

Weekly Economic Update

10th October 2010

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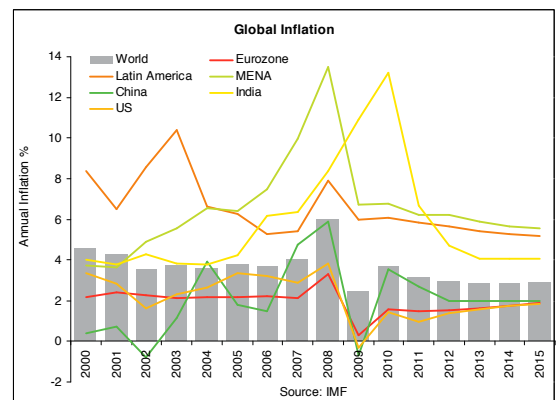
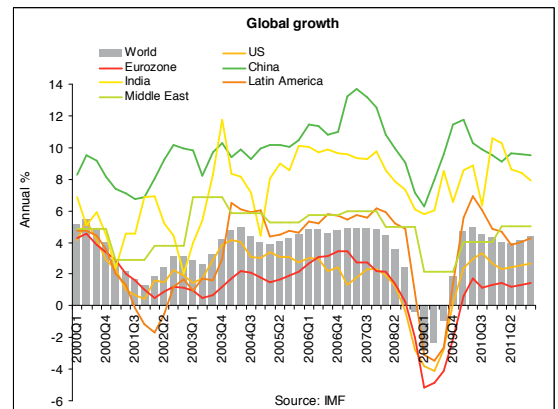
Summary

The world economy is set to expand quicker than previously expected in 2010, but global imbalances and sovereign debt problems are likely to constrain growth in the near term. Fiscal austerity in the developed world, including the UK, will mean markedly slower growth in these regions compared to many emerging economies.

Economy

World Economic Outlook

The IMF in its latest World Economic Outlook report, themed “Recovery, Risk, and Rebalancing”, predicts that global growth would reach 4.8% in 2010, before slowing to 4.2% in 2011. The world average growth rate continues to mask large regional differences. Most advanced economies still face large adjustments. Their recoveries are sluggish, and high unemployment poses major social challenges. By contrast, many emerging and developing economies are seeing strong growth, as they did not experience major financial excesses prior to the recession. The forecast growth for the UK has been revised up to 1.7% this year, but revised down to 2% in 2011. Despite a relatively strong recovery in the first half of 2010, the IMF warns that risks have risen, as global imbalances and sovereign debt issues could pose difficulties for financial stability and the economic outlook. In particular, how Europe deals with fiscal problems, how advanced countries proceed with fiscal consolidation, how advanced economies repair and reform their financial sector, and how emerging market countries rebalance their economies by developing domestic demand and allow for more exchange rate flexibility, will determine the sustainability of world growth in the year ahead.



The IMF also warns that slashing government spending and hiking taxes to reduce debt burden could have unusually damaging effects on growth because of the weak global economy. The impact of austerity measures can be cushioned by a weakening currency, strong export demand and cuts in interest rates, but these factors are absent in most big advanced economies. If many countries adjust simultaneously, the output costs are likely to be greater – since not all countries can weaken their currency and increase net exports at the same time. If underlying growth is sufficiently strong a slide back into recession can be avoided, but with governments cutting simultaneously this could prove difficult to achieve in some countries.

Global financial stability

Progress towards global financial stability has experienced a setback over the past half year, according to the IMF's latest Global Financial Stability report. In the near term, the main risk is an escalation of financial stress and contagion, prompted by rising concern over sovereign risk, in particular in the eurozone's periphery. This could lead to additional increases in funding costs and weaker bank balance sheets, and consequently to tighter lending conditions, consumer confidence, and abrupt changes in exchange rates.

