

# Weekly Economic Update

26<sup>th</sup> September 2010

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The Bank of England's Monetary Policy Committee remains worried about headwinds facing the UK economy. It is keeping monetary policy loose, while leaving the doors open for a resumption of quantitative easing. Survey evidence points to still tight credit conditions and a softening in consumer demand. Meanwhile, public net borrowing remains high.

## Economy

### MPC minutes

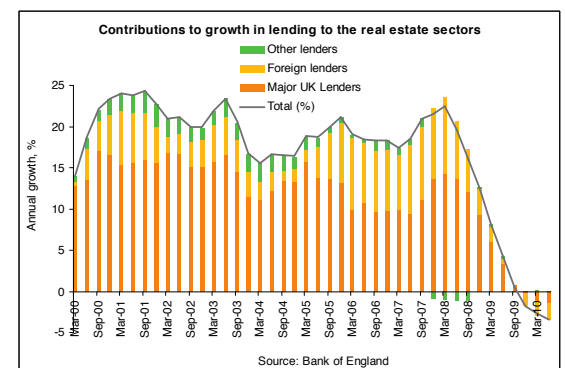
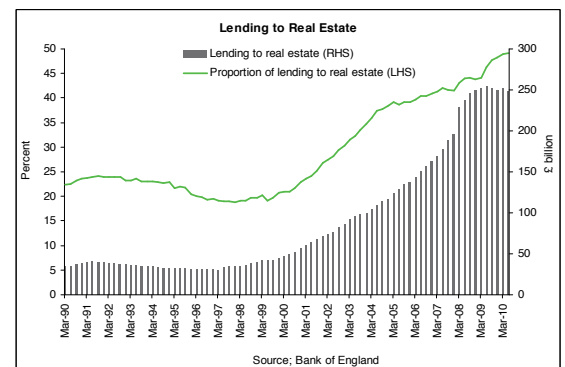
The decision to keep interest rates on hold at 0.5% in September and not to add to the £200 billion quantitative easing programme was made by eight votes to one, according to the meeting minutes of the MPC. The one dissenter (Andrew Sentance) again argued that high inflation justified a small rise in interest rates. However the other MPC members continue to argue that the headwinds facing a sustained recovery - notably the fiscal cuts, slowing global growth, high unemployment and persistently tight credit conditions - warranted unchanged interest rates.

### Trends in lending

The latest Bank of England lending survey shows that:

- Net lending to UK businesses was negative in July and remained subdued in August.
- In the year to July, the value of new syndicated lending facilities remained below levels seen between 2003 and 2007, although the value picked up slightly in August.
- Capital market issuance was subdued in July and August, but UK lenders noted that sentiment improved in early September. Major UK lenders anticipate some recovery in M&A activity, which may support capital market issuance in the months ahead.
- Indicators of corporate financial distress, i.e. corporate liquidation rate, eased in Q2 2010. Lenders report that write-offs in recent months were below or in line with their expectations.
- Indicators of distress in the real estate sector are also stable, though many loans remain in breach of loan to value covenants.
- The stock of lending to the real estate sector has fallen over the past two

years, but real estate lending continued to increase as a share of total corporate lending, as lending to other sectors has fallen more rapidly. Lenders note that the relative resilience of real estate lending partly reflects that commercial real estate



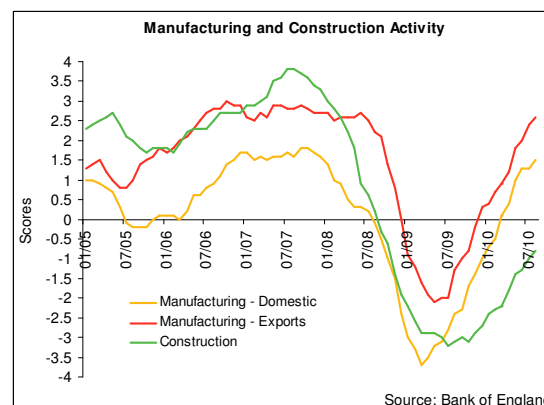
companies typically rely on loans of a longer maturity. In addition, real estate companies are said to be generally more leveraged but also less able to reduce their working capital to generate cash and pay down debt.

- **Credit conditions** are easing for larger businesses, but remain tight for smaller firms. Most major UK lenders report that demand for credit remains subdued.
- The spread over Libor of the **effective interest rate** on new lending to companies was broadly unchanged in July and August.
- The flow of net **mortgage lending** slowed in July. In August, gross **lending for house purchase** was little changed and mortgage approvals for house purchase decreased slightly. Net **consumer credit** increased in July.

