theconstructionindex

Davis Langdon

Weekly Economic Update

28th November 2010

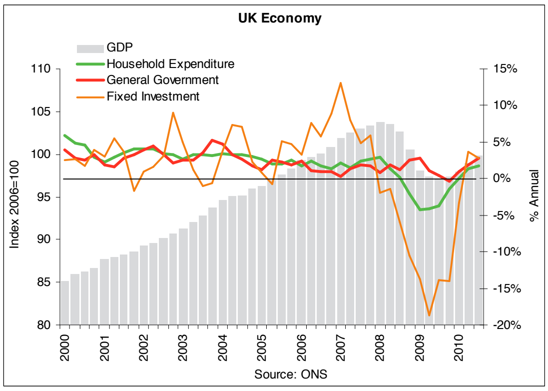
Summary

The EU signed off on an 85bn bail-out package for Ireland and approved the outlines of a new mechanism for dealing with sovereign debt crises in the eurozone, in order to prevent further contagion affecting indebted member countries. The EU and the IMF will provide up to 85bn that Ireland can draw down over the next years, of which 50bn is aimed at helping Ireland's public finances and 35bn for its ailing banking system. The Irish government also last week introduced a 15bn austerity programme - 10bn spending cuts and 5bn tax rises. EU leaders are hoping that the moves will calm bond markets, but with markets still fretting about the prospects for Ireland and Portugal, and to a lesser extent Spain, developments in the eurozone will likely continue to determine market sentiment.

Economy

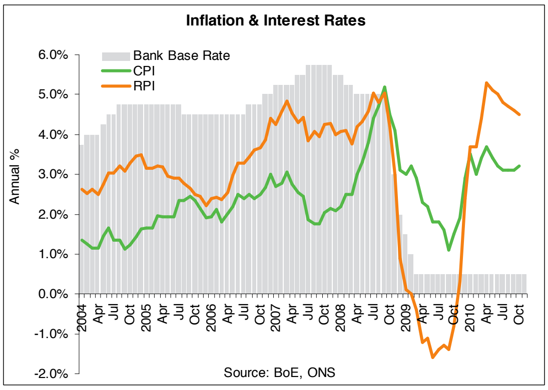
UK growth

GDP growth during the third quarter was confirmed at 0.8% and an annual 2.8%. Net trade made a positive contribution of 0.4% to growth, accounting for around half of the overall increase. In contrast, household spending was sluggish, with quarterly growth slowing to 0.3%. Year-on-year, consumer spending was up 1.8%. Capital investment growth slowed to 0.6% in Q3 to stand 2.8% up on a year ago. Government spending grew by 0.4% in Q3 and up 2.8% year-on-year. The majority of analysts predict slower UK growth in 2011, as major fiscal tightening kicks in, world growth slows and consumers remain cautious.



Inflation

Annual consumer price inflation edged up to 3.2% in October, from 3.1% in September, due to higher food, commodity and oil prices. CPI inflation is now above target for the 11th consecutive month, prompting another open letter by the Bank of England Governor. Once again he cited temporary factors, including a weaker Pound, changes to VAT and higher commodity prices, as having contributed to sticky inflation. Retail price inflation stood at 4.5% in October, marginally down from 4.6% in the preceding month.

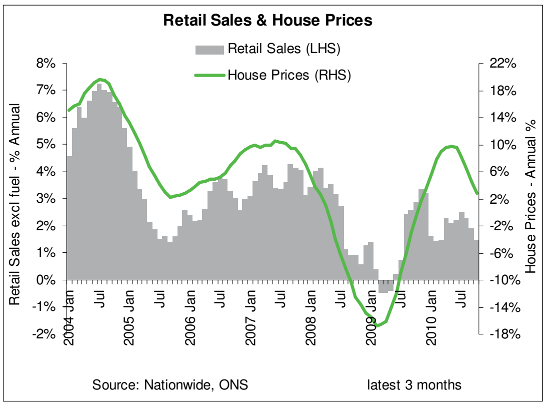


Labour market

Labour market data remain mixed. The benefits claimant count fell by 3,700 in October, in contrast to expectations of a further rise. The total number of unemployed people was 2.45 million in Q3 2010, or 7.7% of the workforce. The number of employed people was up 286,000 on a year ago, but this was again due to a rise in part-time work and movement into self-employment. The number of full-time employee jobs fell. Average earnings in the third quarter rose by 2% year-on-year, up from 1.7% growth in August, but still below current inflation rates.

