

Weekly Economic Update

19th December 2010

Summary

The latest UK economic data were weaker than in recent months, with unemployment and inflation both rising, while consumer confidence fell markedly. Meanwhile, the Bank of England confirmed that it was concerned that the UK financial system was vulnerable to further turmoil in the Eurozone, which last week was further amplified by Moody's downgrade of Ireland. This put pressure on the Pound, which weakened against major currencies.

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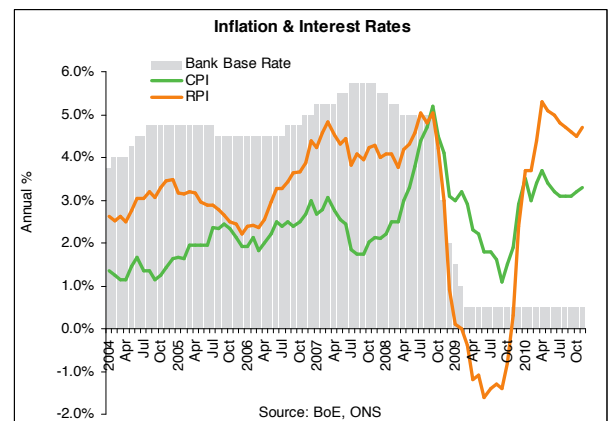
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Economy

Inflation

Consumer price inflation picked up in November, rising by an annual 3.2% compared to 3.1% in October. The largest upward pressure came from food prices. Retail price inflation also accelerated, rising from 4.5% to 4.7% in November. Opinions about the inflation outlook are becoming increasingly divided between those arguing that higher inflation is already becoming entrenched, and those that believe a Japanese-style deflation poses the bigger risk once some of the temporary factors that keep inflation elevated at the moment begin to fade.



Labour market

The latest labour market data were noticeable weaker than in recent months. In the three months to October, the number of unemployed people rose by 35,000 to 2.5 million. A further increase in part-time working partly offset an even large drop in full-time employment. More positively, the number of benefit claimants remained relatively stable at 1.46 million in November. Annual earnings growth (excluding bonuses) stood at 2.3% in the three months to October, up from 2.2% in September, but still well below current inflation rates.

Retail sales

Retail sales volumes (excluding fuel) rose by a weaker-than-expected 0.4% in November and up 1.8% on a year ago. According to reports, there is anecdotal evidence that bad weather had limited sales growth at the end of November, but most of the impact is likely to have been felt at the start of December. The official figures are in contrast to recent relatively upbeat retailer surveys, which showed stronger sales growth amid evidence that consumers were bringing forward purchases in order to beat the VAT rise in January 2011.

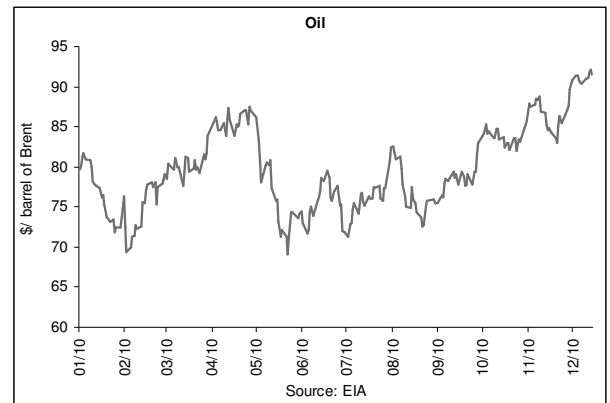
Housing market

The RICS housing market survey shows that sector activity continued to slow in November, with the majority of those surveyed reporting falling house prices. Amid low demand, new buyer enquiries fell for the sixth consecutive month. Transaction levels remain low. The rise in homes coming onto the market seen since spring this year appears to be fading, as new instructions have now fallen for two months in succession. According to the survey, many would-be sellers

have decided to wait until the New Year to put their property on the market. Looking ahead, house prices are expected to continue to fall in the year ahead.

Commodities

Oil prices remained above \$90/ barrel last week. Copper and aluminium held stable, but nickel advanced 4% to \$24,695/ tonne. Iron ore prices, an important component of steel making costs, rose sharply to a 7-month high, due to strong Asian demand and low supplies from key producers. The benchmark MBIO index rose to \$167.2/ tonne, the highest level since May. The global steel price index held stable last week, with global steel prices a fifth higher compared to a year ago.



