysts and forecasters do not expect the economy to bounce back so strongly and argue that trend growth in the medium term is likely to be less than 2%.

2. Public Finances

Recent better-than-anticipated (or less bad-than-feared) public finance figures gave the Chancellor the opportunity to announce a smaller than forecast public finance shortfall for the current financial year. Public sector net borrowing (PSNB) is estimated to total £166.5bn in 2009/10, compared to £178bn predicted in the Pre-budget 2009. Spending was in line with expectations, but receipts from VAT, income tax and corporate tax were higher than anticipated.

The Chancellor modestly lowered the public finance deficit forecasts until 2014/15, largely due to the assumption that the recent trends resulting in the deficit coming in lower than expected in 2009/10 can be extended. Public sector net debt, as a percentage of GDP is expected to peak at 11.8% in 2009/10 before declining steadily over the next years. By 2012/2013 debt is anticipated to be 6.8% of GDP and by 2014/15 it is projected to fall to 4%.

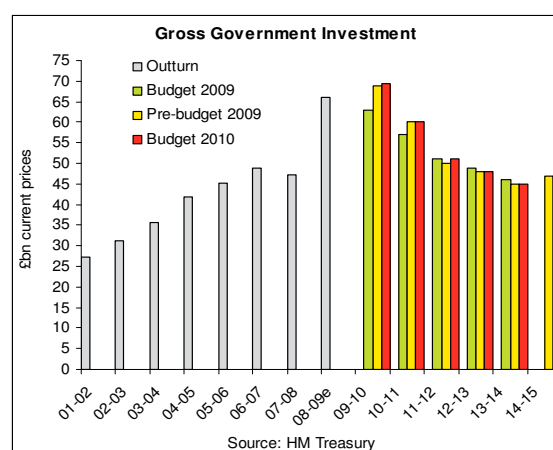
Net public borrowing	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
PSNB (£ billion)	96.1	166.5	163	131	110	89	74
Net borrowing as % of GDP	6.7	11.8	11.1	8.5	6.8	5.2	4

However this makes the underlying public finance picture look only slightly healthier. Over the period to 2014/15, borrowing is expected to have totalled £734bn. This is double the net debt to GDP ratio from its level prior to the recession, to 75% of GDP in 2014/15. In addition, the Chancellor's projections for public debt reduction look optimistic. About half of the decrease in debt of £78bn comes from tax increases (£19bn) and spending cuts (£20bn). The other half comes from assumptions about economic growth (£39bn). It is hard to see where growth of 3.5%+ in 2012 and beyond will come from, particularly given the fiscal squeeze ahead.

The government reaffirmed its plans to halve the level of public sector borrowing in four years. It has stuck to its message that any earlier and faster fiscal tightening, as favoured by the opposition Conservative party, would risk plunging the UK economy back into recession. However, the promises of spending cuts lack credibility, as no detail has been given about how they would be achieved.

3. Capital Spending

According to Departmental Expenditure Limits (DELs), overall current expenditure will be £344bn in 2009/10, rising to £355bn in 2010/11. However, gross capital expenditure is expected to fall from £69.5bn this year to £60bn in 2010/11. Public sector net investment, largely related to construction will fall from the current estimate of 3.5% of GDP in 2009/10 to 1.25% of GDP by 2013/14 and will remain at that level. Capital spending is projected to be £15bn lower in 2013/14 than the Treasury was planning two years ago, but the government has as yet not spelled out where cuts will take place.



Net Investment	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15
£ billion	47.2	50	40	29	26	22	23
*Net investment = gross investment less depreciation							

4. Impact on construction

The infrastructure and public non-residential sectors have over the past two years supported the UK construction industry, as the private sector retrenched. Looking ahead, the looming government spending cuts mean more uncertainty for the industry ahead. There were only few additional measures for construction in 2010 Budget, including:

- *Roads:* The Chancellor announced an additional £100m to fund repairs for local roads following the heavy winter and £285m for the Managed Motorways programme and other major road projects.
- *Education:* A £270m Modernisation Fund for universities to provide an additional 20,000 spaces was also pronounced.
- *Energy:* The initial findings of the *Energy Market Assessment* were published alongside the Budget, narrowing down the options for market reform to incentivise necessary investment over the next few decades. A commitment was made to support financing of renewable energy, through the establishment of a Green Investment Bank (see below).
- *Healthcare:* Spending is largely ring fenced for this year. However, annual efficiency gains are still in place at the NHS, favouring localised care versus hospital and adult care at home.
- *Housebuilding:* A 2-year stamp duty land tax relief for first time buyers of residential property up to value of £250,000 was announced. There is an additional 5% rate of stamp duty land tax for residential property valued at over £1m from 2011/12.