Retail sales

Official figures for retail sales show that sales volumes (excluding fuel) rose by 0.4% during October and up 1.1% on a year ago. The underlying trend still shows slowing sale growth, with retail volumes in the three months to October up 1.5% year-on-year, compared to 1.9% growth in the previous month.



Retailer survey

The latest CBI distributive trades survey paints a more upbeat picture of the retail industry than the official retail sales numbers suggest. According to the survey, the majority of retailers posted sales growth in November, indicating that consumers are now bringing forward purchases in order to beat the VAT rise in January. Looking ahead to the crucial pre-Christmas period, retailers expect strong sales volume growth in December. However, in the New Year retail sales growth could lose momentum, as consumers rein in spending after Christmas. More encouragingly, after the sharp cuts to investment spending over the past three years, retailers are planning to invest more over the next 12 months.

Public finances

Public sector net borrowing in October was £10.3bn, slightly more than last year. Borrowing in the first seven months of this financial year stood at £81.6bn, on track to meet the 2010/11 target of £149bn. Whilst public finances are benefiting from higher tax receipts and lower unemployment benefit claims, the government's debt interest payments are increasing markedly. Net debt (excl. financial interventions) stood at £845.8bn in October or 57.1% of GDP (£955bn, or 64.5% incl. interventions).

Commodities

On the back of a stronger US Dollar, most commodity prices fell last week. Copper decreased 2% to $8,288, while aluminium dropped 4% to $2,243. In contrast, the oil price rose 1% to $85.5 per barrel, amid stronger economic data from the US. The global steel price index held steady last week.

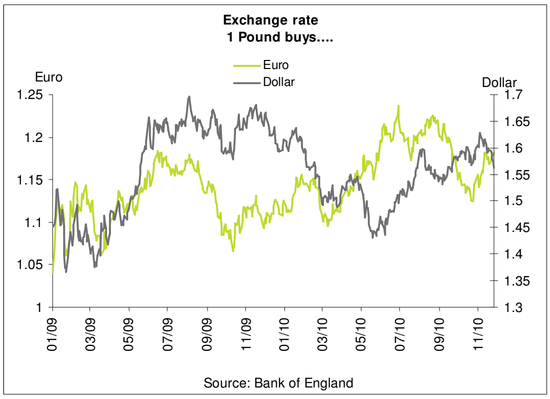
Commodity Prices (26th Nov 2010)

	Price	Weekly change	Monthly change	Annual change
"Brent" Oil ($/ barrel)	85.5	1%	4%	11%
Copper ($/tonne)	8,288	-2%	-2%	20%
Aluminium ($/tonne)	2,243	-4%	-4%	12%
Nickel ($/tonne)	22,510	-3%	-3%	34%
Global Steel Price (Index 04/1994=100)	173.4	0%	-2%	17%

Source: FT, LME, Cruspi

Exchange rates

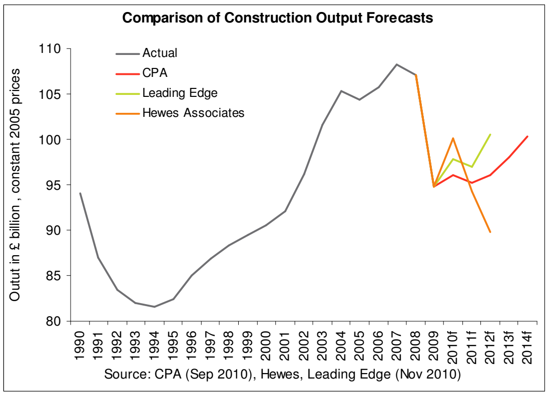
The Euro came under pressure last week, hurt by concerns that an Irish bailout will not be enough to keep financial markets from turning their focus to other debt-ridden eurozone members, i.e Portugal and Spain. The Euro fell to a near two-month low against the Dollar, as investors opted for the perceived safety of the greenback. The Sterling rose 1% against the Euro to £/€1.1813, but fell 2% against the Dollar to £/$1.5612.



