

Weekly Economic Update

4th July 2010

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Summary

After last week's Budget announcement, which set out spending cuts and tax rises to eliminate the UK's structural deficit by the end of this parliament (2014/15) and to start reducing debt levels by 2016, this week was considerably quieter in terms of economic data.

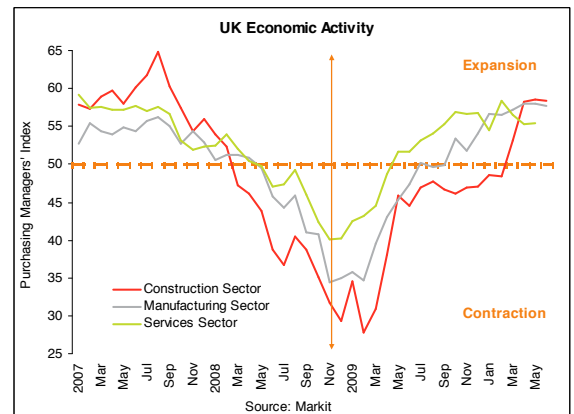
Housing market indicators point to slower activity and price rises. In contrast, survey data for the manufacturing and construction industries indicate firm expansion from last year's depressed levels. Credit conditions remain on the tight side, in particular for households. Meanwhile, a slower global growth outlook for the 2nd half of this year is putting asset prices under pressure.

Statistics

Economy

Manufacturing activity

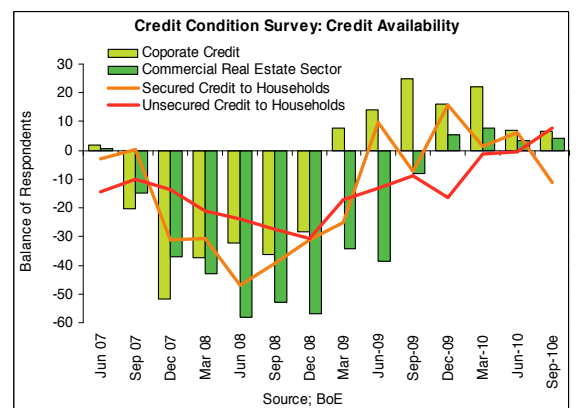
Manufacturing activity expanded in June, albeit at a more modest pace compared to the preceding two months. The CIPS/Markit PMI recorded a reading of 57.7, slightly down on May. Activity was mainly driven by stronger domestic demand, while export orders growth slowed sharply. Manufacturers report higher input prices for chemicals, food products, metal, paper and timber. Part of the increase in costs is being passed on to clients, with average selling prices rising for the 8th successive month.



Credit conditions

The latest Bank of England credit condition survey again revealed a mixed picture. Generally, credit remains tighter for consumers than for corporates.

- o Availability of secured credit to households increased slightly in Q2 2010, but lenders expect a decrease in the next 3 months, in part reflecting expectations that wholesale funding market conditions might tighten.
- o Unsecured credit to households remained broadly unchanged.
- o Corporate credit availability rose in Q2 2010, but by less than had been expected. Availability for commercial real estate was unchanged.
- o Credit demand rose among small businesses but fell from large companies. Uncertainty about the economic outlook continues to limit credit demand, with demand driven mainly by businesses seeking to refinance maturing facilities or re-price existing ones. Demand for credit to finance capital expenditure remains subdued.



- **Default rates** on corporate loans fell in Q2 2010 among medium and large companies but rose for small businesses.
- Spreads on corporate lending continued to fall for medium and large PNFCs, while they were broadly unchanged for small businesses. Increased competition continues to put downward pressure on **price and non-price terms**.

Consumer confidence

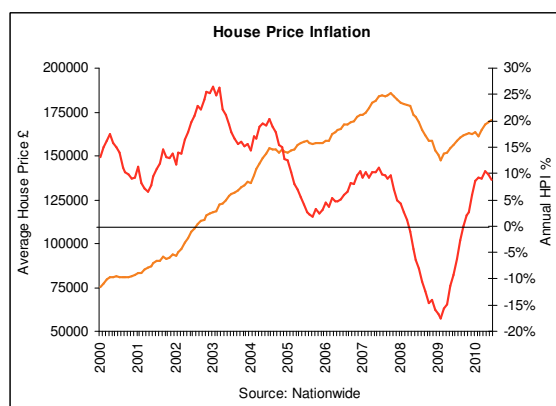
Consumer confidence weakened further in June, with the GfK Consumer Confidence Index dropping to -19, the weakest level since December 2009. The fall in consumer confidence is likely to be due to concerns about the fragility of the UK economic recovery and the impact of the Budget 2010 measures, which outlined tax rises and spending cuts.

