

Weekly Economic Update

8 August 2011

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Summary

Another week, another crisis. Equity markets plunged last week, a flight to safety drove bond yields down and commodity prices dropped sharply. Whilst it is hard to point the finger to a single factor for last week's loss of market confidence, it certainly includes a worsening sovereign debt crisis in the Eurozone, the politically motivated US debt-ceiling crisis, S&P's downgrade of the US credit rating in a contentious and historic move, as well as worries about a double-dip recession on both side of the Atlantic. Meanwhile in the UK, the Bank of England kept monetary policy unchanged amid a sluggish economic outlook.

Economy

Interest rates

Against the backdrop of a fragile economic outlook, the Bank of England kept interest rates on hold at 0.5% during its August meeting. The Monetary Policy Committee will still worry about inflation, as despite CPI inflation dipping to 4.2% in June from 4.5% in May, inflation remains more than double the MPC's 2%-target. With a utility hike expected to kick in October, short-term inflation is predicted to reach 5% in autumn. The European Central Bank also did not make any changes to interest rates, but resumed its bond buying scheme and offered loans to the region's banks, in a move to shore up investor confidence in the Eurozone.

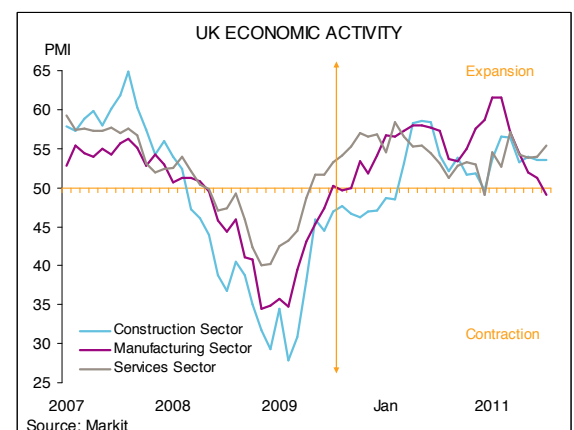
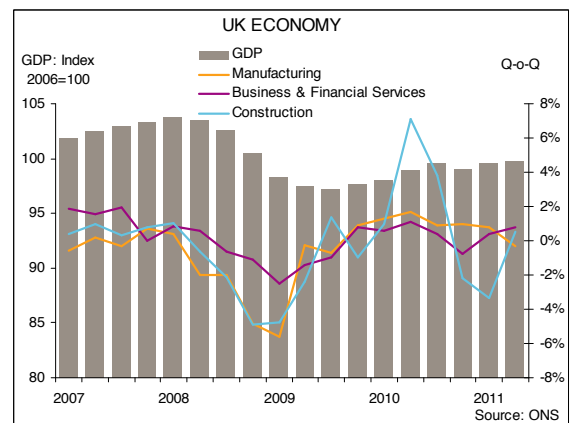
UK growth

UK GDP growth disappointed in Q2 2011, with quarter-on-quarter growth slowing to 0.2% - the weakest since the UK exited recession in late 2009. Annual growth slowed to just 0.8%. Manufacturing output fell by 0.3% in Q2 and annual growth slowed to 2.3%, down from 4.4% in the preceding quarter. Construction expanded 0.5% quarter-on-quarter, but output was down 1.3% on a year ago. Service sector growth slowed to 0.5% in Q2, with sector output up 1.2% year-on-year. Within this, business services and finances rose 0.8% both compared to the preceding quarter and a year ago.

Expectations are that growth will remain subdued this year, due to fiscal cuts, muted consumer spending and slower global growth.

Sector activity

Manufacturing activity slowed in July, according to the latest PMI, which recorded a reading of 49.1, the weakest since June 2009. Output growth slowed to stagnation, new orders declined and employment fell. New orders fell mainly due to a subdued domestic market, in contrast export orders continued to grow. Employment declined slightly in July. Input price pressures eased further, especially for materials such as plastics and steel.

