

# Weekly Economic Update

24 July 2011

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## Summary

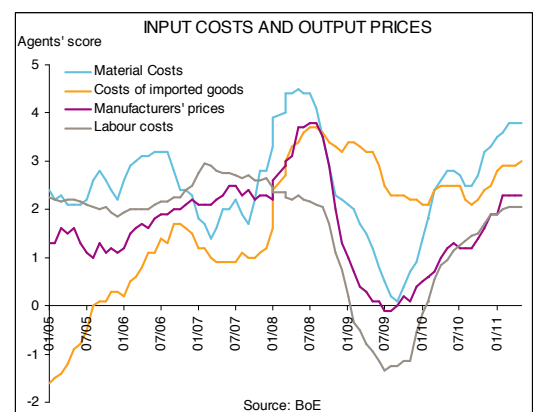
European leaders last week finally agreed on a plan to control Greece's sovereign debt crisis and reduce contagion threats, which calmed markets and increased confidence. The measures focus on reducing Greece's debt burden, including private-sector participation; easing lending terms for Greece, Ireland and Portugal, strengthening the role of the European Financial Stability Facility; and providing direct economic support for Greece. Although this will not automatically resolve the Eurozone crisis, it does mark a decisive step forward.

## Economy

### Business conditions

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

- **Retail sales** growth remains sluggish, given pressure on household incomes from elevated inflation and subdued earnings growth. On a positive note, Central London retailers continue to benefit from increasing numbers of foreign visitors.
- **Housing market** activity continued to soften in recent weeks, with stock levels increasing and prices declining somewhat.
- **Investment intentions** continue to rise, but some firms are becoming more cautious, due to a more uncertain demand outlook.
- **Manufacturing output** continues to expand, driven by export growth rather than the domestic market. The **business services** sector also continues to post steady growth.
- **Construction** output continues to rise very slowly, but remains well below pre-recession levels. There is a marked difference between commercial construction (offices) in Central London and elsewhere in the UK. Construction of new retail space and budget hotels continued, if a little more slowly than before, and utility companies' spend on infrastructure increased. Public sector capital spending declined.
- **Input price inflation** remains high, but the pace of cost increases is expected to slow, due to additional supply and softening world demand. The recent decline in the value of the Sterling has added to **import cost inflation**. Increases in the cost of gas and electricity are an additional concern for businesses and households alike. **Output price inflation** remains limited, putting pressure on firms' margins. **Consumer price inflation** remained high in June.



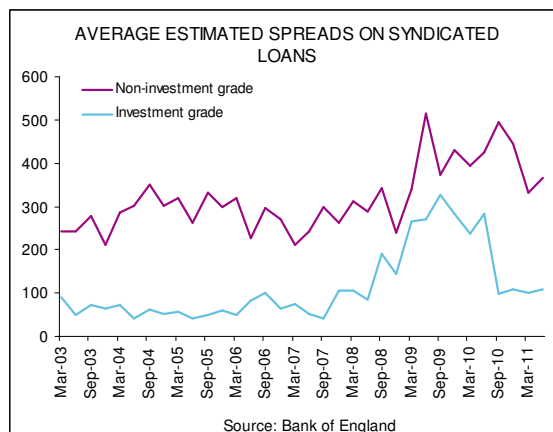
### Retail Sales

Retail sales volumes (excl. fuel) rose by 0.8% month-on-month and 0.2% up year-on-year. Sales volumes were stronger than expected last month, given the more subdued survey evidence for retail sales in June from the CBI and the British Retail Consortium. Industry analysts widely expect consumer spending to be muted for some time to come as household purchasing power remains under severe pressure from high inflation, low wage growth, and tighter fiscal policy.

### Trends in lending

The Bank of England's "Trends in Lending" report provides information on the state of the UK credit market in addition to the recently published Q2 2011 Credit Condition Survey. Highlights:

- Net **lending to UK businesses** contracted in the past three months, mainly due to a decline in lending to SMEs, who according to lenders were de-leveraging and continuing to repay bank debt.
- The value of new **syndicated lending** facilities granted in the UK market was broadly the same in Q2 2011 as in the previous quarter. Syndicated lending continues to be driven by refinancing needs of companies rather than for financing new investment projects.
- **Capital issuance** by UK businesses rose, driven by bond issuance. Net equity issuance was negative. Capital market issuance is expected to remain relatively slow in the short term, partly reflecting expectations of subdued M&A activity.
- Spreads over reference rates on new lending for large businesses narrowed in Q2 2011, with **fees and commissions** falling. Spreads, fees and commissions are expected to fall further for large and medium sized businesses, but could widen for small businesses in Q3 2011.
- **Credit availability** for businesses overall was broadly unchanged in Q2 2011. Larger firms are generally able to access bank lending if required, but opportunities for SMEs remain more variable.



