

Weekly Economic Update

1st May 2011

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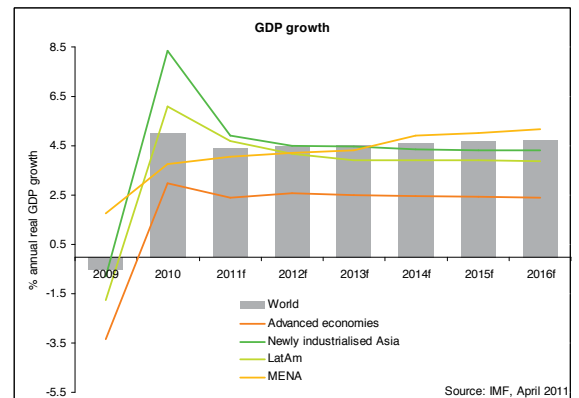
Summary

UK GDP growth during the first quarter disappointed market expectations. Instead of rebounding markedly after a harsh 2010 winter, growth just offset the falls seen during the final months of 2010. Weaker than expected GDP growth is impacting significantly on monetary policy, as in addition to sluggish growth, the Bank of England has to balance high CPI inflation, which stood at 4% in March, significantly above the Bank's 2% target.

Economy

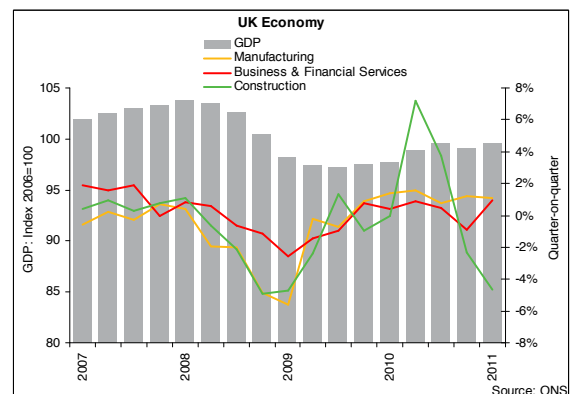
World economic outlook

The IMF's April 2011 World Economic Outlook assesses the prospects for global economic growth in light of policy challenges that remain unaddressed and new challenges that have emerged over the past half year. In the majority of advanced economies a rebound in private demand has reduced concerns that fiscal austerity could cause a "double dip" recession. However, fiscal conditions remain a challenge, in particular in the Eurozone periphery. In addition, despite a recovery in growth, unemployment remains high in many industrialised economies. In contrast, in many emerging economies, in particular in Asia and Latin America, demand is robust and overheating – in particular in asset markets - is a growing policy concern. Overall, world GDP growth is forecast to reach 4.5% in 2011 and 2012, down modestly from 5% in 2010. GDP in advanced economies and emerging economies is expected to expand by about 2.5% and 6.5%, respectively, highlighting the different growth path between these two groups of countries. Rising food and commodities prices are a serious risk to the global economy, and have already added to social and economic tensions, notably in the MENA region. The March 2011 earthquake in Japan has exacted a large human toll, but its macroeconomic impact, in particular on a global scale, is expected to be limited, although uncertainty remains high.



UK economy

Preliminary estimates shows that UK GDP expanded by 0.5% during the first quarter of 2011, only offsetting the 0.5% fall in output during the final quarter of 2010, when activity was hit by severe winter weather. Year-on-year growth stood at 1.8% in Q1 2011, but the economy is still running well below peak times. Growth in Q1 2011 was pulled down by construction activity, which fell 4.7% quarter-on-quarter, after a 2.3% drop in Q4 2010. In contrast, survey evidence shows that construction activity saw a marked rebound

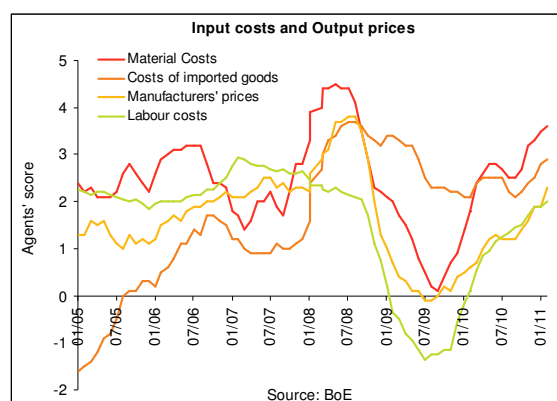


during the first three months of this year, adding to uncertainty over the true state of UK construction. There is an ongoing debate about the official construction statistics, with industry experts highlighting significant problems with the construction data. According to the industry, construction probably did not perform as badly in Q1 as the figures suggest, and chances are that output will be revised up. Service sector activity rose 0.9% quarter-on-quarter and up 1.4% on a year ago, benefiting from a pick up in business and finances sector. Manufacturing output rose 1.1% during Q1 2011 and up 4.7% year-on-year. Overall, UK growth is expected to moderate this year, as the fiscal cuts increasingly kick in and consumers reign in spending amid squeezes on their purchasing power from limited wage growth and higher inflation.