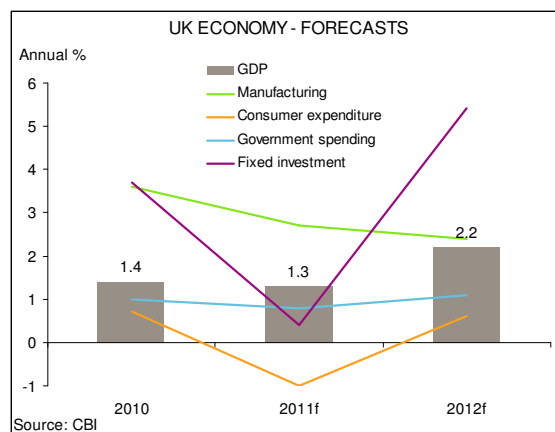


However, although input price inflation has come off recent highs, prices remain elevated in particular for metals, packaging, paper products and power. Output price inflation eased and supply-chain pressures subsided. In contrast to the manufacturing sector, **service sector activity** improved in July, with the services PMI rising to 55.4; the strongest in four months. Activity was supported an increase in new business. However, despite firmer activity, the sector cut job numbers over the past month and business confidence remains low. Input cost inflation eased in July, but remains at an elevated level. Higher energy and utility bills, supply chain pressures and increased food costs are the main drivers of inflation. Output price inflation eased due to competitive pressures.

UK growth forecast

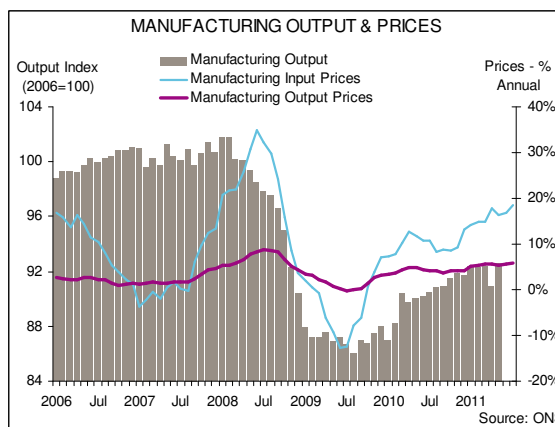
The Confederation of British Industry (CBI) published its latest forecasts for the UK economy. Highlights:

- The outlook for UK growth has become more challenging over the course of 2011, due to slower global growth, the Eurozone debt crisis, high commodity price inflation and the impact of external factors, such as the Japanese earthquake earlier this year.
- UK GDP growth is forecast to reach just 1.3% this year, with modest 2.2% growth envisaged for 2012.
- Inflation is expected to be higher this autumn and early next year than previously forecast, mainly due to the hike in utility prices. Inflation is expected to ease back and to moderate in 2012. The Bank of England is now expected to keep interest rates on hold until Q1 2012 – later than previously thought, due to slower economic growth and little pressure on wages.
- Household disposable incomes will continue to be squeezed in the second half of 2011, due to a combination of high inflation and low wage growth. In 2012, pressure on household incomes should ease a little as inflation slows.
- Corporate earnings have been strong over the past year, but given the uncertain economic backdrop, companies will be cautious about their investment intentions this year and next.



Manufacturing prices

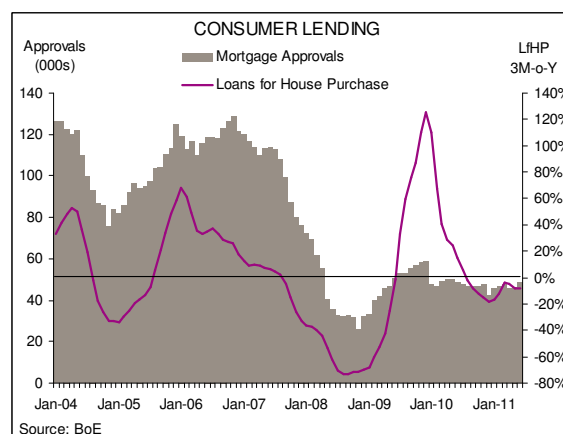
Manufacturing input cost inflation accelerated in July despite easier raw material and oil prices, rising 0.6% during the month and up 18.5% year-on-year. Factory gate prices rose by 0.2% in July and up 5.9% on a year ago, as manufacturers are seeking to pass on higher input costs, though this appears to be limited by a slowdown in demand.