Capital Expenditure - £bn	2008/09	2009/10	2010/11
Education	5.5	7.5	6.7
Health (NHS)	4.2	5.4	4.5
CLG Communities	7.1	9.1	6.4
Transport	7.2	8.3	7.7

Elsewhere, the support for the wider construction industry has been limited, with the majority of measures aimed at consumers and small businesses. The looming spending cuts could prolong the recession in the UK construction industry, if the fall in public investment is not offset by a recovery in private sector construction – private housing, offices, retail, and entertainment.

5. Help for business

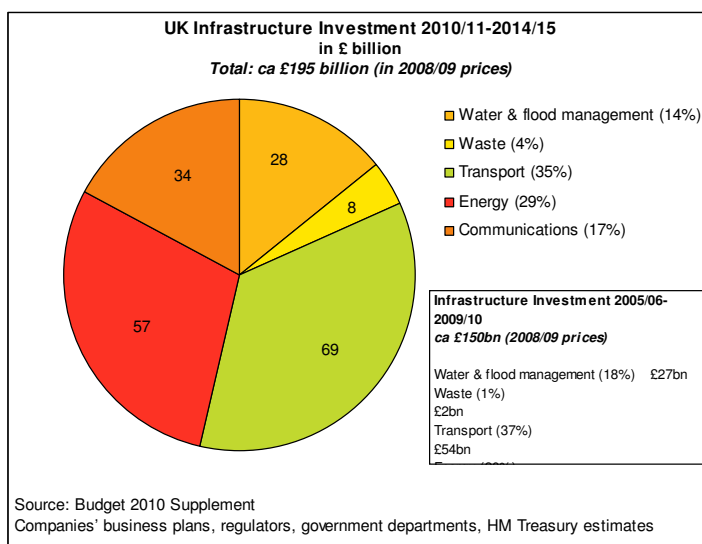
The centrepiece of the Budget was a £2.5bn package to support small businesses. Measures include:

- Lloyds Banking Group and RBS commit to lend £105bn to homebuyers and businesses over the next 12 months. £41bn of this will be lent to small businesses.
- Doubling the Annual Investment Allowance to £100,000
- Doubling Entrepreneur's Relief lifetime limit to £2 million
- Small businesses occupying properties with rateable value up to £6,000 will pay no business rates for one year from October 2010.
- From April 2010 the VAT registration will rise from £68,000 to £70,000
- A new Small Business Credit Adjudicator will be established to help ensure that small businesses are treated fairly when applying for loans.
- UKFG to work in partnership with DECC and Regional Development Agencies to coordinate public low-carbon SME equity schemes including the £170m stock of low carbon finance products under the Carbon Trust's venture capital activities and the UK Innovation investment Fund's (UKIIF) low carbon programmes.

6. Infrastructure Investment

Infrastructure UK's *Strategy for National Infrastructure* announced the development of a National Infrastructure Framework, which will take a long-term cross-sectoral view of infrastructure investment and take decisions on priority and timing. More details will be announced in the Spending Review.

According to the Strategy, it is estimated that over the next five years approximately £195 billion of investment in UK infrastructure is currently planned. This estimate is in line with the Council for Science and Technology's estimate in its report *A National Infrastructure for the 21st Century*, which estimated planned infrastructure investment in the UK at £200 billion in the period 2008-2015. The investment pipeline reflects only planned investment that is relatively certain.



The government is also supporting investment in infrastructure through an Accelerated Development Zone (ADZ) pilot programme across England in 2011/12. Authorities will receive capital grant funding up to a total of £120m to help support projects that deliver key infrastructure and commercial developments

7. Green Investment Bank

The government confirmed plans for a *Green Investment Bank*. The bank will have the mandate to invest in low-carbon infrastructure. The fund would focus on investing in green transport and sustainable energy, particular offshore wind farms. The bank will be funded by £1bn from the government, through asset disposals and additional private investment of £1bn. A further £60m would be offered by the government to develop ports serving the manufacturers of offshore wind turbines.

8. Other Measures affecting Individuals

- There were no significant new measures on personal tax in Budget 2010. In 2010/11, the income tax personal allowance for the under 65s, age-related allowances and limits, and the basic rate limit, are all maintained at 2009/10 levels. The freezing of allowances impacts on individuals' personal finances indirectly by not adjusting for inflation.
- From 2010/11 a new 50% tax rate will apply on all incomes above £150,000. The personal allowance for under-65s will be increasingly restricted for incomes above £100,000, eventually being withdrawn completely.
- National Insurance rates will rise by one percentage point from April 2011.
- Previously announced increase in fuel duty to be phased in. One pence per litre increase on 1st April 2010, a further one pence on 1st October and the remaining 0.79 pence on 1st January 2011.
- Tobacco duty increases by 1% in real terms and then by 2% each year until 2014.
- Alcohol duties to increase by 2% in real terms each year out to 2015.
- Standard interest rate applied to the Support for Mortgage Interest scheme maintained at 6.08% through to end- December 2010, from end-June previously.