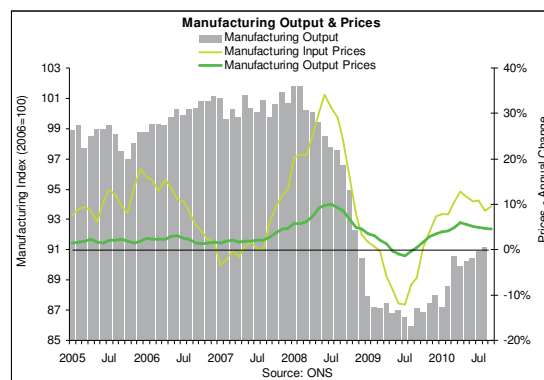
The main policy challenge remains the restoration of financial market confidence without choking the economic recovery. The IMF argues that government policies in advanced economies should focus on credible fiscal consolidation, as well as measures to enhance medium-run growth prospects, such as labour market and tax reforms. Fiscal actions should be complemented by financial sector reform. However, policies should be determined by circumstances. For example most advanced economies do not need to tighten before 2011 because tightening sooner could undermine the fragile recovery, but they should not stimulate their economies more. Policies in emerging economies to help rebalance global demand and to prevent bubbles building in domestic asset markets should also be implemented, including through structural reforms and, in some cases, greater exchange rate flexibility.

Interest rates

The Bank of England's Monetary Policy Committee has kept interest rates unchanged at 0.5% and left the stock of quantitative easing at £200 billion during its October meeting. The Bank maintains its wait-and-see approach, as still-elevated inflation inhibits an immediate expansion of QE. However, with key indicators now pointing to slower economic growth in the months ahead, the likelihood of an early rise in interest rate has diminished considerably.

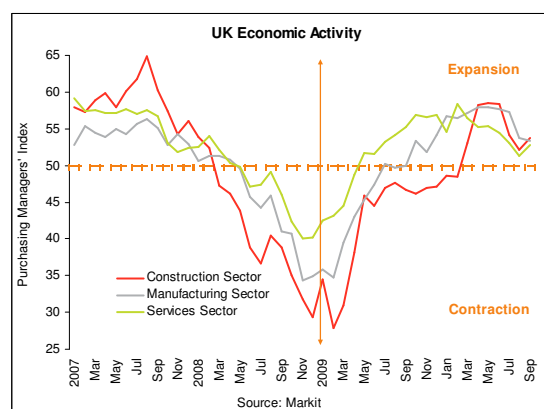
Manufacturing activity and prices

Manufacturing output rose by 0.3% in August compared to July and up 6% on a year ago. This is the strongest annual increase since 1994. However, manufacturing activity remains well below pre-crisis levels, with output 10% lower compared to its peak in early 2008. Producer input prices rose 0.7% in September and up 9.5% on a year ago, mainly reflecting rises in the price of imported metals, parts and equipment and chemicals. Output prices rose 0.3% in September, while annual inflation eased to 4.4% down from 4.7% in August.



Services activity

Services sector growth was stronger in September compared to the preceding month, according to the latest CIPS/ Markit services PMI. The PMI index came in at 52.8 in September, up from 51.3 in August. However, companies reported that new business rose at a slower pace last month. Business confidence improved, but remains historically low. Sentiment within the sector is mixed. Some companies are expecting the UK economy to pick up in the next 12 months, but sectors more susceptible to changes in discretionary consumer spend are less confident. According to the survey, input cost pressures intensified in September, mainly due to higher supplier charges, utility bills and food prices. Competitive pressures continue to restrict companies' ability to pass on higher input costs and average output prices remain broadly unchanged.



Housing market

The Halifax reported that UK house prices fell 3.6% in September compared to August. This is in stark contrast to last week's report from the Nationwide which showed prices holding steady

last month. The relatively limited number of property transactions has made it more difficult to estimate the extent of house price movements over the past year. However, recent increases in the number of properties for sale coupled with uncertainty about employment prospects, is likely to exert downward pressure on house prices in the months ahead.

Commodities

Raw material and commodity prices rose last week, as investors increase demand for commodities amid fears that currency devaluations and quantitative easing by the world's central banks will lead to high future inflation. Supply disruptions are putting additional pressure on some commodities. Oil prices rose 2% in the week to Friday to \$84.5/barrel of Brent. Global steel prices were up 1% compared to a week earlier.