Consumer lending

Total **net lending** to consumers rose by £0.7bn in May, stronger than the increase in April. **Mortgage approvals** for house purchases stood at 49,800 in May, unchanged compared to April. **Net consumer credit** rose by £0.3bn in May, reversing the fall seen in the preceding month. Consumer appetite for taking on new debt is set to remain limited, given the uncertain economic environment and fiscal squeeze ahead. At the same time, credit conditions remain relatively tight and there appears to be limited availability of unsecured credit from banks.

UK house prices

House price growth slowed to 0.1% in June, down from a 0.5% rise seen in May. Annual house price inflation slowed to 8.7%. According to the Nationwide, there are signs of an increase in the supply of property coming to the market for sale. With the level of demand broadly stable, this may in parts explain the recent ease in house price inflation.



Commodities

Global commodity prices continued to fall last week on the prospect of slower economic growth in the second half of this year. Oil prices fell 7% to \$71.9 per barrel of Brent crude. Copper declined 4% in the week to Friday to \$6,354/tonne, while aluminium prices slipped 1% to \$1,928. The global steel price index recorded a 4% decline last week, due to lower demand from China.

Commodity Prices (2nd July 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/barrel)	71.9	-7%	-3%	8%
Copper (\$/tonne)	6,354	-4%	-4%	27%
Aluminium (\$/tonne)	1,928	-1%	-1%	20%
Nickel (\$/tonne)	19,150	-2%	-4%	18%
Global Steel Price (Index 04/1994=100)	187.2	-4%	-7%	31%

Source: FT, LME, Cruspi

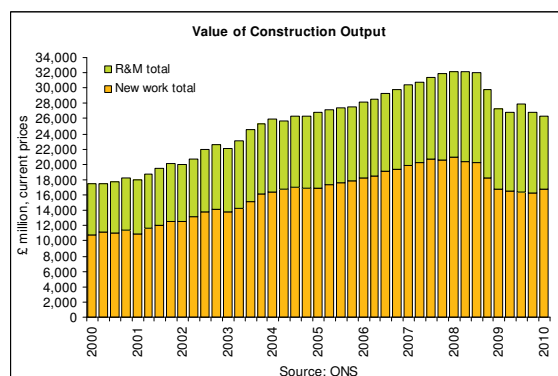
Exchange rates

On the back of weak US economic data, the Dollar is retreating from recent highs. At the same time the Euro remains weak on concerns about sovereign debt levels. The Sterling last week rose 1% against the Euro to £/€1.2364, its highest level since November 2008. Against the Dollar, the Sterling also rose 1% to £/\$1.5189.

Construction

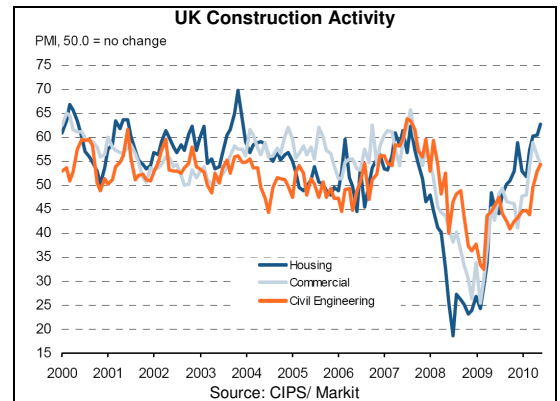
Construction output

Official data show that the value of construction during the 1st quarter of 2010 fell by 4% year-on-year and down 2% on the preceding three months. The value of construction totalled £26.3bn in Q1 2010. Within this, the value of new work was flat year-on-year and up 3% on the previous quarter. New work totalled £16.7bn in Q1 2010. Repair and maintenance work fell to £9.5bn in the 1st quarter, down 10% year-on-year and 9% down on the previous three months.



Construction activity

The June construction industry PMI shows that the sector continued to expand last month. The index held at 58.4, down only marginally from 58.5 in May. Residential construction performed strongest. Employment in UK construction was broadly unchanged during June. Subcontractor usage increased marginally, but at a much weaker pace than in the previous month. Looking ahead, the industry remains cautious about its outlook, given the prospect of public spending cuts and rising prices.