Business conditions

The Bank of England's survey of Business Conditions for March reveals that:

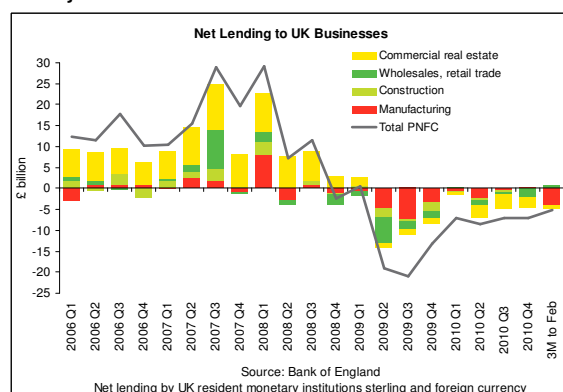
- **Retail sales** growth slowed in March in particular for discretionary items, while goods price inflation continued to rise.
- Concerns about future incomes and the prospects for house prices are weighing **housing market activity**, while first-time buyers are constrained by a lack of credit. The re-emergence of buy-to-let investment is helping housing demand, while there is also evidence of a pick up in demand for new-built homes.
- An increase in investment intentions suggests a strengthening in capital spending in the year ahead.
- The **services sector** grew moderately, supported by rising private sector demand, but there is still downward pressure on fees.
- **Manufacturing** activity continues to be boosted by foreign demand, while domestic demand is much weaker. The level of capacity utilisation is broadly normal in the manufacturing sector, but there is still significant slack in the service sector.
- **Construction activity** remained slow in March. There was a small increase in commercial projects in London, but outside there was little speculative commercial development underway. Small increases were also seen in projects related to renewable energy and infrastructure, and house building, albeit from very low levels.
- **Input costs** continue to rise, mainly due to raw materials price increases. Rising foreign wages added upward pressure on the cost of imported finished goods. **Output prices** in manufacturing rose in response to rising costs, but the competitive service sector environment continues to exert downward pressure on fees, especially for standardised legal and accountancy work, and for firms related to the construction sector. **Consumer price inflation** also remains high, reflecting the recent increase in VAT, and rising costs of imports, raw materials and fuel.



Trends in lending

The latest Bank of England *Trends in Lending* report shows that:

- **Credit availability** for businesses increased somewhat in Q1 2011, due to a modest increase in risk appetite and market share objectives. Demand for credit from businesses overall was reported to be subdued, however.
- **Lending to UK businesses** fell again in the first few months of 2011, contracting by £5bn in the three months to February. Net lending to the manufacturing and commercial real estate sectors was negative.
- The total value of new **syndicated lending facilities** granted fell back in Q1 2011. Syndicated lending continues to be driven largely by refinancing needs of companies,

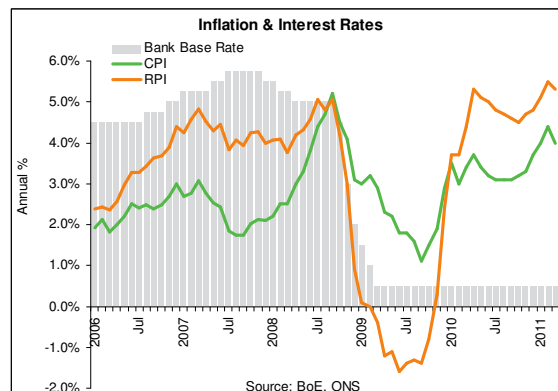


rather than for financing new investment projects.

- In terms of **corporate loan pricing**, spreads over reference rates on new lending for large businesses continued to narrow in 2011 Q1, with fees and commissions reported to have fallen. Increased competition has lowered the cost of borrowing, although it was still high compared to pre-crisis levels. Spreads over reference rates on lending to medium-sized businesses also narrowed, but they increased for small businesses. The effective interest rate on new borrowing for businesses ticked up slightly in the three months to February.