Exchange rates

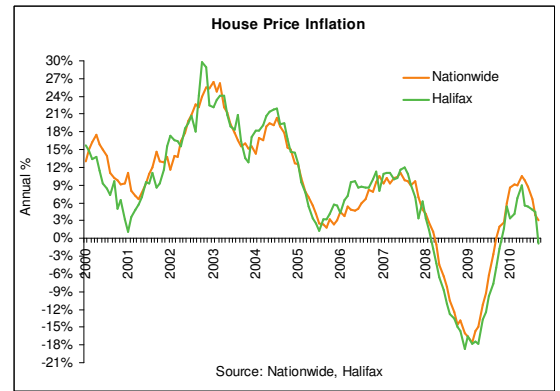
Tensions over trade imbalances and "currency wars" have risen over the past months, amid rising fears of countries seeking competitive devaluations. The IMF's managing director, Dominique Strauss-Kahn, is proposing a new surveillance mechanism whereby the IMF would monitor its large members, including China, the US and the eurozone, and assess how their policies affect the others. Many are worried that currency interventions could derail the recovery of many economies, leading to trade protectionism. In an effort to appease the West, China has let its currency rise recently, with the Yuan hitting its highest level against the Dollar since 2005, but officials ruled out a more significant appreciation. Meanwhile Japan said it would continue to intervene in currency markets to curb the rise of the Yen when necessary. In Europe, there have been complaints about the strength of the Euro. In the UK, the Pound fell 1% against the Euro last week to £/€1.1435, but gained 1% against the Dollar to £/\$1.5932.

Construction

Construction output

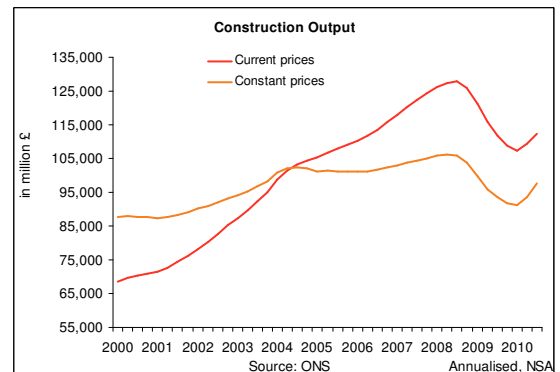
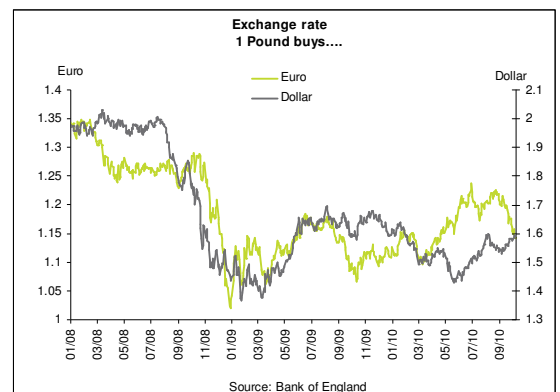
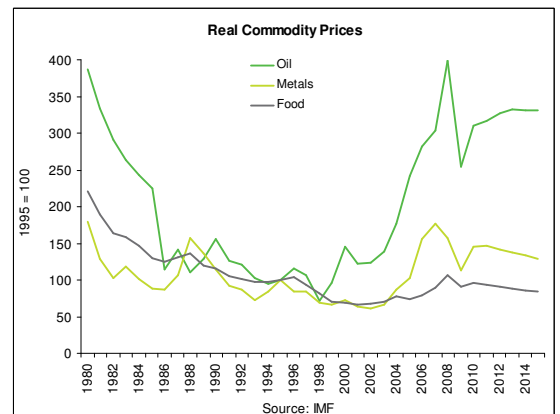
Construction output continued to rise in August, with total work valued at £10.42bn, up from £10.17bn in July. In the three months to August, construction output totalled £30.75bn (in current price terms), a real increase of 8% on the preceding three months.

- **Public housing** work totalled £1.27bn in the three months to August, up 10% on the preceding three months, while **private housing** at £3.84bn was up 8% over the same period.
- **Infrastructure** work stood at £3.47bn in



Commodity Prices (8th Oct 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	84.5	2%	8%	22%
Copper (\$/tonne)	8,104	0%	6%	30%
Aluminium (\$/tonne)	2,321	-1%	9%	25%
Nickel (\$/tonne)	23,705	0%	6%	24%
Global Steel Price (Index 04/1994=100)	180.8	1%	0%	14%

Source: FT, LME, Cruspi



the three months to August, unchanged compared to the three months to May. Meanwhile, **public non-residential** work totalled £3.78bn, up 5% on the previous three months.