### Public finances

Public sector net borrowing increased slightly in June to £14bn, compared to £13.6bn a year ago, as higher tax receipts were offset by an increase in spending. The current budget had a deficit of £11.8bn in June 2011. Net debt excl. the temporary effects of financial interventions was £944.3bn or 61.9% of GDP (£2,276bn or 149.3% of GDP incl. interventions). The slower than expected improvement in public finances is already casting doubts as to whether Chancellor George Osborne will be able to meet his target of cutting net borrowing to £122bn in the 2011/12 fiscal year, from £143.2bn in 2010/11.

### Commodities

Oil prices rose last week, as the International Energy Agency ruled against the release of its strategic oil reserves for a second month, as OPEC members, mainly Saudi Arabia, appeared to have increased their supplies. Brent crude rose to \$119.1/barrel, up 1% on the week. In other commodities markets, copper rose 1% to \$9,698/ ton, while aluminium increased 4% to \$2,548/ ton.

COMMODITY PRICES (22 Jul 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	119.1	1%	6%	54%
Copper (\$/tonne)	9,698	1%	8%	39%
Aluminium (\$/tonne)	2,548	4%	2%	27%
Nickel (\$/tonne)	24,060	0%	10%	18%
Global Steel Price (Index 04/1994=100)	204.0	0%	-2%	14%

Source: FT, LME, Cruspi

### Exchange rates

Over the week to Friday, the Pound fell 0.5% against the Euro to €/\$1.1355, but rose 1.2% against the Dollar to £/\$1.6312.

## Construction

### School funding and building

The Secretary of State for Education, Michael Gove, announced a number of outcomes for capital and revenue funding. Highlights:

- The recommendations of the James Review were broadly accepted, subject to a consultation process, which will focus on the most appropriate model for allocating and prioritising capital, as well as the suggested centralised approach for procurement and project management.
- The School Premises regulations will be revised.
- £500m to help local authorities provide extra school places has been allocated.
- The government will carry out a condition survey of all school buildings.
- Allocations totalling £81.5m have been made to the Capital Maintenance Fund, which will fund a total of 344 projects across 217 Academies.
- A new school building programme - **School Priority Building Programme** - has been launched, which the Secretary of State described as a “privately financed school building programme” to address schools in the “worst condition”. The government expects that the programme will cover the equivalent of building or rebuilding approximately 100 secondary schools. The programme is likely to include a mix of primary schools, secondary schools, special schools, sixth form colleges and alternative provision, and so could cover between 100 and 300 schools in total. It is expected that 20% of the total programme will be delivered each year, with the first schools to open in the academic year 2014/15. Those schools included in the initial group for procurement are expected to commence procurement during Q2 2012.

### Public construction spending pipeline

The Cabinet Office announced details of its forward pipeline of funded construction projects, which from autumn 2011 will be published quarterly.

FUNDED CONSTRUCTION PIPELINE 2011-2014					
SR 2010 (£m)					
Department		2011/12	2012/13	2013/14	Comments
Communities and Local Government	Homes & Communities Agency: New Build (Affordable Housing)	1640	830	840	Investment is targeted to deliver at least 120,000 new and around 150,000 refurbished homes over the years 2011-15, when combined with other sources of funding. On the basis of historical averages HCA's new build investment typically represents 40% of the total project value, while the construction element typically represents 65% of the total project value, which means that the total construction element might be expected to be of the order of 1.625 times HCA's new build investment given here.
	Homes & Communities Agency: Refurbishment (Decent Homes)	260	352	389	
Ministry of Defence	Defence Infrastructure Organisation	296	640	488	Committed expenditure against Capital Works Projects. Potential PFIs are not been included. Does not projects with a Construction Start Date after March 2015, projects in the Single Living Accommodation Programme (SLAM) and construction projects in development through Defence Equipment and Support procurement.
Department for Education		2504	1640	486	Private sector capital investment in PFI projects has been estimated by dividing the PFI credits allocated by 1.65. Due to the nature of the BSF programme, all BSF projects have already been procured and will not be openly tendered. Framework projects that have not already been procured will only be available to those contractors on the PFS Contractors Framework. The costs only include central government capital support and not any funding contributions from the local authorities themselves.
Dep. for Environment, Food and rural affairs	Environment Agency	222	223	220	The Environment Agency has not published a detailed scheme programme beyond 2011/12 due to the potential for change that their new funding approach may bring, the spend figures for 2012/13 onward therefore provides a scale of expected spend.
	Waste Infrastructure Delivery Programme	989	1234	1687	
Department of Health	Procure 21 +	515	228	98	Overall pipeline figures are provided for P21+ schemes. Further information is available on P21+ website.
	PFI, Local Investment Finance Trust and major public capital funded schemes	126	482	732	
Ministry of Justice		202	260	280	Majority of future spend will be committed/assigned to the supply chain through established contracts.
Department for Transport	HA - Major Projects	797	435	450	Most expenditure will be undertaken through contracts with the supply chain. HA have a firm delivery programme for the current year, beyond that aggregated figures are provided at programme level. Annual spend figures are provided on key programme expenditure types - Renewal of Roads, Structures, Technology and Small Scale Improvements.
	HA - Maintenance Schemes	437	488	417	
	HA - PFI Schemes	394	447	441	

In addition to figures in the above table, we expect capital expenditure on rail infrastructure of some £6bn pa, funded directly by central Government and by other partners including Transport for London and Network Rail. This includes expenditure on railway systems such as track signalling and power, as well as construction projects.