Exchange rates

After strengthening in recent weeks amid relatively robust UK economic data, the Pound came under pressure last week, as fears over the health of the economy resurfaced. Over the week, the Pound fell 2% against both the Euro and the Dollar to £/€1.176 and £/\$1.547, respectively.

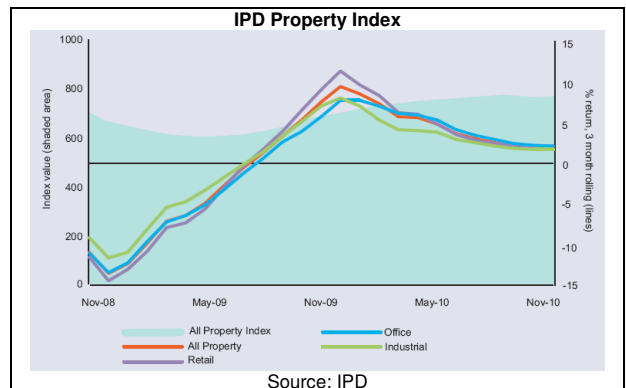
Commodity Prices (17th Dec 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	91.6	1%	8%	27%
Copper (\$/tonne)	9,101	0%	12%	32%
Aluminium (\$/tonne)	2,306	0%	4%	4%
Nickel (\$/tonne)	24,695	4%	15%	45%
Global Steel Price (Index 04/1994=100)	179.7	0%	4%	20%

Source: FT, LME, Cruspi

Construction

Commercial property returns

Commercial property capital growth stood at 0.1% in November, unchanged compared to the preceding month. Year-to-date capital growth stood at 6.6% in November. Together with a 6.5% income return, the total return for the year-to-date is 13.5%. Across the three main sectors, there was little movement in monthly values. Industrial property capital values fell marginally by 0.1% for the fourth consecutive month, which with a 0.7% income return gave a total return of 0.6%. Offices capital values rose marginally by 0.1%, while income return stood at 0.6%. Retail property capital values rose 0.2% in November, with income return totalling 0.5%.



House building

According to the NHBC, UK housing starts in October totalled 10,028, a slight increase compared to September, but still well below pre-crisis average levels. In the three months to October, housing starts totalled 29,015, up 17% on the same period last year. Private sector starts rose 20% year-on-year to 19,971. Public starts, at 9,044, were 9% higher compared to last year. One of the major factors cited by builders as holding back housebuilding numbers is the lack of mortgage availability or restrictive terms for those mortgages that are available.

Looking ahead

Third-quarter UK GDP growth is likely to be confirmed at 0.8%, despite expectations that construction output growth was slower than first estimated. This would still show that UK economic activity remains resilient, with growth broadly based across the sectors. Nevertheless, most commentators expect the UK economy to lose momentum in the months ahead, as global growth slows and the impact of fiscal cuts increasingly kicks in. The GfK/NOP consumer confidence index is expected to show that consumer confidence fell in November, despite relatively good economic news in recent months. Consumers will remain worried about public spending cuts, subdued wage growth and perhaps rising inflation. Public finances in November

are likely to have improved, given stronger tax receipts and lower benefits payments. However, debt interest payments have increased sharply over the past year, which the government sees as an important reason to cut spending and improve public finances. The minutes of the [Bank of England's December meeting](#), at which the MPC kept interest rates and quantitative easing unchanged, will provide clues as to the direction of future monetary policy. To date, the MPC had little need to inject additional stimulus into the UK economy, given the reasonable recovery in economic activity. In addition, with inflation well above target, the MPC will be reluctant to vote for additional quantitative easing in the immediate future.

Market Watch

EU leaders last week approved an amendment to EU treaties to create a new bail-out system for Eurozone members that get into financial difficulties. The amendment must be ratified by all 27 member states. If ratified, the European Stabilisation Mechanism (ESM) would come into effect from June 2013.

