

# Weekly Economic Update

7<sup>th</sup> February 2010

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## Summary

It was a tough week for the global economy: sovereign debt fears soared, global recovery hopes dampened and stocks, commodities and currency markets fell around the world.

## Statistics

### Economy

#### Interest Rates

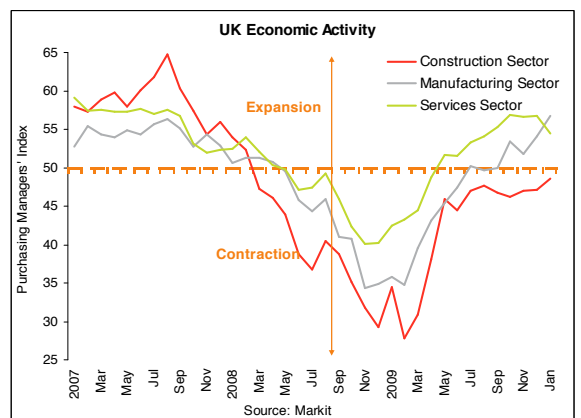
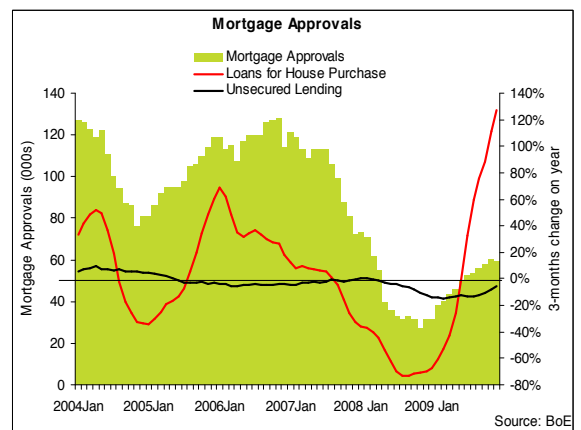
The Bank of England's Monetary Policy Committee decided to hold interest rates at 0.5%. It also voted to end its quantitative easing (QE) programme, under which it bought £200bn of assets since March 2009. The MPC's move to hold rates was widely anticipated, despite concerns that inflation may become a problem, although marginal GDP growth in the 4<sup>th</sup> quarter of 2009, banking sector weakness and persisting credit constraints are pushing prices in the opposite direction. The decision about QE was probably harder, as it is difficult to judge to what extent it helped the economy so far.

#### Consumer Lending

Consumer borrowing outstripped repayments for the first time since June 2009, according to the Bank of England. **Consumer credit** increased by £0.1bn, the first rise since June 2009. In contrast, **mortgage lending** and the number of **mortgage approvals** fell slightly. Despite these figures, there is no sign that a return to the lending and spending habits of the pre-credit crunch days will soon be seen. With a widespread expectation that taxes will go up soon and the government will cut expenditure, consumers will remain cautious.

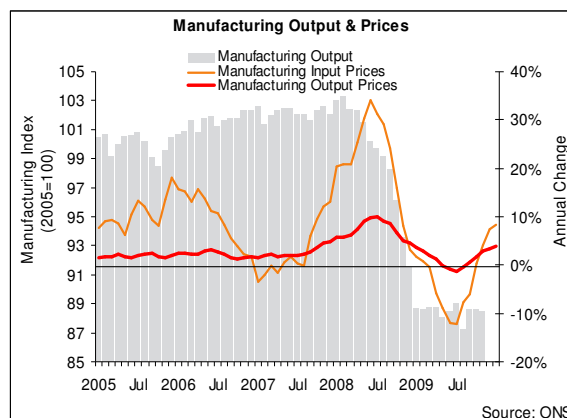
#### Sector Activity

Survey evidence points to an improvement in **manufacturing activity** in January. The purchasing managers' index for the sector rose from 54.6 to 56.7, its highest level since October 1994. The increase is a result of new orders, which rose at the fastest pace in 6 years, as well as companies' efforts to clear outstanding business. Manufacturers are currently profiting from re-stocking, improved competitiveness due to the weak Pound, and firmer demand in key overseas markets. Nevertheless, doubts remain about the sustainability of manufacturing demand, particularly once stimulus measures are being withdrawn. In sharp contrast to the manufacturing figures, the **service sector** PMI fell to 54.5 from 56.8. According to CIPS, the chaos caused by the worst snowfall in 50 years hit the service sector particularly hard in January.