### Business conditions

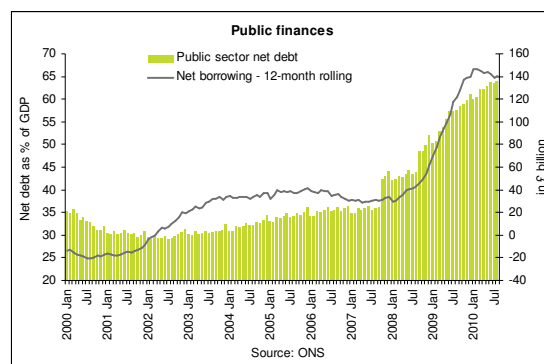
The Bank of England's survey of Business Conditions in August reveals that:

- **Retail sales** softened further, but consumer services growth remained steady. Retailers reported that consumer confidence stalled in recent months, which many ascribed to concerns about future employment prospects.
- **Housing market activity** also softened. Looking ahead the industry expects prices to fall over the remainder of the year, due to a combination of weak demand (reflecting restrictions on mortgage finance, consumer uncertainty and lower confidence), and an increase in supply of properties for sale.
- **Investment intentions** remain subdued. Spending plans are focused on improving efficiency and replacing assets, though there are some exporters reporting plans to invest in additional capacity and equipment.
- **Credit conditions** are becoming increasingly polarised, easing for those firms perceived to be better-quality credits, but remaining tight for many smaller firms, and those operating in certain sectors, such as construction and real estate.
- **Services** sector activity continued to rise modestly in August. The pickup in **manufacturing** output also continued.
- **Construction** output in August was below its level a year earlier. The industry remains pessimistic about the outlook for the sector, with many citing concerns about the impact of cuts in public sector spending on demand over the coming year or so.
- **Pay settlements** had been edging higher throughout 2010, but they remain moderate overall. **Non-labour costs** continue to rise, but are tentative signs that the annual inflation rate might have passed its peak. The prices of a number of raw materials, including steel, timber, cotton and paper continued to rise in August. Oil and fuel prices retreated from their recent peaks, and reports of increases in shipping rates were balanced by reports of declines.
- **Consumer price inflation** appears to have stabilised in recent months.



### Public finances

Public sector net borrowing in August was £15.9bn, compared to £14.1bn a year ago. Higher borrowing last month was mainly due to higher accrued interest payments for index-linked gilts, reflecting the impact of higher RPI inflation this year. Borrowing in the first five months of this financial year stood at £58.1bn, down 6% compared to 2009/10. Net debt (excl. financial interventions) stood at £823.3bn in August or 56.3% of GDP (£934.9bn, or 64% incl. interventions). Government revenues rose during the month, helped by stronger economic growth, the rise in VAT in January and an improvement in tax receipts.



## Commodities

**Metals prices** rose last week, led by aluminium, up 5% to \$2,272/ ton and copper, up 2% to \$7,911/ ton. **Oil** pushed close to the \$80 per barrel-mark, ending the week at \$79/ barrel, up 2% compared to a week earlier. However, the pace of real demand growth remains subdued, with **global steel prices** unchanged and the **Baltic dry index** (BDI), the benchmark for shipping bulk commodities, such as iron ore, falling 9% in the week to Friday.

## Exchange rates

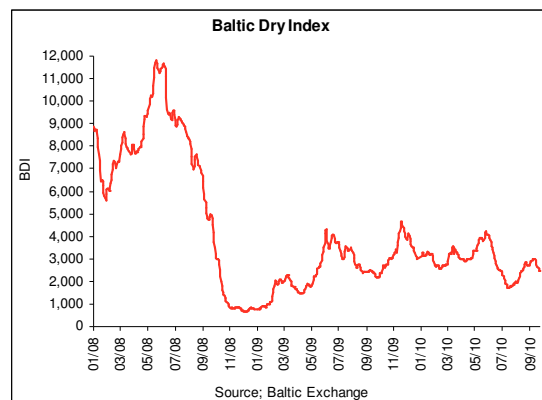
The Dollar fell last week, touching a five-month low against the Euro, though the Euro's advance was mainly due to Dollar weakness rather than eurozone strength. The Pound fell 2% against the Euro to £/€1.174, but rose 1% against the Dollar to £/\$1.581.

## Looking ahead

UK **second quarter GDP** growth is expected to be confirmed at 1.2%. However, more recent data and survey evidence point to appreciably slower activity in the third quarter. Growth in the year ahead is likely to come under pressure from major fiscal tightening, slower global growth, subdued consumer confidence and still tight credit conditions. The CBI's September **distributive trades survey** should show that the majority of retailers still saw retail sales in September ahead of a year ago, but the pace of sales growth is likely to have slowed appreciably. **Consumer lending** data from the Bank of England are expected to reveal that **mortgage approvals** declined further in August, while the Nationwide is likely to report another monthly decline in **house prices**. **Consumer confidence** is expected to have edged back in September. The **manufacturing purchasing managers' index** (PMI) is expected to show that sector activity continued to expand in September, but at a slower pace than in recent months.

Commodity Prices (24th Sep 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	79.0	2%	9%	21%
Copper (\$/tonne)	7,911	2%	10%	30%
Aluminium (\$/tonne)	2,272	5%	11%	24%
Nickel (\$/tonne)	22,900	-2%	11%	30%
Global Steel Price (Index 04/1994=100)	180.5	0%	3%	13%

Source: FT, LME, Cruspi



## Market Watch

Equities climbed to a 5-month high last week, despite conflicting signals about the global recovery and renewed nervousness over the Eurozone sovereign debt problem. Financial markets took an optimistic view and sent share higher, with the **FTSE 100** advancing 1.6% to 5598.5 points. The UK **real estate index** climbed 1.8%.