Calls for a more immediate EU-wide response to the sovereign debt crisis were resisted by a group of countries, including Germany, the Netherlands and the Nordic states. In particular these countries refused suggestions that the EU should issue common bonds, that the interim European Financial Stability Facility (EFSF) should be increased, and that the EFSF could be used to buy the bonds of distressed countries before they would have to be rescued. Instead these countries insisted that the EU re-emphasise fiscal austerity in member states.

Against this background, financial markets remain uncertain about the resolution of the European sovereign debt crisis, a trend that will persist well into 2011. The FTSE100 closed at 5,871.8 on Friday, up 1% on the preceding week. The real estate index outpaced the wider index, rising 1.7%.

Capital Shopping Centres jumped 7.1% last week, amid reports that Simon Property Group made a 425p indicative offer, subject to due diligence.

There has been an increase in shopping centre deals in recent months. Hammerson last week agreed to buy £250m of retail properties from St Martins, the real estate investment arm of Kuwait. According to reports, Hammerson is in talks to acquire shopping centres including Centrale (Croydon), Monument Mall (Newcastle), Three Spires (Lichfield), Cathedral Lanes (Coventry) and retail parks in Rugby and Folkestone. Hammerson's share price rose 2.2% in the week to Friday. Meanwhile, Land Securities has bought the 420,000 sq ft Overgate shopping centre in Dundee, Scotland from Lend Lease Overgate Partnership for £141m. This represents a yield of close to 6.9%. The deal is Land Securities' largest single asset purchase in the retail property market since 2005 (Source: FT).

Stock Market		Friday 17th December 2010			
Index	Index	Week	Month	Year	
FTSE100	5,871.80	▲ 1.0%	3.2%	12.5%	
EPRA/NAREIT UK	385.5	▲ 1.7%	3.4%	5.0%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,410	▲ 1.6%	5.6%	15.7%	
Hammerson	2,950	▲ 2.2%	2.8%	9.0%	
Land Securities	5,070	▼ -0.6%	-1.7%	1.6%	
Capital & Counties	911	▼ -1.4%	0.7%		
Capital Shopping Centres	2,900	▲ 7.1%	10.6%		
Shaftesbury	1,040	▲ 0.7%	3.3%	22.0%	
Great Portland Est.	1,100	▲ 0.1%	7.4%	29.2%	
Derwent London	1,550	▼ -0.5%	5.2%	23.8%	
Segro	2,170	▲ 2.3%	-1.2%	-11.3%	
Quintain Estates & Development	180	▼ -1.4%	-7.3%	-40.6%	
St. Modwen Properties	333	▲ 1.6%	13.8%	-16.2%	
Unite Group	317	▼ -3.0%	-0.7%	-28.8%	
Workspace Group	280	▲ 0.0%	-3.1%	8.1%	
Minerva	119	▼ -4.6%	-6.2%	-5.3%	
Average*		▲ 1.4%	3.2%	4.8%	
Building Contractors					
Balfour Beatty	2,140	▲ 2.6%	12.9%	26.7%	
Carillion	1,470	▼ -0.2%	8.5%	22.0%	
Morgan Sindall	286	▼ -2.1%	1.8%	8.2%	
Kier Group	520	▲ 1.9%	10.6%	41.7%	
Lend Lease Corp*	2,863	▲ 6.2%	12.5%	-3.8%	
Average		▲ 3.2%	11.2%	14.1%	
Building material suppliers					
Wolseley	5,510	▲ 7.2%	12.5%	61.5%	
SIG	721	▲ 1.3%	8.7%	9.7%	
Marshalls	207	▲ 3.8%	-2.5%	24.7%	
Kingspan	1,019	▲ 5.4%	17.1%	16.6%	
Average		▲ 6.3%	12.3%	49.3%	
Housebuilders					
Persimmon	1,250	▼ -1.2%	17.8%	-6.2%	
Taylor Wimpey	897	▼ -3.3%	13.3%	-19.0%	
Barratt	829	▼ -5.6%	13.0%	-27.5%	
Bovis Homes	519	▼ -1.1%	19.7%	0.2%	
Bellway	762	▼ -2.9%	20.3%	-15.8%	
Berkeley	1,190	▼ -1.3%	13.9%	8.5%	
Average		▼ -2.5%	16.0%	-9.1%	

**Sector averages are weighted according to current market capitalisations