Consumer price inflation

Consumer price inflation unexpectedly moderated to 4% in March from 4.4% in February, though this is still double the Bank of England's inflation target. The main upward pressure to inflation still comes from higher fuel and energy bills, as well as housing and household services. Annual retail price inflation stood at 5.3% in March, down from 5.5% in February.

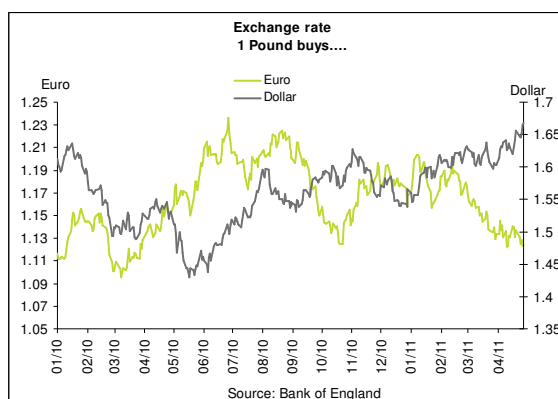


Retail sales

Retail sales rose by a modest 0.2% in March compared to February, as most consumers remain cautious about their spending in the face of squeezed purchasing power. Year-on-year retail growth stood at 2.2% in March.

Exchange rates

The Dollar hit a three-year low against a basket of major currencies last week, as the US Federal Reserve raised its inflation forecast for this year and signalled its policy of ultra-low interest rates would persist. The Pound gained 0.7% against the Dollar to £/\$1.668, its highest level since August 2009. In contrast, the Euro continues to hold up well in the face of EU periphery sovereign debt troubles. Against the Euro the Pound weakened by 1.1% last week, falling to £/€1.1243.



Commodities

Political instability in the Middle East, Dollar weakness and concerns about inflation pushed commodity prices higher last week. Oil rose 5% to \$126.3/ barrel of Brent. Other commodities, such as aluminium, nickel and the global steel price index ended the week unchanged, however, while copper fell 3% to \$9,370/ ton.

Commodity Prices (29 Apr 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	126.3	5%	9%	47%
Copper (\$/tonne)	9,370	-3%	-1%	26%
Aluminium (\$/tonne)	2,772	2%	7%	31%
Nickel (\$/tonne)	26,610	0%	0%	5%
Global Steel Price (Index 04/1994=100)	219.1	0%	-2%	12%

Source: FT, LME, Cruspi

Construction

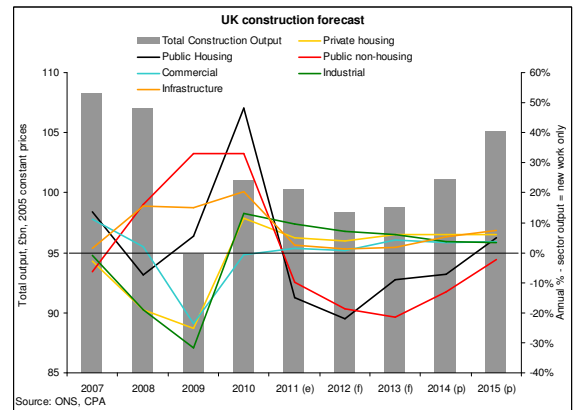
Construction forecast

The latest CPA construction industry forecasts were revised up modestly compared to the outlook released in January 2011. However, the broader picture remains the same, with the industry expected to dip into another recession this year and next, after the rebound seen in 2010. Only marginal growth is expected in 2013, as private sector construction finally begins to offset falls in the public sector. Significant construction growth is only expected from 2014, driven by private housing, commercial and infrastructure. However, even in 2015, the volume of construction work is predicted to still be below the pre-recession peak in 2007. Highlights:

- **Private housing:** Private house building levels rose in 2010 from 2009's historical lows. However, a still tight mortgage market, high unemployment and subdued earnings growth, as well as the prospect of higher interest rates, is likely to hinder a marked pick up in housing market activity in the near term. Housing starts are expected to pick up

only slowly in 2011 and 2012, before stronger demand should push up growth rates in the subsequent years.