All **property stocks** gained last week. **Hammerson** rose 6.1%, after an upgrade to “outperform” from Credit Suisse, which argued that the threat of further quantitative easing has made property yields look more attractive compared to government bonds. The **Unite Group** climbed 7.7%, while **Shaftesbury** advanced 6% in the week to Friday.

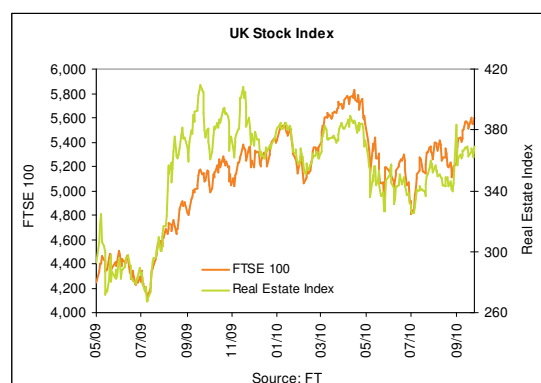
**Minerva**, in its annual results for 2009/10 reported that the value of its investment properties rose 17.4%, compared to a 35.4% fall last year. The property portfolio has been valued at £1,124.9m at 30 June 2010 (£807m at 30 June 2009). It reported profit after tax of £69.1m, compared to a £287.1m loss a year ago. NAV per share rose from 47.1p to 131.8p. According to the firm, gearing fell from 79% to 72%. It has extended the terms of the four loans which matured this year and has no further loans maturing this financial year. Minerva’s shares last week rose 1.9%.

**Wolseley** jumped 7.5% last week, as analysts played down concerns about its exposure to the US housing market. Other **building material suppliers** also had a good week, with Kingspan up 5.7%, Marshalls rising 3.9% and BSS gaining 3.1%.

**Building contractors** also gained albeit much more modestly than the wider market, with the exception of Morgan Sindall, which fell 0.9%. All **housebuilders** with the exception of Taylor Wimpey rose, led by Bellway (2.5%) and Bovis Homes (2.2%).

Stock Market		Friday 24th September 2010			
Index	Index	Week	Month	Year	
FTSE100	5,598.5	▲ 1.6%	8.6%	10.2%	
EPRA/NAREIT UK	369.0	▲ 1.8%	8.2%	-2.8%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,150	▲ 0.8%	5.5%	-0.4%	
Hammerson	2,870	▲ 6.1%	14.8%	1.2%	
Land Securities	4,920	▲ 2.9%	6.8%	-1.6%	
Capital & Counties	824	▲ 2.3%	13.7%		
Capital Shopping Centres	2,290	▲ 2.4%	13.5%		
Shaftesbury	1,030	▲ 6.0%	11.9%	27.0%	
Great Portland Est.	1,070	▲ 4.0%	8.9%	25.9%	
Derwent London	1,560	▲ 4.2%	12.1%	21.6%	
Segro	1,980	▲ 1.2%	-3.3%	-27.1%	
Quintain Estates & Development	207	▲ 1.3%	1.9%	-58.3%	
St. Modwen Properties	336	▲ 3.1%	4.8%	-24.5%	
Unite Group	331	▲ 7.7%	15.5%	-22.9%	
Workspace Group	245	▲ 1.2%	7.6%	0.0%	
Minerva	153	▲ 1.9%	4.1%	146.1%	
<b>Average*</b>		▲ 3.0%	8.4%	-1.5%	
Building Contractors					
Balfour Beatty	1,840	▲ 0.6%	14.3%	-6.8%	
Carillion	1,270	▲ 0.9%	9.1%	15.6%	
Morgan Sindall	289	▼ -0.9%	21.7%	-1.9%	
Kier Group	429	▲ 0.8%	16.7%	-3.2%	
Lend Lease Corp*	2,420	▲ 1.1%	8.8%	-28.7%	
<b>Average</b>		▲ 0.8%	11.6%	-10.3%	
Building material suppliers					
Wolseley	4,350	▲ 7.5%	23.5%	15.2%	
SIG	582	▲ 1.0%	8.6%	-25.8%	
Marshalls	213	▲ 3.9%	17.4%	-16.1%	
Kingspan	835	▲ 5.7%	16.8%	-5.9%	
BSS	566	▲ 3.1%	7.0%	56.8%	
<b>Average</b>		▲ 6.2%	19.7%	11.4%	
Housebuilders					
Persimmon	1,220	▲ 1.8%	16.8%	-12.5%	
Taylor Wimpey	926	▼ -1.2%	10.9%	-31.4%	
Barratt	1,000	▲ 2.0%	12.4%	-39.4%	
Bovis Homes	517	▲ 2.2%	14.7%	-17.2%	
Bellway	725	▲ 2.5%	15.3%	-28.0%	
Berkeley	1,090	▲ 0.4%	3.2%	-7.5%	
<b>Average</b>		▲ 1.2%	11.9%	-22.1%	

\*\*Sector averages are weighted according to current market capitalisations



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