

# Weekly Economic Update

8<sup>th</sup> November 2010

## Summary

UK economic activity continues to hold up better than thought in the final quarter of this year, with survey evidence pointing to sustained – if slower – growth. Meanwhile producer price inflation remains elevated, driven by a surge in global commodity prices.

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## Economy

### Interest rates

On the back of surprisingly strong UK GDP in the third quarter of 2010, the Bank of England's Monetary Policy Committee kept interest rates unchanged at 0.5% and left the stock of quantitative easing at £200 billion during its November meeting. The resilience of UK growth appears to have convinced most MPC members that there is no need at this stage to provide further support to the economy, particularly as consumer price inflation remains elevated and well above-target its 2% target.

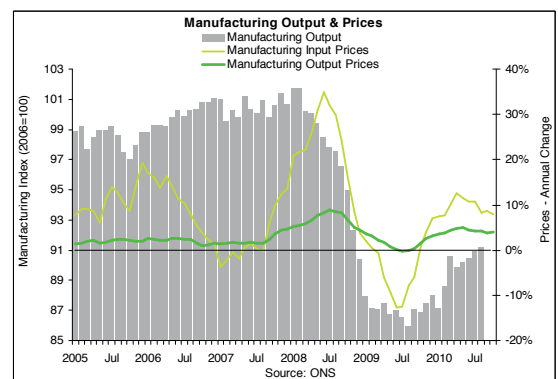
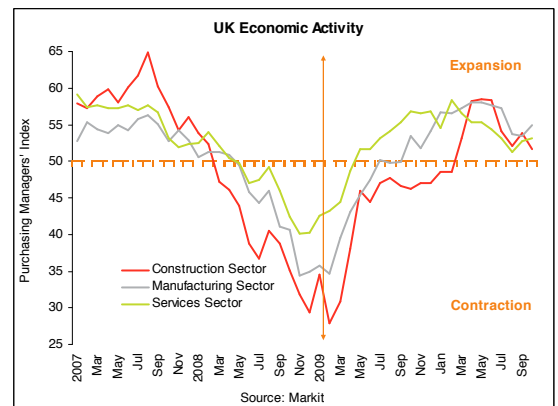
### Manufacturing and service sector activity

The manufacturing PMI shows that sector activity picked up pace modestly in October, with the index recording a reading of 54.9, up from 53.4 in September. Manufacturers' input costs rose for the 14<sup>th</sup> consecutive month in October, reflecting higher prices for chemicals, copper, food products, metals, packaging materials, paper and timber. Shortages of certain inputs also resulted in higher purchase prices. Part of the increase in costs was passed on through the supply chain. Services sector activity improved modestly in October, with the services PMI edging up to 53.2, from 52.8 in the preceding month. Survey respondents reported that growth was mainly driven by an increase in enquiry levels and rising levels of new sales. However, overall sales growth remained modest and well below its trend level. A number of respondents reported that clients continue to defer spending, reflecting continued uncertainty over the impact of government spending cuts on the economy.

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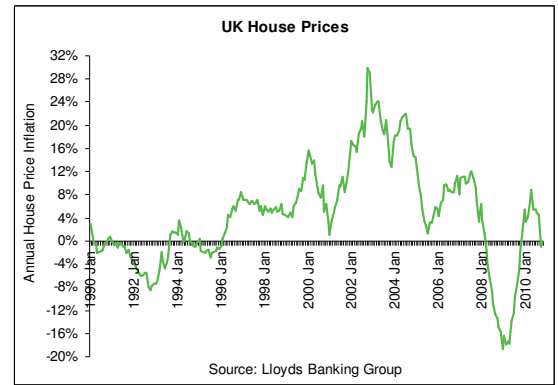
### Producer prices

Input price inflation accelerated sharply in October, rising 2.1% on the preceding month, as sharp rises in the cost of key commodities in the food and energy sectors took hold. Annual input price inflation stood at 8% in October, compared to 8.7% in September. Producers are looking to take advantage of improved sector activity to push through price rises to support their margins. Consequently, factory gate inflation jumped in October, rising 0.6% during the month and up 4% on a year ago.