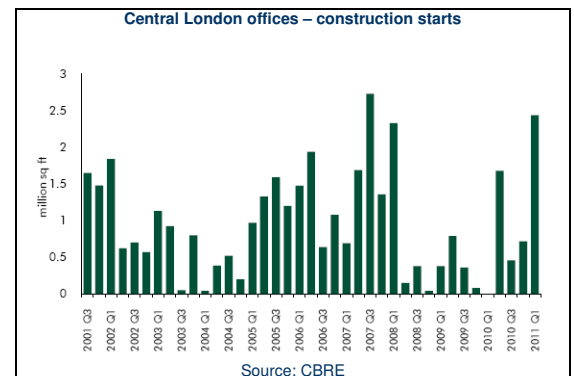
- **Public housing:** At £4.2bn, public housing output in 2010 was nearly 50% higher than in 2009 and starts rose by 8% to 27,500 units. However, the impetus from public stimulus spending will now wane and the sector is set to contract in the years ahead.
- **Public non-residential:** Public work – mainly education and health-related - is now set to contract sharply, given the capital spending cuts set out by the government. Public non-housing output is forecast to fall in 2011-15 by more than 50%.
- **Commercial:** Commercial work had begun to recover last year, driven by high-profile office schemes in London. However, activity remains subdued in other parts of the UK. Further expansion in central London office construction, and major supermarket expansion plans should boost commercial work in the years ahead, though overall growth is expected to remain moderate. The outlook for PFI education is relatively subdued, given funding cuts and the end of the BSF programme. The focus in the years ahead will be on academies and maintenance. The same is likely to be observed in the PFI/ PPP health sector.
- **Industrial:** After years of decline, the industrial sector is now expected to expand in 2011-15, driven by factories construction on the back of manufacturing growth.
- **Infrastructure:** Infrastructure is expected to be the key growth area of UK construction in the years ahead. The £3bn roads sector is benefiting from schemes started under the fiscal stimulus, but going forward finances for the Highways Agency and local authorities are likely to be more constrained. Water-industry investment is determined by the current five year spending plan, AMP5 2010-15. The rail sub-sector has doubled over the last four years and, with major projects such as Crossrail, is expected to double again by 2015. Energy-related work is also expected to double over the next five years, boosted by work on renewables and the nuclear programme.



Central London offices

The CBRE published its latest review of the Central London offices market for the first quarter of 2011. Highlights:

- After a firm rebound in 2010, **take-up** of offices space fell in Q1 2011 to its lowest level since the first half of 2009.
- **Offices supply** fell for the 7th consecutive quarter to stand at 13.8m sq ft, 35% below the recent peak. The Central London vacancy rate fell to 5.1%, compared with 5.5% the previous quarter.
- **Rental growth** slowed in Q1 2011 compared to the final quarter of 2010, but still recorded a firm 7.9% year-on-year. Rental growth slowed across all markets, particularly in the City (from 19.9% to 11.3%).
- Due to the limited number of offices construction starts in the last few years, **completions** are set to drop significantly this year. Although completions are expected to increase in 2012, it will take until 2013 until there is any significant rise.
- Central London **investment volumes** slowed in Q1 2011, after strong transaction volumes in the preceding three months. Overseas investors accounted once again for the majority of transactions, but the difference was small. West End prime yields remained at 4%, while City prime yields moved to 5.25%.

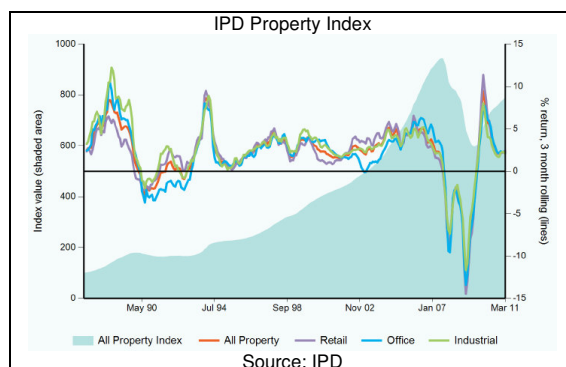


Commercial property returns

UK commercial capital growth stood at 0.3% in March, up from 0.2% growth in February, according to the IPD UK Monthly Index. The increase was driven by yield movements, with a yield impact of 0.4% in March. In contrast, rents fell 0.1% after four consecutive months of overall rental growth. Offices rents fell for the first time in four months due to a slower Central London market and further declines elsewhere in the regional office markets.