Construction

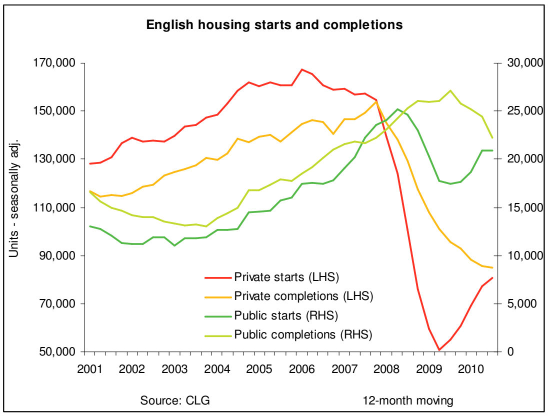
Construction forecasts

The latest set of construction sector forecasts show a diverging assessment of the industry's fortunes in the years ahead, indicating the uncertain outlook for UK construction. *Hewes & Associates* predict that after a 5.6% increase in construction output this year, the industry will slide back into recession, decreasing 5.8% next year and falling a further 4.8% in 2012. The decline in construction activity in the two years ahead is mainly due to the inability of the private sector to offset the cut backs in public sector investment. In contrast, *Leading Edge's* forecast is more optimistic. After a 3.2% increase in 2010, they also expect output to decline next year, but by a shallower 0.9%. However, *Leading Edge* expects the private sector to pick up pace in 2012, offsetting the fall in public construction work. In particular, private housing and commercial construction are expected to strengthen from next year, while infrastructure and industrial work are also predicted to be strong.



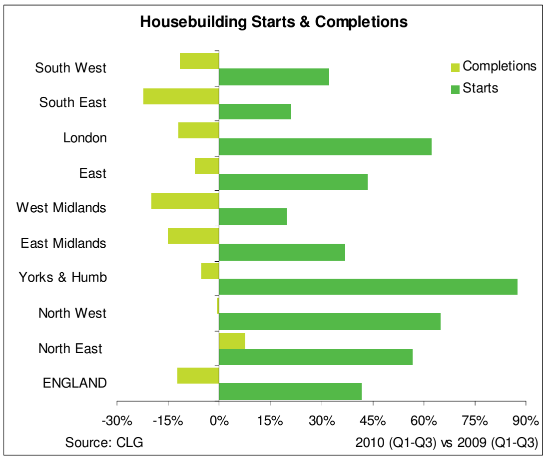
House building

The housebuilding recovery stalled in the third quarter of this year. Private housing starts, at 20,780 dwellings, were down 7% on the previous quarter, but remained up 20% on a year ago. Private completions totalled 21,540, up 4% on the quarter, but 4% lower compared to last year. Public housing starts totalled 5,091 dwellings, down 17% on the previous quarter, but relatively unchanged compared to a year ago. Public completions dropped sharply, down 15% during Q3 2010 and almost a third lower compared to a year ago. Overall, housebuilding remains well below levels seen in recent years and given the uncertain outlook for the residential sector, activity is likely to remain contained in the year ahead.



Construction survey

In sharp contrast to the official figures that show strong construction growth this year, the RICS construction survey for Q3 2010 shows that the majority of those surveyed saw little changed levels of activity in the third quarter. Industry sentiment turned negative, due to the announced public spending cuts and continued concerns over access to developing funding. The overall outlook for 2011 worsened, with the majority of surveyors expecting workload and profits to fall over the next twelve months.



Looking ahead

The Office for Budget Responsibility will publish its latest forecast for the UK economy.
The manufacturing, services sector and construction industry purchasing managers' indices are expected to indicate that the UK economy is still clearly expanding, but the pace of growth in some sectors - if not all - is beginning to slow. Consumer lending data are expected to show that mortgage approvals for house purchases weakened further in October. House price in November are likely to have fallen further after a significant drop in October. Most analysts now expect house prices to fall moderately in 2011, due to subdued consumer confidence, low wage growth and public spending cuts.

Market Watch

Stock markets fluctuated last week, with unexpected positive US economic news offset by worries over the European sovereign debt crisis and the conflict on the Korean peninsula.

The EU/ IMF and Ireland finally agreed on a support package, which will provide Ireland with up to €85bn - €50bn for helping Ireland's public finances and €35bn for its stricken banks. At the same time the Irish government introduced a €15bn austerity programme - €10bn spending cuts and €5bn tax rises.