Consumer lending

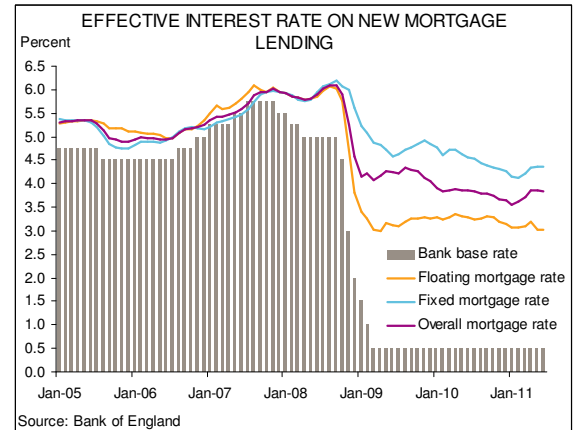
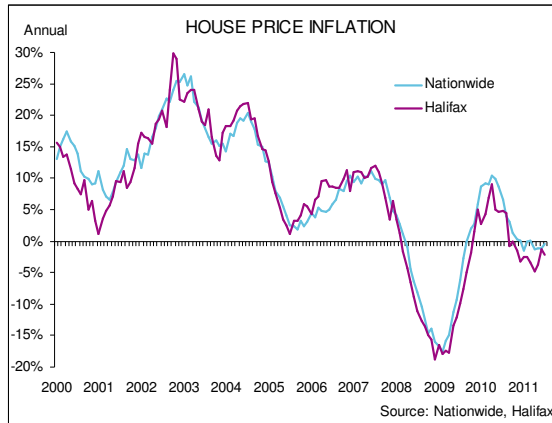
Mortgage approvals for house purchases rose slightly in June to 48,400, up from 46,400 in May. However, since the start of the housing crisis in late 2007, mortgage approvals are still very low compared to historic norms. The number of mortgage approvals per month averaged more than 100,000 between 1997 and 2007.

Consumer credit in June rose by a modest £432m, as consumer appetite for taking on new debt remains limited, with many households still reducing their debt. At the same time, availability of unsecured credit from banks remains tight.



House prices

The Nationwide reported that house prices rose 0.3% in July, leaving house prices down 0.4% year-on-year. The Halifax also reported house prices up 0.3% in July, with prices down 2.1% year-on-year. House prices are widely expected to show a fall overall this year, as housing market activity will remain subdued on the back of squeezed household purchasing power, tight mortgage lending and a fragile economic outlook. The main support for house prices is coming from low interest rates, although mortgage rates have not fallen as much as the bank base rate since early 2009.



Exchange rates

On the back of a slump in investor confidence in the ability of Eurozone leaders to deal with the region's debt crisis, the Pound rose 1.1% against the single currency last week, ending the week at £/€1.1544. However, despite the ratings downgrade in the US, the Dollar held up and the Sterling fell 0.2% against to greenback to £/\$1.6385. Elsewhere in currency markets, the Yen and the Swiss Franc strengthened, both rising to fresh high against the Euro on Friday, as the fallout from the drop in global asset markets fuelled safe haven demand for both currencies.

Commodities

Commodities prices fell last week, amid a general drop in market confidence. The price of a barrel of Brent crude fell 5% to \$109.9 on Friday, while copper, aluminium and nickel all dropped 6%. The global steel price index recorded a 2% decrease in the week to Friday.

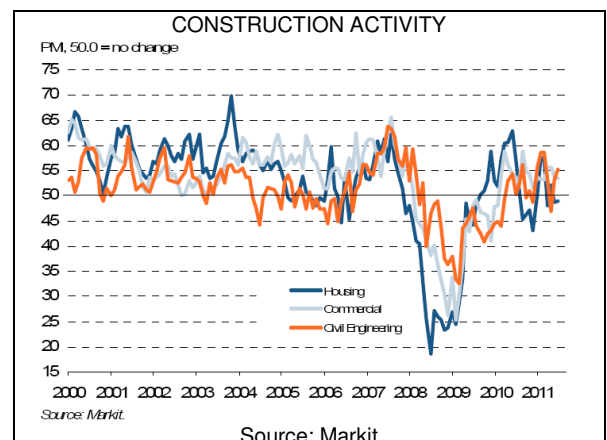
COMMODITY PRICES (5 AUGUST 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	109.9	-5%	-3%	36%
Copper (\$/tonne)	9,190	-6%	-2%	24%
Aluminium (\$/tonne)	2,430	-6%	-2%	10%
Nickel (\$/tonne)	23,090	-6%	0%	5%
Global Steel Price (Index 04/1994=100)	200.3	-2%	-3%	15%

Source: FT, LME, Cruspi

Construction

Construction activity

Construction activity in July expanded at the same pace as in the preceding month, according to the latest Markit construction PMI. New orders and output continued to show a moderate rise. On a sector level, commercial and civil engineering activity expanded in July, while residential construction contracted for a second consecutive month. Despite growth, the sector shed jobs for the second successive month. Usage of sub-contractors decreased again, but their rates rose for the fifth time in the last six months. On the back of a rise in purchasing activity at construction companies, suppliers' delivery times lengthened. Input cost inflation accelerated in July compared to June, mainly due to higher raw material prices.