European construction forecast

Euroconstruct published its forecasts for the key European construction markets. Highlights:

- The construction recession in Europe has been deeper than the general economic downturn. By the end of 2010 construction will have been in recession for three years.
- Western Europe has been more severely affected by the global economic and financial crisis than the Central and Eastern European countries.
- Spain, Ireland, Portugal and the UK were particularly hard hit as the global crisis came on top of sharp adjustments in their housing markets.
- Poland is the only country, which did not experience a decline in output.
- The outlook varies among countries, but overall the recovery from the current crisis will be modest from 2011 onwards. Several EU countries are now prioritising budget cutbacks as opposed to stimulus spending, which does not augur well for construction.
- The overall prospects for Western Europe are for a sluggish but gradual pick up in construction in 2011, gathering pace in 2012.
- Construction in Central and Eastern Europe is expected to perform considerably better in the three years ahead than in Western Europe. The key drivers are new non-residential construction and civil engineering, both of which benefiting from EU Structural Funds for public investment.
- Poland is expected to continue to be the star performer due to substantial investment in EU funded infrastructure projects, a recovery in new residential construction from 2011 and preparations for the Euro 2012.

	Construction Output - Europe							
	2009	2006	2007	2008	2009	2010f	2011f	2012f
	in million €, 2009 prices							
	Change % real							
Germany	255,435	4.5%	0.7%	2.6%	-0.7%	0.4%	0.4%	1.4%
France	199,847	4.5%	3.4%	-2.4%	-7.2%	-3.4%	0.6%	1.1%
Italy	184,017	1.0%	-0.4%	-4.2%	-8.7%	-4.8%	2.4%	3.9%
UK	145,673	0.9%	2.2%	-0.7%	-11.0%	-1.3%	1.8%	1.5%
Spain	131,425	5.9%	2.9%	-18.9%	-26.1%	-17.7%	-4.7%	-0.1%
Netherlands	71,611	4.0%	5.1%	5.7%	-4.9%	-8.0%	0.0%	1.3%
Poland	36,785	11.4%	12.7%	11.4%	4.3%	10.0%	14.5%	14.1%
Switzerland	36,553	-0.9%	-2.3%	0.1%	1.0%	1.1%	0.9%	1.5%
Norway	35,522	6.0%	8.7%	-0.1%	-3.4%	-3.9%	2.3%	4.0%
Belgium	34,996	5.2%	4.1%	1.7%	-2.6%	-2.7%	1.5%	2.3%
Austria	29,739	2.8%	2.9%	1.8%	-6.1%	-1.0%	0.3%	0.5%
Denmark	26,512	10.5%	1.5%	-5.0%	-11.3%	-2.9%	4.1%	6.0%
Sweden	25,597	8.4%	4.6%	-0.2%	-4.4%	2.1%	7.8%	3.4%
Finland	25,480	3.4%	6.4%	0.1%	-12.7%	1.2%	0.2%	2.3%
Portugal	23,051	-5.3%	-0.4%	-4.8%	-9.9%	-10.2%	-3.1%	0.8%
Ireland	18,056	5.4%	0.9%	-8.1%	-34.6%	-27.5%	-7.3%	1.6%
Czech R	21,019	9.7%	7.1%	0.0%	-1.0%	-7.0%	2.1%	3.1%
Ireland	18,057	105.4%	100.9%	91.9%	65.4%	72.5%	92.7%	101.6%
Hungary	9,390	-1.7%	-3.8%	-2.9%	-9.4%	2.6%	5.3%	6.9%
Slovak R	5,528	16.1%	6.0%	11.0%	-13.0%	4.6%	11.2%	4.2%

Source: Euroconstruct, June 2010

Growth Prospects 2010-2012	
Poland	Best performer. Double-digit growth forecast
Slovakia Hungary Sweden Denmark	Firm recovery expected
Norway Italy Czech R Belgium UK	Modest recovery in 2011 expected
Finland Switzerland Germany France Netherlands Austria	Fragile recovery in 2011 and 2012
Portugal Ireland	Continued decline in 2010/11, only weak recovery in 2012
Spain	No end to recession in sight, but pace of decline slowing

Source: Euroconstruct, June 2010

Looking ahead

The Bank of England's Monetary Policy Committee is expected to keep interest rates at 0.5% in its July meeting, despite some concern about inflation sticking well above the 2%-target. The service sector PMI is expected to show that industry activity expanded in June, but at a slower pace than the manufacturing and construction industries. Official manufacturing output data is likely to show a solid increase, with the sector benefiting from stronger demand and re-stocking. Manufacturers' input costs growth is likely to have eased in June, given lower fuel prices recently. Output prices are also expected to have grown at a more modest pace, although manufacturers are trying to push through price increases on the back of markedly higher input costs recently.