### Housing market

The Halifax reports that UK house prices rose 1.8% in October compared to September. This is in stark contrast to last week's report from the Nationwide which showed prices falling 0.7% over the last month. The underlying picture is more consistent however, with most reports pointing to a weakening in housing market activity. House prices in October were broadly unchanged compared to a year ago. They have risen only 7% from the trough in December 2008 and are still 17% below the pre-recession peak.



### Exchange rates

The Dollar weakened markedly last week after the Federal Reserve extended its quantitative easing programme by \$600bn in a bid to stimulate the US economy. In contrast, the Pound was helped by the MPC's decision to hold interests and keep APF unchanged at £200bn. The Pound rose 1% against the Dollar to £/\$1.6208 and was unchanged compared to the Euro at £/€1.1551.

### Commodities

The Federal Reserve's decision to support US growth by pumping more money into the economy caused a surge in commodity prices last week. Oil touched its highest level since 2008 with Brent crude up 5% to \$87.5/ barrel. Copper surged 6% last week to within touching distance of an all-time high at \$8,700/ tonne. Aluminium also rose 6% to \$2,438/ tonne.

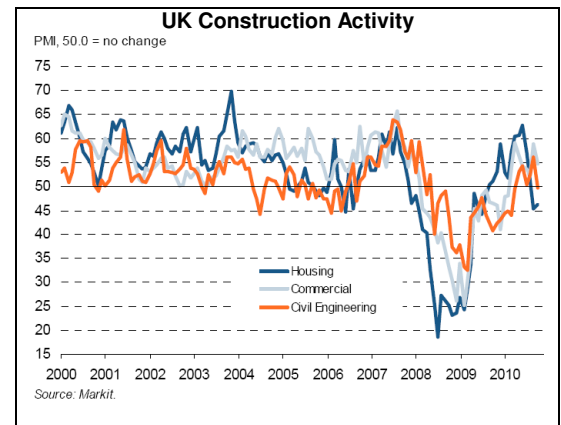
Commodity Prices 5th Nov 2010				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	87.5	5%	2%	12%
Copper (\$/tonne)	8,700	6%	7%	35%
Aluminium (\$/tonne)	2,438	6%	4%	29%
Nickel (\$/tonne)	24,450	8%	1%	37%
Global Steel Price (Index 04/1994=100)	176.3	-1%	-3%	19%

Source: FT, LME, Cruspi

## Construction

### Construction activity

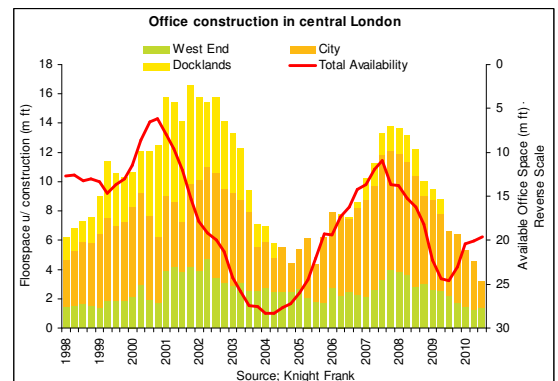
UK construction activity grew in October, but the pace of expansion continues to moderate, with both new orders and output growth slowing. The construction PMI recorded a reading of 51.6 in October, down from 53.8 in September. Of the three construction sub-sectors, only commercial saw a rise in activity last month, while housing and civil engineering both recorded a decline in activity. Anecdotal evidence suggests that the flow of new tender opportunities is decreasing, as clients are reluctant to commit to new projects. Input prices continued to increase in October, due to raw material price increases. Business sentiment remains weak, as companies are wary over the potential negative impact that impending cuts in government spending will have on the sector and the economy in general.