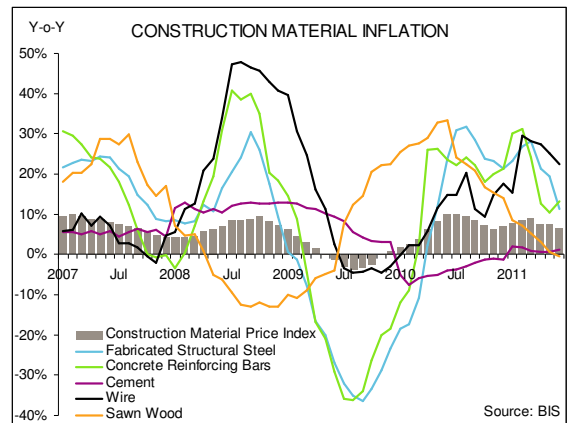


UK construction survey

According to the RICS construction industry survey, workload was broadly flat in the second quarter of 2011, as a rise in commercial and private housing work was offset by a fall in all other sectors of the industry. Regional divergences that emerged at the end of 2010 have become more pronounced over the course of this year, with industry activity driven by London and the South East, while other regions saw workload fall – in particular the North. According to those surveyed, the industry is facing a highly competitive tendering environment and a general lack of funding for projects. Looking ahead, the industry is modestly positive about workload and employment in the year ahead, but at the same time, profit expectations continue to deteriorate, due to pressure on margins as input costs rise more rapidly than output prices

Building material prices

Construction material price inflation slowed in June, with prices up 0.4% during the month and up 6.6% year-on-year, compared to 7.4% annual inflation in May. Asphalt saw the largest jump in June, up 1.1% during the month and 8.8% higher compared to last year. Wire prices rose 0.6% in June and were 22.6% up year-on-year due to higher copper prices. Fabricated structural steel prices rose 0.2% in June and up 11.2% on a year ago. Concrete reinforcing bars fell 0.7% during the month, but prices remain 13.3% up on a year ago.

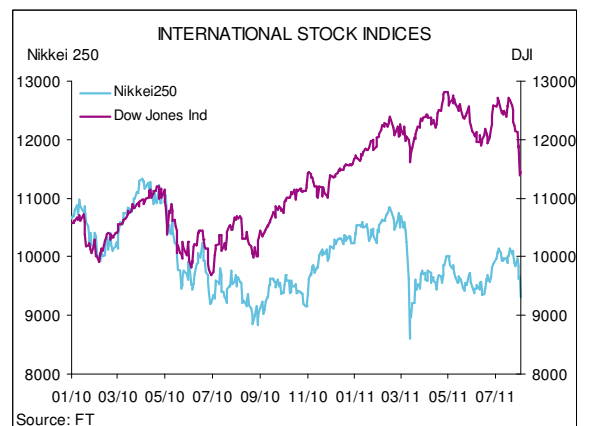
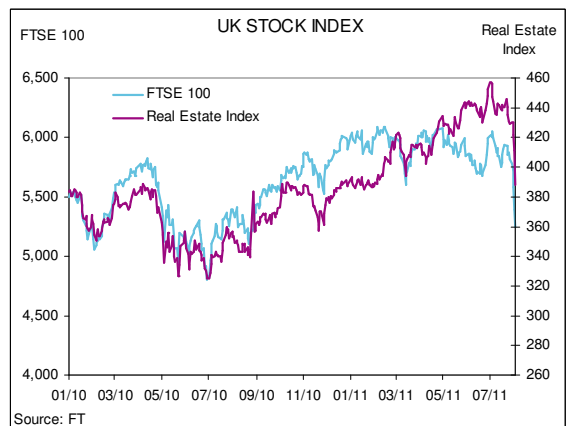


Market Watch

Global equities plummeted last week, suffering their worst falls since the depths of the financial crisis in autumn 2008. Finance ministers from the G7 major economic powers held emergence talks over the weekend on how to calm the markets before they reopen on Monday, but further sell-offs in global equities are expected this week.

The US debt deal early last week had temporarily lifted market confidence, but an escalation of the Eurozone debt crisis, fears of fading economic recoveries and worries over policy options of cash strapped governments, as well as S&P's downgrade of the US credit rating by one notch from triple A to double A plus on Friday, spooked investors.