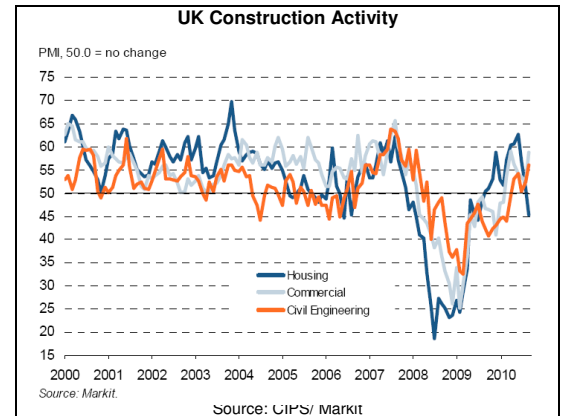
- **Industrial** (£0.99bn) and **commercial** work (£6.42bn) were both up 15% in the three months to August compared to the preceding three months.
- **All repair and maintenance** work totalled £10bn, 6% up on the previous three months.

Construction Output - 3 months to August		
	Value £ million, current	Volume %, Q-o-Q
Public Housing	1,271	10%
Private Housing	3,837	8%
Infrastructure	3,467	0%
Public non-residential	3,775	5%
Industrial	989	15%
Commercial	6,417	15%
All Repair & Maint.	10,995	6%
Total Construction	30,752	8%

Source: ONS

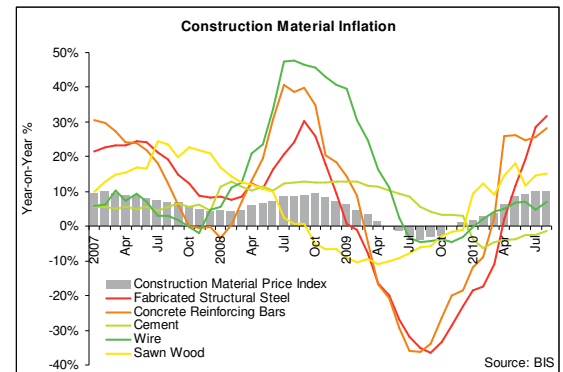
Construction activity

The pace of expansion in the UK construction industry accelerated modestly in September, but concerns about an imminent slowdown are growing, according to the latest Markit/ CIPS Construction Purchasing Managers' Index (PMI). The index rose to 53.8 from 52.1 in August. New contract wins and work on existing projects support the current expansion. Growth last month was led by the commercial and civil engineering sectors, with the rise in civil engineering activity the strongest since February 2008. In contrast, residential construction fell for the first time in twelve months. Confidence continued to fall in September, as concerns over public spending cutbacks grow. Jobs were cut at the fastest pace in six months. Anecdotal evidence suggests that companies continue to reassess costs and resourcing requirements in order to remain competitive. Sub-contractors usage remained unchanged in September. Construction input prices increased for an eighth successive month, though the pace of increases slowed.



Construction material prices

Construction material prices continued to rise markedly in August, with the All Works index up 0.3% during the month and 9.9% on a year ago. Inflation remains highest in the non-residential work sector, with the index up 11% on a year ago. Fabricated structural steel prices rose 2% in August and up 32% on a year ago. Concrete reinforcing bars held stable in August, but were up 28% on last year. Pre-cast concrete and cement also held stable in August, but were down slightly on last year. Wire rose 2% last month and up 7% year-on-year, due to higher copper prices. Sawn wood was up 1% during the month and 15% on last year.



Looking ahead

This week's data are likely to show relatively unchanged conditions in the UK **labour market**, but unemployment is likely to rise in the year ahead, in parts due to public-sector job cuts. **Earnings** growth is expected to have remained relatively subdued in August, reflecting relatively high unemployment and the ongoing need for companies to limit their costs amid an uncertain economic outlook. **Consumer price inflation** is likely to have remained well above target in September. The BRC's **retail sales monitor** for September is expected to show stronger sales growth in September compared to August, but consumer spending is anticipated to be relatively constrained in the year ahead. The RICS's **housing market survey** is likely to reveal that the supply/demand balance remains in favour of buyers, putting downward pressure on prices.