8. Efficiency gains and Property, assets and relocations

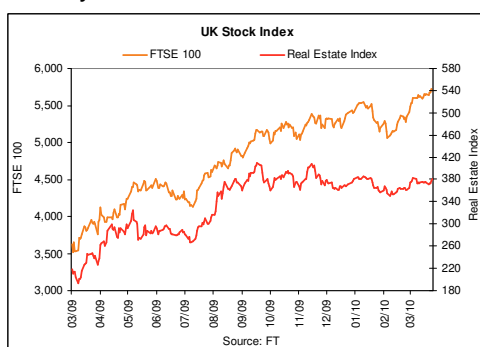
The Treasury's *Total Place Report* outlines plans to generate significant savings in the public sector by improving efficiency and reducing costs. The Chancellor also announced further departmental efficiency gains to cut public borrowing, but did not spell out government departments would meet the £11bn in planned efficiency saving.

The government is to sell of portions of its property holdings over the next years, worth £35 billion. It said it would do more to relocate government departments from London and the South East to cheaper areas, with 15,000 jobs leaving Central London for the regions in the next five years. The civil service in the long term would be cut by a third. This should provide opportunities for the office refurbishment sector in the region to meet anticipated space requirements.

Market Watch

The **FTSE100** gained 0.9% in the week to Friday and rose to a 21-month high.

The **Real Estate Index** outperformed the wider index modestly last week, gaining 1.4%. The majority of real estate firmed rose, with the Workspace Group (+9%) and Minerva (7.4%) leading the way. Among the large real estate firms, Liberty International gained most, rising 3.9% in the week to Friday.



Among **building contractors**, Balfour Beatty's share price rose by 3.1% in the week to Friday and Carillion rose 2.8%

Material suppliers had a mixed week, with Kingspan gaining 6.6% and BSS advancing 2.6%, while SIG lost 3.4% and Marshalls 2.1%. Wolseley, whose share price held stable last week, reported a further 15% fall in sales during the 1st half of its financial year. Losses were reduced by closing unprofitable operations in Ireland, Belgium, Czech Republic and Slovakia.

High Street retailer Next announced plans to expand its business property portfolio by 247,000 sq ft in the coming year. This will include 12 stand-alone Home stores measuring a combined 150,000 sq ft. Last year Next increased the number of shops it operates to 517, adding 257,000 sq ft of commercial trading space.

Friday 26 th March 2010				
Share Prices	Index	Week	Month	Year
FTSE100	5,703	0.9%	6.5%	45.3%
	Market Cap, £m	Week	Month	Year
Real Estate				
British Land	4,120	0.7%	8.5%	35.3%
Hammerson	2,750	1.0%	2.1%	48.2%
Land Securities	5,170	1.4%	8.2%	56.4%
Liberty Intl.	3,150	3.9%	7.4%	26.7%
Shaftesbury	876.9	3.1%	2.8%	59.9%
Great Portland Est.	957.1	2.7%	8.9%	58.9%
Derwent London	1,380	3.0%	5.2%	97.1%
Segro	2,390	1.9%	2.0%	33.8%
Quintain Estates & Development	299.3	-2.5%	-5.7%	577.7%
St. Modwen Properties	381.5	3.5%	-1.6%	185.5%
TR Property Inv	398.2	-1.7%	0.5%	46.4%
Unite Group	405.9	-3.6%	-12.5%	224.8%
Workspace Group	278.7	9.0%	11.5%	115.6%
Minerva	146.5	7.4%	13.8%	1313.0
Average**		1.8%	5.6%	68.5%
Contractors				
Balfour Beatty	2,010	3.1%	6.3%	0.5%
Carillion	1,320	2.8%	17.2%	32.5%
Morgan Sindall	240.6	-1.3%	0.5%	-2.2%
Kier Group	400.9	1.8%	8.3%	24.1%
Lend Lease Corp*	2,858	2.1%	-5.8%	45.5%
Average		2.4%	3.2%	26.8%
Material Suppliers				
Wolseley	4,600	0.1%	4.6%	61.0%
SIG	687.1	-3.4%	1.5%	6.0%
Marshalls	177.7	-2.1%	11.8%	-3.2%
Kingspan	960	6.6%	28.3%	130.3%
BSS	348.8	2.6%	5.9%	-6.1%
Average		0.7%	7.9%	60.1%
House Builders				
Persimmon	1,400	1.9%	19.5%	31.3%
Taylor Wimpey	1,240	-1.8%	9.2%	159.3%
Barratt	1,250	1.6%	13.6%	128.0%
Bovis Homes	542.5	-0.4%	11.7%	-5.0%
Bellway	943.5	4.5%	17.4%	16.8%
Berkeley	1,120	0.2%	12.1%	-1.7%
Average		1.0%	14.2%	63.5%

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