Market Watch

Equity markets fell sharply last week, amid increasing signs that global growth will slow in the second half of this year.

The **FTSE 100** fell 4% in the week to Friday to 4,838.1, the lowest level since September 2009. The **real estate index** recorded a 3.4% fall last week.

Among **real estate stocks**, Capital & Counties and Minerva outperformed the industry, with share prices up 3.4% and 1.7%, respectively. The Workspace Group held stable. All other real estate stocks fell in the week to Friday. The Unite Group, Derwent, Capital Shopping Centres and Land Securities saw the largest losses.

All **building contractors** saw their share prices fall last week. Kier was the biggest loser, down 7.7%.

According to reports, Kier is in court appealing against a £17.9m fine from the Office of Fair Trading. The fine was imposed on the contractor last September for three infringements relating to cover pricing. Kier was the hardest hit of 103 firms that were fined a total of £129.5m. Kier is seeking a reduction in the fine, claiming that its impact is excessive and/or discriminatory.

Building material suppliers also declined last week, with the exception of Marshalls, whose share price rose 6.3%.

House builders saw particularly heavy losses last week, amid further signs of a renewed slowing in UK housing market activity. Taylor Wimpey shed 15.6%, Barratt fell 11.6% and Bellway was down 10.3%.

Stock Market		Friday 2nd July 2010			
Index	Index	Week	Month	Year	
FTSE100	4,838.1	▼ -4.1%	-6.1%	14.3%	
EPRA/NAREIT UK	325.5	▼ -3.4%	-7.1%	15.9%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	3,810	▼ -0.9%	-5.5%	15.4%	
Hammerson	2,380	▼ -4.6%	-9.4%	12.5%	
Land Securities	4,200	▼ -5.1%	-10.7%	19.5%	
Capital & Counties	677	▲ 3.4%	5.6%	-	
Capital Shopping Centres	1,890	▼ -5.2%	-8.7%	-23.9%	
Shaftesbury	797	▼ -4.9%	-7.3%	17.0%	
Great Portland Est.	885	▼ -2.8%	-8.7%	27.8%	
Derwent London	1,240	▼ -5.3%	-9.4%	36.3%	
Segro	1,890	▼ -3.2%	-11.5%	9.4%	
Quintain Estates & Development	215	▼ -3.5%	-17.9%	71.6%	
St. Modwen Properties	344	▼ -4.9%	-6.7%	-4.9%	
Unite Group	280	▼ -5.4%	-9.8%	42.1%	
Workspace Group	241	▲ 0.0%	-3.5%	52.7%	
Minerva	168	▲ 1.7%	-11.3%	688.7%	
Average*		▼ -3.5%	-8.4%	20.0%	
Building Contractors					
Balfour Beatty	1,600	▼ -2.5%	-8.7%	-12.8%	
Carillion	1,200	▼ -5.6%	-7.0%	20.5%	
Morgan Sindall	221	▼ -3.4%	-6.1%	-24.0%	
Kier Group	242	▼ -7.7%	-12.8%	2.5%	
Lend Lease Corp*	2,144	▼ -2.6%	-5.5%	6.9%	
Average		▼ -3.5%	-7.1%	2.6%	
Building material suppliers					
Wolseley	3,750	▼ -7.8%	-19.3%	15.4%	
SIG	593	▼ -8.9%	-13.8%	1.3%	
Marshalls	167	▲ 6.3%	-9.6%	-0.9%	
Kingspan	849	▼ -2.6%	-13.7%	46.6%	
BSS	518	▼ -6.3%	-4.3%	65.2%	
Average		▼ -6.6%	-16.4%	22.4%	
Housebuilders					
Persimmon	1,030	▼ -9.8%	-14.3%	-2.9%	
Taylor Wimpey	822	▼ -15.6%	-22.5%	-24.4%	
Barratt	891	▼ -11.6%	-12.5%	-3.7%	
Bovis Homes	437	▼ -8.9%	-13.8%	-11.2%	
Bellway	707	▼ -10.3%	-14.7%	-3.2%	
Berkeley	1,030	▼ -3.5%	-2.2%	-4.0%	
Average		▼ -9.8%	-12.8%	-7.6%	

**Sector averages are weighted according to current market capitalisations