

Weekly Economic Update

3rd October 2010

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Summary

UK retail sales remain surprisingly resilient, despite expectations that consumers will reign in spending in light of the substantial fiscal squeeze, relatively high unemployment, subdued earnings growth and elevated debt levels. Construction output growth for the second quarter was revised up, but the industry is very unlikely to maintain recent growth rates, given public capital expenditure cuts and the slow pace of private sector recovery. Meanwhile, latest survey evidence points to slower UK manufacturing growth and housing market activity.

Economy

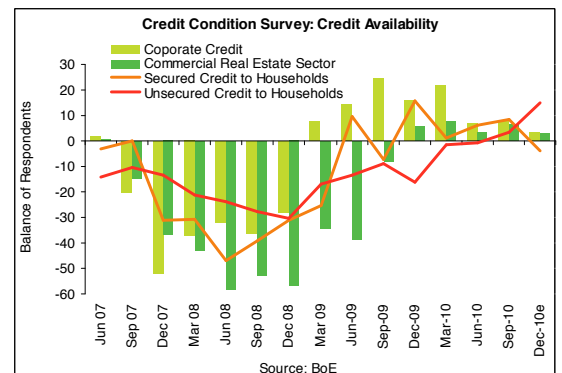
UK economy

The latest estimate of Q2 2010 GDP left the headline quarterly and annual growth rate unchanged at 1.2% and 1.7%, respectively. The details however included some significant revisions. Construction output growth was revised up to 9.5% quarter-on-quarter, from 8.5% in the previous estimate. The volume of work during Q2 was 9.9% up on a year earlier. On the expenditure side, government spending rose by 1% during the quarter and up 1.9% on a year ago. Gross fixed capital formation was up 1.4% during the quarter and up 3.7% year-on-year. Household spending rose 0.7% in Q2 and up 1.9% on a year ago. However, at the same time household disposable income fell by 1.6%, indicating that consumer spending was financed by a decline in savings, with the savings ratio dropping to 3.2% from 5.5% in the first quarter.

Credit conditions

The Bank of England's credit conditions survey for the 3rd quarter reveals a further modest improvement in the cost and availability of credit to households and businesses.

- o Availability of **secured credit** to households rose slightly in Q3, while availability of **unsecured credit** weakened slightly. Demand for loans remains relatively subdued.
- o Availability of **credit to the corporate sector** rose in Q3, with a larger increase reported in availability to small businesses than for larger companies. Overall, availability was not expected to change in Q4.
- o **Demand for credit** from small businesses fell unexpectedly, while demand for loans from larger businesses did not change in Q3. Lenders expect demand from large corporations to fall slightly in Q4. There is still little evidence of capital investment intentions contributing to demand.
- o Credit availability to the **commercial real estate** sector rose modestly during the quarter, with further small increases expected for the quarter ahead.
- o **Default rates** fell in Q3 and losses given defaults were also generally lower for both households and businesses.
- o **Spreads** continued to fall for large businesses, possibly reflecting competition from capital markets and non-resident lenders. Spreads are not expected to fall further in Q4.

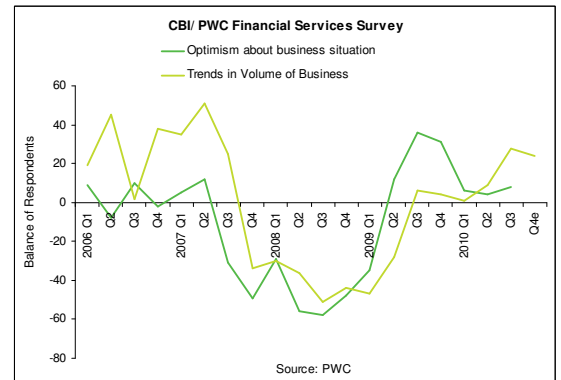


Financial services activity

Activity in the UK financial services sector is improving, according to the latest **CBI/ PWC financial services survey**. The results show that the industry during the third quarter grew at the fastest pace since June 2007. **Business volumes** rose across all sub-sectors, with the exception of general insurance. Banks' volumes increased after two quarters of decline, but at a slower pace.

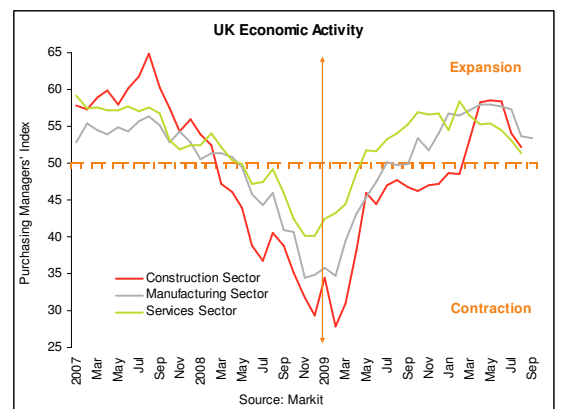
Fee, commission and premium **income** rose only slightly in Q3, while the value of income from net interest, investment and trading was broadly flat. For the fifth quarter in a row,

profitability improved and is expected to continue growing over the next three months. The industry remains cautious about the **outlook for business**, with firms worried that financial regulation and the demand outlook may limit growth.