### Central London offices market

According to Knight Frank's Central London Quarterly report:

- Take-up of office space in the central London market improved during Q3 2010, rising from 2.7m sq ft in Q2 to 3.5m sq ft. Active demand fell back slightly in Q3, but this was mainly due to UBS transacting at 5 Broadgate.
- Office construction levels continued to fall during Q3 to 3.1m sq ft, which is the equivalent of about 7 months take-

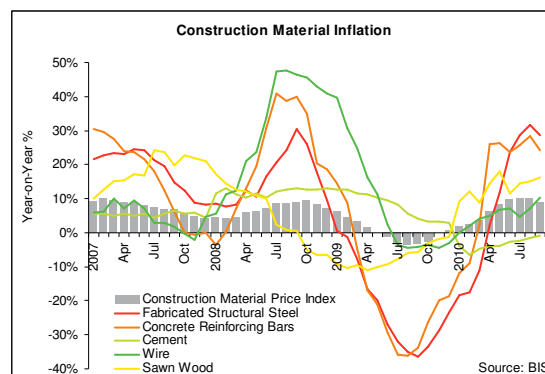


up of new and refurbished space. Some significant new schemes are planned to go ahead on a speculative basis, but 2011/ 12 will see the lowest levels of development completions in Central London during this business cycle.

- Availability continued to fall for the fourth consecutive quarter to the lowest level since Q4 2008, as second-hand space is being absorbed due to a lack of new space. With the development pipeline constrained in the short to medium-term, there are limited high quality options available to occupiers.
- Investment activity improved in Q3, with overseas investors dominating the market.

### Construction material prices

Construction material prices held steady in September and the annual rate of inflation for All Works moderated to 8.9% from 9.9% in August. Within this, fabricated structural steel prices fell 1% in September, but remained 29% up on a year ago. Concrete reinforcing bars also fell 1% in September, but prices were 24% higher than last year. Pre-cast concrete and cement held stable in September, but were down 1% on last year. Wire rose 3% last month and up 10% year-on-year, due to higher copper prices. Sawn wood was up 1% during the month and 16% on last year.



### Looking ahead

This week, attention will be focused on the Bank of England's [Quarterly Inflation Report](#). Updated UK growth and inflation forecasts contained in the report are likely to provide clues about the direction of UK monetary policy in the near and medium term. The British Retail Consortium's [retail sales monitor](#) for October is expected to show that retail sales improved modestly compared with September. The RICS October [housing market survey](#) is likely to show a further weakening in sector activity and that the supply-demand balance continues to favour buyers, putting house prices under pressure. [Manufacturing output](#) is set to have continued to expand in September, but the pace of growth is likely to have slowed somewhat.

## Market Watch

Investor risk appetite rose last week due to the Fed's \$600bn Treasury purchase programme, which offset renewed concern over the Eurozone periphery where bond and CDS spreads hit new record highs.

The FTSE 100 rose to a two-year high, up 3.5% to 5,875.4 points. The real estate index also advanced, but underperformed the wider market. Most large real estate stocks increased last week, with Hammerson up 3.7%, Land Securities rising 2.1% and British Land advancing 1.7%.

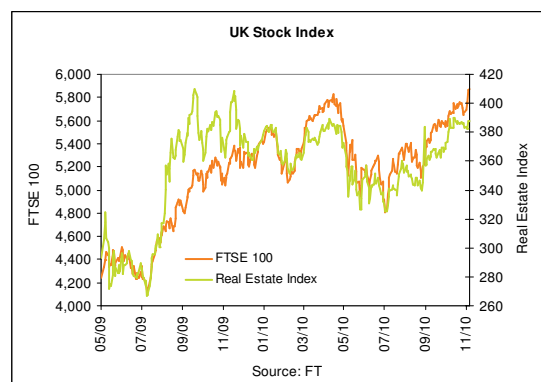
Capital & Counties rose 5.1% last week. Capital Shopping Centres, the shopping centre arm of what used to be Liberty International, reported that it continued to see an improvement in its occupancy rate in the second half of the year. Occupancy at the beginning of November stood at 98.8%, up from 98.1% at the end of June. Capital Shopping Centres advanced 1.7%, with market capitalisation rising to £2.43bn.