### Producer Prices

**Factory gate inflation** rose at its fastest rate for 13 months in January, fuelled by a jump in the cost of oil. Producer output prices rose 0.4% during the month and up 3.8% year-on-year. Oil prices last month were 71% higher than a year ago. **Producer input prices** jumped 2% in January and up 8.4% on a year ago. Again, this mainly reflects unfavourable base effects due to the sharp fall in oil prices a year ago, though the Pound's weakness has also pushed up input prices. Core producer prices excluding food and energy costs rose 2.5%, which raised concerns that that increase in producer prices could spread to consumer price inflation.

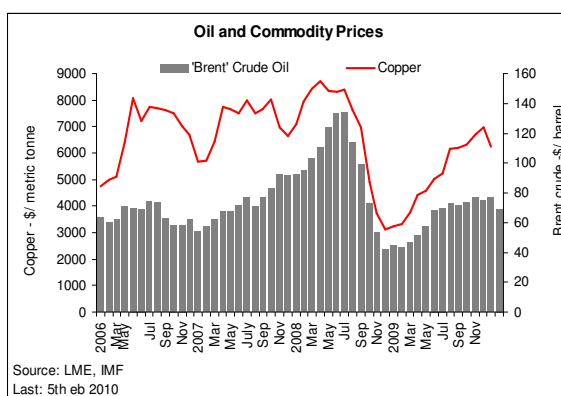


### Exchange Rates

The main development in currency markets over the past month was the depreciation of the Euro against other major currencies, on the back of concerns over Government debt in the region. The Euro dropped to a 7-month low against the Dollar, as worries about debt in Greece, Portugal and Spain caused a rush to the relative safety of the US currency. At the same time, the UK's fiscal position also continues to weigh Pound. Overall, Sterling lost 1% against the Euro in the week to Friday to £/€1.144 and slipped 3% against the Dollar to £/\$1.564.

### Commodity Prices

Commodity prices have fallen sharply since the beginning of 2010, due to concerns over the US economic recovery, European sovereign debt and Chinese stimulus withdrawal. Copper and aluminium have fallen 15% and 12% respectively, as consumer industries, automobile and construction sectors will face withdrawal of stimulus measures soon. Oil has fallen 13% since the beginning of the year. Over the last week, Brent crude oil prices fell 4% below the \$70 mark (\$69.4) for the first time since October 2009. Copper fell 9% last week to \$6,242/ tonne, while aluminium dropped 5% to \$1,942 and nickel fell 7% to \$17,350/ tonne.



### Construction

The **Construction PMI** surprisingly showed an increase to 48.6 in January from 47.1 in December, despite the bad weather. The index still indicates contraction in activity, but it is the highest reading since spring 2008. Whilst the PMI data shows that construction declined throughout 2009, the official data paints a different picture. According to the national accounts, construction output was unchanged in the 4<sup>th</sup> quarter of 2009, after growing by 0.6% in the 2<sup>nd</sup> quarter and 1.9% in the 3<sup>rd</sup> quarter. Nevertheless, there are serious uncertainties lying ahead for the sector, in particular regarding the prospects for the commercial and industrial sectors, as well as public capital investment in the face of potentially tough spending cuts.

### Looking ahead

The **Bank of England** will publish its **Inflation Report**. It is expected to revise down its 2010 growth forecasts and revise up its near-term inflation profile with more uncertainty surrounding its 2011 forecasts. **Manufacturing output** is anticipated to have picked up in December after a disappointing flat reading in November. The **UK's trade deficit** is expected to have narrowed for a 2<sup>nd</sup> consecutive month in December, helped by the weakness of the pound and improving demand for British exports. The **British Retail Consortium retail sales** monitor for January is expected to show that sales slowed in January, amid fierce weather conditions and the VAT rising from 15% to 17.5% at the beginning of January, which is likely to have hit sales of big-ticket items.

## Market Watch

Fears over the health of some Eurozone economies and the broader global economy sent global stock markets sharply lower last week.

The **FTSE 100** fell for a 4<sup>th</sup> consecutive week, down 1.5% to 5,060.9. Banks were hit hard, as figures revealed that the sector has a near £100bn exposure to some struggling European economies, including Greece, Portugal, Spain and Ireland.

Performance among **real estate companies** was mixed, with British Land and Hammerson up 1.7% and 0.6%, respectively in the week to Friday. In contrast, Land Securities was down 1.5%.