Manufacturing activity

Latest survey evidence indicates that the pace of manufacturing growth may be starting to slow. The manufacturing Purchasing Managers' Index (PMI) fell for a 3rd consecutive month in September to 53.4 – the weakest reading in ten months. Slower growth in September mainly reflects a marked decline in investment goods output. Total new orders growth slowed and new export orders fell slightly for the first time since July 2009, as global demand weakened. Cost inflation remains elevated, due to higher prices for chemicals, food, metals, paper, packaging, plastics and timber. Global manufacturing growth also continued to moderate in September, with the global PMI edging down to 52.5 - a 14-month low. Production, new orders and employment growth slowed. Growth eased in the US, Japan and the Eurozone. In contrast, China saw a slightly faster pace of manufacturing activity in September.



Retail sales

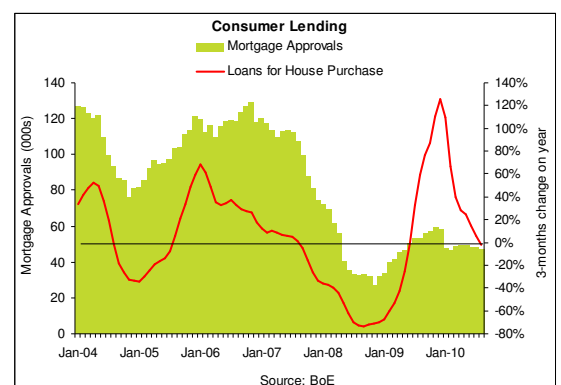
Retail sales growth continues to surprise on the upside, with the CBI's distributive trade survey showing that 60% of retailers saw their sales increase in September. Sales volumes were above average for the time of the year for the first time since June 2007. Retailers expect another strong rise in sales in October, helped by households bringing expenditure forward ahead of the VAT rise in January. However, weak prospects for average pay growth are likely to limit consumer spending in 2011.

Consumer confidence

Consumer confidence weakened in September, with the GfK/NOP index of consumer confidence falling from -18 to -20. Households became more concerned about their personal financial situation, as confidence in the general economic declined.

Consumer lending

Housing market activity continues to slow. Mortgage approvals totalled 47,370 in August, falling for a fourth consecutive month. Approvals remain at half their 10-year average. Unsecured consumer lending also fell in August, indicating that households are trying to repair their balance sheets amid high debt levels and an uncertain economic outlook.



House price inflation

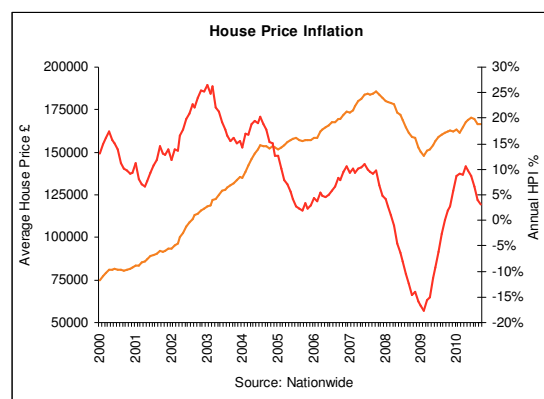
The Nationwide reports that house prices were little changed in September, with the index showing a marginal increase of 0.1% compared to August. The annual pace of house price inflation slowed to 3.1% from 4.1% in August.

Exchange rates

The Dollar continued to fall against most of its counterparts last week, as the Federal Reserve's plan to perk up growth via quantitative easing (asset buying programme) weighed on the greenback. In contrast, despite persistent sovereign debt problems in the Eurozone periphery, the Euro continued to strengthen. The Pound lost ground against major currencies last week, falling 2% against the Euro to £/€1.1502. Over the past month the Sterling lost 6% against the Euro. The Pound held stable against the Dollar at £/\$1.5811.

Commodities

Commodity prices rose last week, amid better than expected US economic data and firm Chinese manufacturing output growth. Oil prices rose 5% to \$83 per barrel of Brent crude – a five-month high. Copper and aluminium gained 3%, with copper at \$8,115/ ton and aluminium at \$2,345/ton. Commodity prices, from metals to food, are also being pushed up by tight supply conditions, caused underinvestment in mine capacity and bad weather. In contrast, steel prices fell last week, with the global steel price index down 1%.