Looking ahead

The Bank of England is likely to keep **interest rates** on hold at 0.5% during its May policy meeting. The rebound in first quarter GDP was judged to be muted, while the latest CPI figures showed a slight drop in inflation, which eased pressure on the Bank of England to hike rates. Survey results will provide evidence as to how well the UK economy started the second quarter of this year. The **manufacturing purchasing managers' index** should show that the sector still saw firm if somewhat slower growth in April. Manufacturing **input costs** are expected to have further increased significantly in April, due to elevated fuel and commodity prices. Consequently **output prices** have also risen further, as companies are under pressure to secure margins. The **construction PMI** is likely to show that sector growth moderated in April. Survey results and official statistics paint a sharply different picture of the current state of the UK construction industry. While survey evidence points to growth in the first months of this year, the official data saw output falling sharply. Consequently, both sets of data should be treated with some caution. **Service sector activity** is expected to have expanded in April, though growth may have slowed, due to muted consumer spending and the cut in government spending. House prices in April are expected to have remained unchanged compared to March, but **house prices** are widely expected to see modest falls this year, as housing market activity remains relatively weak.



Market Watch

Investor confidence returned last week, as the dust settled from S&P's revision of its long-term US sovereign rating outlook from stable to negative, questioning whether the government would be able to adopt a framework for significant public deficit reduction before the 2012 presidential election. Whilst this was not a downgrade, nor a signal that a downgrade is inevitable, it does mean that the risk of a downgrade has risen.

Equity markets moved higher last week, on the back of robust first quarter US corporate earnings, a reassurance from Federal Reserve president Ben Bernanke that US interest rates will not rise any time soon and continued flows into equity funds.

In a short trading week, the FTSE 100 rose 0.9% to end the week at 6,069.9 points. Survey evidence of strong manufacturing activity pushed up the index earlier in the week, while relatively subdued first quarter GDP data weighed on equities later on.

Stock Market		Thursday 28th April 2011			
Index	Index	Week	Month	Year	
FTSE100	6,069.9	▲ 0.9%	2.3%	8.1%	
EPRA/NAREIT UK	430.6	▲ 5.3%	3.7%	16.4%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	5,320	▲ 3.6%	6.4%	29.0%	
Hammerson	3,320	▲ 2.8%	3.3%	24.3%	
Land Securities	6,070	▲ 3.0%	7.2%	22.2%	
Capital & Counties	1,050	▲ 1.1%	1.6%		
Capital Shopping Centres	3,490	▲ 2.6%	6.5%	-16.5%	
Shaftesbury	1,280	▲ 4.4%	8.2%	32.8%	
Great Portland Est.	1,320	▲ 4.8%	9.7%	36.0%	
Derwent London	1,810	▲ 2.8%	9.0%	25.2%	
Segro	2,410	▲ 1.4%	-1.9%	5.8%	
Quintain Estates & Development	243	▲ 0.0%	6.9%	-15.4%	
St. Modwen Properties	339	▲ 1.8%	-6.0%	-2.6%	
Unite Group	334	▲ 3.7%	-1.0%	-3.4%	
Workspace Group	334	▲ 7.4%	9.4%	26.1%	
Minerva	150	▲ 4.5%	1.4%	-20.2%	
Average*		▲ 3.0%	5.5%	16.8%	
Building Contractors					
Balfour Beatty	2,250	▲ 1.1%	-3.7%	19.5%	
Carillion	1,680	▲ 1.0%	4.7%	14.4%	
Morgan Sindall	301	▲ 5.9%	5.8%	21.7%	
Kier Group	504	▼ -2.1%	1.5%	16.8%	
Lend Lease Corp*	3,261	▼ -3.4%	-1.5%	2.4%	
Average		▼ -0.8%	-0.3%	11.3%	
Building material suppliers					
Wolseley	6,170	▲ 0.7%	3.8%	35.8%	
SIG	825	▼ -1.1%	0.0%	11.0%	
Marshalls	240	▲ 2.3%	5.9%	18.5%	
Kingspan	975	▼ -1.6%	1.2%	-5.0%	
Average		▲ 0.3%	3.1%	28.0%	
Housebuilders					
Persimmon	1,450	▲ 2.8%	3.8%	0.2%	
Taylor Wimpey	1,240	▲ 2.1%	-7.2%	-6.1%	
Barratt	1,080	▲ 2.7%	-0.8%	-11.7%	
Bovis Homes	586	▲ 3.6%	-2.1%	2.9%	
Bellway	854	▲ 0.8%	1.9%	-7.2%	
Berkeley	1,390	▼ -0.2%	2.5%	26.3%	
Average		▲ 1.8%	-0.1%	1.8%	

**Sector averages are weighted according to current market capitalisations

The real estate index confidently outperformed the wider equity market last week, rising 5.3% in the week to Thursday. The Workspace Group was the top performer, jumping 7.4%. Great Portland Estate was up 4.8%, while Shaftesbury gained 4.4%.

Building contractors, material suppliers and housebuilders had a more mixed week, though the majority of listed companies saw their share prices rise.