**Liberty International** is said to be mulling a division of its £6.1bn portfolio into two separate listed companies, with the Financial Times reporting that it is to split its £2.8 billion business. Its £4.4bn of shopping centres will be split off into a new REIT, with an expected market capitalisation of more than £2bn. The other business will own Liberty's £1.7bn of London properties. Liberty declined to comment.

Opinions are split over the fate of the UK commercial property market. According to **Knight Frank**, commercial property in London could see strong growth this year, with rents at some offices rising into double digits, due to increased financial market activity, while it predicts supply to fall. **Jones Lang LaSalle** sees London leading the way in the recovery of the European commercial property sector, with the 1<sup>st</sup> quarter of 2010 expected to bring an increase in prime rents. **PWC** and the **Urban Land Institute**, in their *Emerging Trends in Real Estate Europe 2010* study, have identified London as one location where investing in

commercial property could prove beneficial. Investor sentiment is improving, with an increasing number of purchases being made by Asian and Middle Eastern buyers. In contrast, **Ernst & Young** warns that the current upturn in the commercial property market may not be sustainable. According to an ITEM Club research, the end of quantitative easing and the lack of banks able to refinance loans may end the growth that has been seen in the sector recently. To date, there has been little to suggest that the trend of falling rents and rising vacancy rates is reversing, which is fundamental for a sustained recovery.

Share Prices	Friday 5 <sup>th</sup> February 2010			
	Market Cap, £mn	Week	Month	Year
<b>FTSE100</b>		-2.5%	-8.4%	19.7%
<b>Real Estate</b>				
British Land	3,850	1.7%	-5.2%	24.9%
Hammerson	2,680	0.6%	-6.7%	49.0%
Land Securities	4,770	-1.5%	-5.3%	8.0%
Liberty Intl.	2,840	-0.1%	-11.2%	36.0%
Shaftesbury	846.9	-2.0%	-5.8%	81.5%
Great Portland Est.	889.9	1.2%	-4.2%	70.8%
Derwent London	1,320	-0.3%	-2.5%	134.5%
Segro	2,240	-2.9%	-13.3%	19.0%
Quintain Estates & Development	312.3	2.1%	-6.3%	291.6%
St. Modwen Properties	373.7	-1.5%	-7.7%	100.4%
TR Property Investment Trust	553.0	-3.5%	-5.3%	37.0%
Unite Group	450.3	-2.2%	-8.5%	310.5%
Workspace Group	247.1	-2.3%	-10.4%	63.5%
Minerva	127.3	9.7%	8.6%	378.8%
<b>Average**</b>		<b>-0.4%</b>	<b>-7.0%</b>	<b>49.9%</b>
<b>Contractors</b>				
Balfour Beatty	1,800	-1.8%	-2.1%	-19.5%
Carillion	1,130	-4.8%	-6.1%	23.1%
Morgan Sindall	227.2	-2.1%	-10.9%	-4.3%
Kier Group	340.6	-5.5%	-14.5%	-4.5%
Lend Lease Corp*	2,141	-3.7%	-12.0%	60.6%
<b>Average</b>		<b>-3.4%</b>	<b>-7.8%</b>	<b>21.0%</b>
<b>Material Suppliers</b>				
Wolseley	3,830	-2.8%	3.9%	74.3%
SIG	667.6	-1.4%	-1.7%	17.5%
Marshalls	165.7	0.6%	-1.4%	39.1%
Kingspan	847	-0.9%	-7.0%	124.8%
BSS	329.5	4.3%	2.7%	2.3%
<b>Average</b>		<b>-1.9%</b>	<b>1.4%</b>	<b>70.0%</b>
<b>House Builders</b>				
Persimmon	1,260	-3.2%	-9.6%	31.9%
Taylor Wimpey	1,210	-2.3%	-4.3%	193.2%
Barratt	1,100	-5.0%	-10.8%	121.6%
Bovis Homes	523.2	-1.3%	-6.9%	-4.2%
Bellway	885.3	-1.2%	-7.0%	13.9%
Berkeley	1,050	-3.1%	-7.2%	-6.2%
<b>Average</b>		<b>-2.9%</b>	<b>-7.7%</b>	<b>68.2%</b>

\*Lend Lease Corporation Limited is listed on the Australian and NZ stock exchange  
\*\*Sector averages are weighted according to current market capitalisations