According to S&P, the long-term outlook for the US remains negative and it did not rule out another rating cut within the next two years if spending was reduced by less than agreed under the debt deal last week, US interest rates rose or debt climbed on a higher trajectory. Apart from the forecast deficit increase, S&P stressed the political factors regarding the US government's ability to tackle debt reduction, in particular



in light of the political brinkmanship of recent months, which was judged as making the US' policymaking less stable and less predictable than before. S&P's move is the first ever downgrade of the US by a rating agency and consequently sent shockwaves through markets.

At the end of a tumultuous week, the FTSE 100 index plunged by nearly 10%. The real estate index dropped in line with the wider market, also suffering heavy losses.

British Land in its first quarter trading update, reported that net asset value per share rose to 583p in the last twelve month from 510p, a 13% increase. Pre-tax profits however were almost unchanged at £65m, compared to £64m a year ago. British Land's property portfolio is now worth £9.9bn, of which 64% is retail and 33% London offices. Share in British Land dropped 9.6% last week amid turmoil in wider equity markets, given it a market capitalisation of £4.69bn.

Hammerson in its latest trading update reported that adjusted pre-tax profits had declined by 0.7% from end-2010 to £69.7m during the six months to 30 June 2011. Hammerson indicated it is looking to step up its development pipeline over the remainder of this year. Eleven projects, including new developments, refurbishments and extensions, have been identified at an estimated cost of £335m over the next two years. Hammerson last week plunged 11.9%, giving it a market capitalisation of £2.92bn.

EQUITIES		Friday 5th August 2011			
Index	Index	Week	Month	Year	
FTSE100	5,247.0	▼ -9.8%	-12.9%	-2.2%	
EPRA/NAREIT UK	388.0	▼ -9.6%	-15.0%	9.9%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,690	▼ -9.6%	-14.4%	17.6%	
Hammerson	2,920	▼ -11.9%	-15.7%	9.2%	
Land Securities	6,020	▼ -9.2%	-12.3%	26.3%	
Capital & Counties	1,130	▼ -12.5%	-19.2%	45.1%	
Capital Shopping Centres	2,840	▼ -11.4%	-17.4%	-2.6%	
Shaftesbury	1,150	▼ -10.1%	-14.3%	13.5%	
Great Portland Est.	1,170	▼ -10.3%	-16.1%	19.6%	
Derwent London	1,660	▼ -8.7%	-12.8%	18.9%	
Segro	1,910	▼ -14.5%	-18.1%	-5.8%	
Quintain Estates & Development	242	▼ -21.2%	-23.5%	16.3%	
St. Modwen Properties	312	▼ -9.9%	-19.2%	-9.8%	
Unite Group	294	▼ -13.2%	-16.7%	-3.9%	
Workspace Group	349	▼ -10.2%	-13.9%	22.9%	
Minerva	193	▶ 0.0%	-1.0%	17.7%	
Average*		▼ -10.6%	-14.9%	15.3%	
Building Contractors					
Balfour Beatty	1,830	▼ -12.3%	-15.8%	0.4%	
Carillion	1,400	▼ -11.3%	-15.9%	3.3%	
Morgan Sindall	267	▼ -6.4%	-6.3%	8.1%	
Kier Group	440	▼ -13.2%	-17.5%	9.9%	
Lend Lease Corp*	4,780	▼ -5.5%	-6.9%	13.4%	
Average		▼ -8.3%	-10.7%	8.7%	
Building material suppliers					
Wolseley	4,420	▼ -14.4%	-25.2%	4.7%	
SIG	652	▼ -13.9%	-22.8%	7.5%	
Marshalls	194	▼ -9.4%	-10.2%	11.0%	
Kingspan	975	▼ -14.8%	-19.3%	5.0%	
Average		▼ -14.3%	-23.5%	5.3%	
Housebuilders					
Persimmon	1,220	▼ -12.4%	-17.7%	3.5%	
Taylor Wimpey	1,050	▼ -7.3%	-14.2%	4.4%	
Barratt	794	▼ -16.6%	-28.3%	-21.4%	
Bovis Homes	488	▼ -11.4%	-18.0%	0.4%	
Bellway	754	▼ -5.5%	-12.5%	-1.1%	
Berkeley	1,450	▼ -10.2%	-13.0%	34.3%	
Average		▼ -10.5%	-16.7%	7.1%	

**Sector averages are weighted according to current market capitalisations