The Unite Group in a trading update was upbeat about prospects for student property growth, reporting that 97% of its portfolio of student accommodation had been reserved for the 2010/2011 academic year, and that it expected rents to increase by 3-4% this year. Its shares, down 18% over the past year, rose 3.8% in the week to last Friday, giving the group a market capitalisation of £346m.

Housebuilders rebounded last week, following a relatively upbeat house price report from the Halifax and a better than expected trading update from Redrow. Taylor Wimpey rallied 17%, Barratt Development gained 8.5% and Persimmon rose 5.8%.

Stock Market		Friday 5th November 2010			
Index	Index	Week	Month	Year	
FTSE 100	5,875.40	▲ 3.5%	4.3%	14.6%	
EPRA/NAREIT UK	387.9	▲ 1.3%	0.9%	3.6%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,550	▲ 1.7%	6.2%	12.3%	
Hammerson	3,070	▲ 3.7%	8.1%	6.2%	
Land Securities	5,300	▲ 2.1%	4.2%	2.7%	
Capital & Counties	975.7	▲ 5.1%	17.0%		
Capital Shopping Centres	2,430	▲ 1.7%	1.8%		
Shaftesbury	1,010	▼ -0.2%	0.1%	19.2%	
Great Portland Est.	1,090	▲ 1.0%	-1.3%	40.3%	
Derwent London	1,550	▲ 0.9%	-2.2%	22.9%	
Segro	2,250	▲ 2.5%	5.6%	-10.3%	
Quintain Estates & Development	203.0	▼ -1.3%	-11.9%	-55.3%	
St. Modwen Properties	323.4	▼ -0.4%	-8.9%	-24.4%	
Unite Group	346.0	▲ 3.8%	-4.5%	-18.3%	
Workspace Group	282.4	▲ 3.2%	11.4%	19.5%	
Minerva	142.6	▼ -1.1%	-7.6%	147.6%	
<b>Average*</b>		▲ 2.1%	4.2%	5.7%	
Building Contractors					
Balfour Beatty	1,940	▲ 2.1%	4.0%	6.7%	
Carillion	1,420	▲ 3.6%	11.0%	17.9%	
Morgan Sindall	292.6	▲ 0.6%	0.4%	15.8%	
Kier Group	499.2	▲ 0.6%	10.5%	28.0%	
Lend Lease Corp*	2,459	▲ 1.4%	-4.1%	-17.9%	
<b>Average</b>		▲ 2.0%	2.8%	1.9%	
Building material suppliers					
Wolseley	5,070	▲ 7.3%	10.3%	40.6%	
SIG	658.2	▼ -1.9%	11.6%	-8.2%	
Marshalls	203.9	▼ -3.9%	-5.3%	8.7%	
Kingspan	837.3	▼ -3.0%	-4.0%	3.0%	
BSS	565.8	▲ 2.7%	1.6%	76.0%	
<b>Average</b>		▲ 4.6%	7.7%	33.8%	
Housebuilders					
Persimmon	1,090	▲ 5.8%	-8.4%	-12.8%	
Taylor Wimpey	834.2	▲ 17.0%	-8.2%	-34.9%	
Barratt	818.1	▲ 8.5%	-15.4%	-36.8%	
Bovis Homes	466.5	▲ 0.6%	-9.0%	-14.2%	
Bellway	665.2	▲ 3.1%	-8.0%	-27.0%	
Berkeley	1,100	▲ -0.1%	0.5%	-3.4%	
<b>Average</b>		▲ 6.0%	-7.5%	-20.4%	

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



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