Source: Cabinet Office

## Market Watch

Financial markets rose last week on hopes of a solution to the sovereign debt crisis in the Eurozone, as European leaders agreed on a new aid package for Greece and an overhaul of the European Financial Stability Fund.

Whilst the direct support for Greece, which includes a further €109bn bail out, will certainly give it more breathing space, it will not solve its debt crisis and the Eurozone as a whole will remain vulnerable to speculation over its long-term ability to survive in its current form. Meanwhile, the debate on the US debt ceiling continued last week, with S&P reiterating its warning of a ratings downgrade.

Overall, the FTSE 100 rose 1.6%, ending the week above the 5,900-mark at 5,935. The real estate index underperformed the wider market, falling 0.3% in the week to Friday. Quintain Estates & Development rose, up 5.5%, while Hammerson (2.4%), Segro (1.7%) and the Workspace Group (0.9%) also ended the week on a positive note. St. Modwen Properties was the biggest faller in the sector, down 6.4%, followed by Great Portland Estates, down 2.9%.

Land Securities, in a trading statement, said that it continues to step up its retail and offices development activity. According to Land Securities, the group benefits from the “race for space” by the four big supermarket chains - Tesco, Sainsburys, Asda and Morrisons – which has led to a marked increase in retail construction. The vacancy rate in Land Securities portfolio fell from 4.2% at the end of March to 3.9% at the end of the second quarter. Shares in Land Securities closed the week at 867p, giving the group a market capitalisation of £6.7bn.

Stock Market		Friday 22nd July 2011			
Index	Index	Week	Month	Year	
FTSE100	5,935.0	▲ 1.6%	2.8%	11.7%	
EPRA/NAREIT UK	440.7	▼ -0.3%	0.3%	28.1%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	5,320	▼ -0.7%	1.4%	31.4%	
Hammerson	3,360	▲ 0.6%	-0.2%	24.8%	
Land Securities	6,700	▼ -1.3%	2.1%	43.8%	
Capital & Counties	1,300	▼ -0.5%	1.2%		
Capital Shopping Centres	3,270	▲ 2.4%	-1.3%	10.7%	
Shaftesbury	1,320	▲ 0.5%	1.5%	31.5%	
Great Portland Est.	1,350	▼ -2.9%	1.5%	40.7%	
Derwent London	1,830	▲ 0.4%	0.5%	34.8%	
Segro	2,310	▲ 1.7%	-0.4%	11.3%	
Quintain Estates & Development	325	▲ 5.5%	5.0%	58.2%	
St. Modwen Properties	346	▼ -6.4%	-5.9%	3.6%	
Unite Group	340	▲ 0.6%	-0.7%	15.0%	
Workspace Group	400	▲ 0.9%	-2.3%	44.1%	
Minerva	194	▲ 0.2%	2.8%	24.0%	
<b>Average*</b>		▼ -0.1%	0.7%	31.8%	
Building Contractors					
Balfour Beatty	2,100	▲ 0.1%	0.7%	19.9%	
Carillion	1,600	▼ -0.4%	1.0%	16.7%	
Morgan Sindall	272	▼ -3.8%	-1.9%	10.1%	
Kier Group	514	▲ 0.1%	1.5%	30.8%	
Lend Lease Corp*	3,410	▲ 2.7%	5.1%	25.8%	
<b>Average</b>		▲ 1.0%	2.6%	22.2%	
Building material suppliers					
Wolseley	5,430	▲ 1.1%	-3.4%	38.1%	
SIG	804	▼ -0.3%	-1.0%	33.4%	
Marshalls	214	▼ -0.5%	-1.6%	20.6%	
Kingspan	1,022	▲ 0.5%	-1.9%	26.4%	
<b>Average</b>		▲ 0.8%	-2.8%	35.5%	
Housebuilders					
Persimmon	1,410	▼ -2.7%	-0.1%	27.0%	
Taylor Wimpey	1,190	▲ 1.2%	0.2%	39.7%	
Barratt	987	▼ -2.1%	-7.6%	4.3%	
Bovis Homes	561	▼ -0.9%	-0.5%	22.8%	
Bellway	819	▼ -0.4%	-2.9%	18.0%	
Berkeley	1,640	▼ -2.4%	6.9%	48.9%	
<b>Average</b>		▼ -1.4%	0.2%	29.9%	

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