Commodity Prices (1st Oct 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	83.0	5%	9%	22%
Copper (\$/tonne)	8,115	3%	8%	33%
Aluminium (\$/tonne)	2,345	3%	14%	26%
Nickel (\$/tonne)	23,775	4%	13%	35%
Global Steel Price (Index 04/1994=100)	179.4	-1%	-2%	11%

Source: FT, LME, Cruspi

Looking ahead

The Bank of England's Monetary Policy Committee is expected to keep **interest rates** unchanged during its October meeting. It is also likely to hold off from renewed **quantitative easing** until its next economic and inflation forecast in November. Survey evidence from the **construction** and **services sectors** is expected to point to a further moderation in growth following the second-quarter jump in activity. Official **manufacturing output** data should confirm recent survey evidence of a slowing in industry growth, although the pace of growth is still decent. Producer **input price inflation** is expected to have risen in September, after three months of declines, due to higher raw material and commodity prices. Manufacturing **output prices** are likely to have remained relatively unchanged in September, as businesses will find it increasingly difficult to raise their prices, given excess capacity and slower growth.

Market Watch

The FTSE 100 closed the week at 5,592.9, marginally down on a week earlier, with the banking sector dragging the index down. Banks lost ground amid concerns about their exposure to European sovereign debt and the impact of the Basel III reforms.

Ireland last week announced additional capital injections into its financial sector, including a further €6.4bn for Anglo Irish Bank. The Irish Government has already spent some €33bn to support its banking system.

The real estate index outperformed the wider index last week, rising 1%. Experian, in its latest Insolvency Index reported that the number of property business insolvencies declined in August to 78, from 151 a year ago. Overall, 1,392 UK businesses failed last month, down from 1,783 recorded in August 2009. The average financial strength score for businesses increased in August.

Among real estate stocks, Quintain Estates & Developments was the top performer, ending the week up 15.5%. The Unite Group gained 8.9%, while St. Modwen Properties was up 6%. Segro advanced 4.9%. Hammerson and Shaftesbury were the only two to decline last week, falling 2% and 2.4%, respectively.

Housebuilders all ended the week in red, amid widespread evidence of a slowing in UK housing market activity.

Housebuilders are likely to see lower sales in the months ahead, partly due to the government's HomeBuy Direct scheme coming to an end last Friday.

Building contractors and material suppliers had a mixed week. Wolseley reported that it made a pre-tax loss of £328m in its financial year to 31st July, on sales down 9% at £13.2bn. Wolseley shares closed on Friday at 1582p valuing the company at £4.5bn.

Stock Market		Friday 1st October 2010			
Index	Index	Week	Month	Year	
FTSE100	5592.9	▼ -0.1%	4.2%	10.8%	
EPRA/NAREIT UK	372.5	▲ 1.0%	4.5%	1.4%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,090	▲ 0.3%	0.8%	0.5%	
Hammerson	2,790	▼ -2.0%	8.2%	1.7%	
Land Securities	4,930	▲ 2.0%	1.6%	5.0%	
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Capital & Counties	815.8	▲ 0.9%	11.5%		
Capital Shopping Centres	2,340	▲ 2.3%	10.2%		
Shaftesbury	1,000	▼ -2.4%	3.6%	21.8%	
Great Portland Est.	1,070	▲ 2.6%	6.6%	34.1%	
Derwent London	1,570	▲ 1.1%	8.1%	26.2%	
Segro	2,020	▲ 4.9%	2.3%	-19.3%	
Quintain Estates & Development	236.8	▲ 14.5%	23.0%	-55.6%	
St. Modwen Properties	356.6	▲ 6.0%	3.2%	-20.2%	
Unite Group	352.6	▲ 8.9%	15.5%	-14.1%	
Workspace Group	253.6	▲ 3.5%	14.3%	0.0%	
Minerva	158.0	▲ 3.4%	12.0%	157.9%	
Average*		▲ 1.5%	5.1%	2.1%	
Building Contractors					
Balfour Beatty	1,830	▼ -0.6%	9.0%	-3.8%	
Carillion	1,260	▼ -0.7%	1.8%	13.6%	
Morgan Sindall	291.4	▲ 0.8%	12.5%	2.3%	
Kier Group	437.4	▲ 2.0%	15.0%	-0.4%	
Lend Lease Corp*	2,508	▲ 3.4%	7.5%	-24.2%	
Average		▲ 1.2%	7.6%	-7.9%	
Building material suppliers					
Wolseley	4,500	▲ 3.4%	18.4%	4.0%	
SIG	580.2	▼ -0.3%	-1.2%	-26.3%	
Marshalls	216.7	▲ 1.9%	8.4%	-10.4%	
Kingspan	837.2	▼ -1.8%	2.9%	-9.1%	
BSS	548.5	▼ -3.0%	0.7%	52.8%	
Average		▲ 1.9%	13.0%	3.3%	
Housebuilders					
Persimmon	1,180	▼ -3.3%	4.0%	-14.1%	
Taylor Wimpey	915.4	▼ -1.1%	5.8%	-31.8%	
Barratt	938.2	▼ -6.6%	-3.6%	-39.3%	
Bovis Homes	507.8	▼ -1.7%	4.4%	-17.6%	
Bellway	696.0	▼ -4.4%	6.7%	-29.1%	
Berkeley	1,090	▼ -0.1%	-1.3%	-5.9%	
Average		▼ -2.9%	2.3%	-22.2%	

**Sector averages are weighted according to current market capitalisations