Market Watch

The FTSE 100 index dropped 0.1% on Friday to 5,657.6, paring its gain last week to 1.2%. The index ended the week on a subdued note, as speculation grew that European governments' austerity measures will curb economic growth, while reports from the US pointed to a slowdown in the world's largest economy. The UK market underperformed global indices in recent weeks, with analysts attributing this to uncertainty over the outlook for the British economy, with the UK in a similar position to the US, to further devalue its currency through another round of quantitative easing.

Real estate stock outpaced the wider index last week, with the real estate index up 2.9%. Large real estate stocks all ended the week in green. Hammerson was the top performer, rising 4.9%. Segro was up 4.2%, British Land gained 3.9% and Land Securities rose 3.1%. In contrast, Quintain Estates & Developments fell 6.6%, while the Workspace Group dropped 2.3%.

Building contractor Carillion posted a 3.9% rise last week, with the contractor reporting a strong pipeline of work, despite lower public sector work.

Among material suppliers, SIG and Kingspan had a good week, rising 5% and 3.3%. In contrast, Marshalls shed 4.1%, while Wolseley ended the week down 0.8%.

Downbeat house price data kept housebuilding stocks in the red. Taylor Wimpey shed 7.8%, while Persimmon was down 4.8%. The only exception within the sector was Bellway, which rose 1.3%.

Stock Market		Friday 8th October 2010			
Index	Index	Week	Month	Year	
FTSE100	5657.6	▲ 1.2%	4.2%	9.8%	
EPRA/NAREIT UK	383.16	▲ 2.9%	5.5%	0.9%	
Stocks		Market Cap, £m	Share Prices		
			Week	Month	Year
Real Estate					
British Land	4,330	▲ 3.9%	1.7%	3.0%	
Hammerson	2,950	▲ 4.9%	9.1%	3.9%	
Land Securities	5,170	▲ 3.1%	3.5%	6.9%	
Capital & Counties	861.2	▲ 3.6%	7.7%		
Capital Shopping Centres	2,400	▲ 2.6%	10.1%		
Shaftesbury	1,040	▲ 3.7%	7.2%	21.9%	
Great Portland Est.	1,110	▲ 1.2%	8.8%	28.3%	
Derwent London	1,590	▲ 1.2%	7.7%	25.9%	
Segro	2,170	▲ 4.2%	10.7%	-19.3%	
Quintain Estates & Development	221.2	▼ -6.6%	12.6%	-60.8%	
St. Modwen Properties	354.6	▼ -0.6%	1.8%	-20.6%	
Unite Group	356.8	▼ -1.1%	10.0%	-20.9%	
Workspace Group	247.8	▼ -2.3%	7.5%	-5.5%	
Minerva	156.3	▼ -1.0%	2.9%	181.2%	
Average*		▲ 3.0%	6.3%	2.9%	
Building Contractors					
Balfour Beatty	1,800	▼ -1.5%	7.6%	-6.0%	
Carillion	1,310	▲ 3.9%	5.6%	9.9%	
Morgan Sindall	289.2	▼ -0.7%	4.1%	10.8%	
Kier Group	453.5	▲ 3.7%	17.5%	12.9%	
Lend Lease Corp*	2,597	▲ 2.1%	9.3%	-22.8%	
Average		▲ 1.4%	8.4%	-7.5%	
Building material suppliers					
Wolseley	4,470	▼ -0.8%	15.8%	4.3%	
SIG	609.2	▲ 5.0%	4.0%	-26.1%	
Marshalls	207.8	▼ -4.1%	1.0%	-17.6%	
Kingspan	865.9	▲ 3.3%	8.1%	-9.4%	
BSS	553.5	▲ 0.9%	1.4%	53.0%	
Average		▲ 0.3%	12.1%	3.1%	
Housebuilders					
Persimmon	1,130	▼ -4.8%	-3.8%	-18.7%	
Taylor Wimpey	848.9	▼ -7.3%	-5.5%	-41.0%	
Barratt	906.8	▼ -3.3%	-5.9%	-46.3%	
Bovis Homes	490.1	▼ -3.4%	-0.5%	-21.8%	
Bellway	702.1	▲ 1.3%	5.6%	-27.6%	
Berkeley	1,080	▼ -0.8%	-1.8%	-10.6%	
Average		▼ -3.2%	-2.4%	-27.0%	

**Sector averages are weighted according to current market capitalisations