The EU is also outlining a proposal for a permanent mechanism to deal with sovereign debt crisis in the eurozone. The plan would replace the current €440bn eurozone rescue fund with a permanent "European stabilisation mechanism". EU leaders are hoping that this will calm bond markets. However, contagion risk remains widespread, as markets have already shifted their attention to other countries with similar problems to those in Ireland and Greece, i.e. Portugal and Spain, whose borrowing costs have soared.

Stock Market	Friday 26th November 2010				
Index	**Index**		**Week**	**Month**	**Year**
FTSE100	5,668.7	▼	-1.1%	-0.7%	9.1%
EPRA/NAREIT UK	369.9	▼	-0.3%	-2.9%	-0.2%
Stocks	**Market Cap, £m**		**Share Prices**		
			Week	**Month**	**Year**
Real Estate					
British Land	4,270	▼	-1.3%	-3.6%	8.9%
Hammerson	2,870	▲	0.8%	-1.6%	1.9%
Land Securities	5,020	▼	-3.3%	-4.4%	-2.0%
Capital & Counties	932	▲	3.2%	0.4%	
Capital Shopping Centres	2,400	▲	9.7%	4.7%	
Shaftesbury	1,010	▲	1.1%	1.2%	22.2%
Great Portland Est.	1,060	▲	0.0%	-1.2%	24.6%
Derwent London	1,470	▼	-0.7%	-4.2%	13.9%
Segro	2,150	▼	-2.5%	-4.2%	-13.0%
Quintain Estates & Development	191	▼	-0.7%	-10.5%	-47.7%
St. Modwen Properties	292	▲	2.0%	-16.1%	-29.2%
Unite Group	316	▼	-4.2%	-12.5%	-29.6%
Workspace Group	265	▼	-7.2%	-2.2%	9.8%
Minerva	118	▼	-4.4%	-24.7%	29.7%
Average*		▼	-0.1%	-2.7%	0.8%
Building Contractors					
Balfour Beatty	1,870	▲	0.1%	0.7%	9.1%
Carillion	1,360	▲	0.5%	-1.3%	21.2%
Morgan Sindall	273	▼	-5.2%	-2.8%	19.3%
Kier Group	485	▲	4.5%	-0.8%	43.2%
Lend Lease Corp*	2,530	▼	-0.3%	3.4%	-12.1%
Average		▲	0.2%	1.1%	6.4%
Building material suppliers					
Wolseley	5,010	▲	1.5%	5.6%	50.7%
SIG	603	▼	-5.3%	-2.1%	4.6%
Marshalls	213	▲	0.0%	-1.8%	16.8%
Kingspan	849	▼	-3.8%	1.1%	6.8%
BSS	558	▼	-0.9%	-1.7%	78.6%
Average		▲	0.1%	3.7%	42.8%
Housebuilders					
Persimmon	1,080	▲	1.9%	0.5%	-12.1%
Taylor Wimpey	803	▲	1.3%	4.6%	-29.0%
Barratt	718	▼	-0.7%	-9.4%	-35.3%
Bovis Homes	448	▲	2.8%	-6.3%	-13.7%
Bellway	634	▲	4.2%	-4.1%	-23.5%
Berkeley	1,080	▲	3.3%	-1.1%	0.2%
Average		▲	2.1%	-1.9%	-17.3%
**Sector averages are weighted according to current market capitalisations					

In the UK, the FTSE100 fell 1.1% over the week to Friday to 5,668.7 points. The real estate index outperformed the wider index, but also ended the week in red.

Capital Shopping Centres Group (CSC) jumped 9.7% amid reports that it received a potential takeover offer from Simon Property Group, which currently owns a 5.6% stake. CSC last week also announced its decision to buy Manchester's Trafford Centre in a deal worth almost £1.6bn, subject to shareholder approval, and raised £221.2m through a placing of 62.3m shares at 355p to fund it.

Quintain Estates & Developments, in its half-year to end September 2010 report, revealed a pre-tax loss of £56.8m due to a 5% loss in the value of its portfolio. Its net asset value fell 6.7% to 112p. Quintain's shares closed the week down 0.7%, valuing the company at 191m.

Balfour Beatty is reported to have reached an agreement with the trustees of its pension fund to deal with the company's £375m pension fund deficit. They have agreed contributions which should see the deficit cleared over a period of eight years. Balfour Beatty will make a one-off payment of £40m (£29m after tax) at the end of this year. Thereafter, annual contributions of £48m (or around £35m after tax) will be made (Source: FT).