

Weekly Economic Update

14 August 2011

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Summary

Amid ongoing global financial market volatility and domestic social issues, the latest UK economic news provide little comfort, with the manufacturing recovery stalling and housing market activity stagnating. Consequently, the Bank of England expressed its concerns about the global and UK economic outlook, raising expectations that interest rates are to remain at record low levels for the time being.

Economy

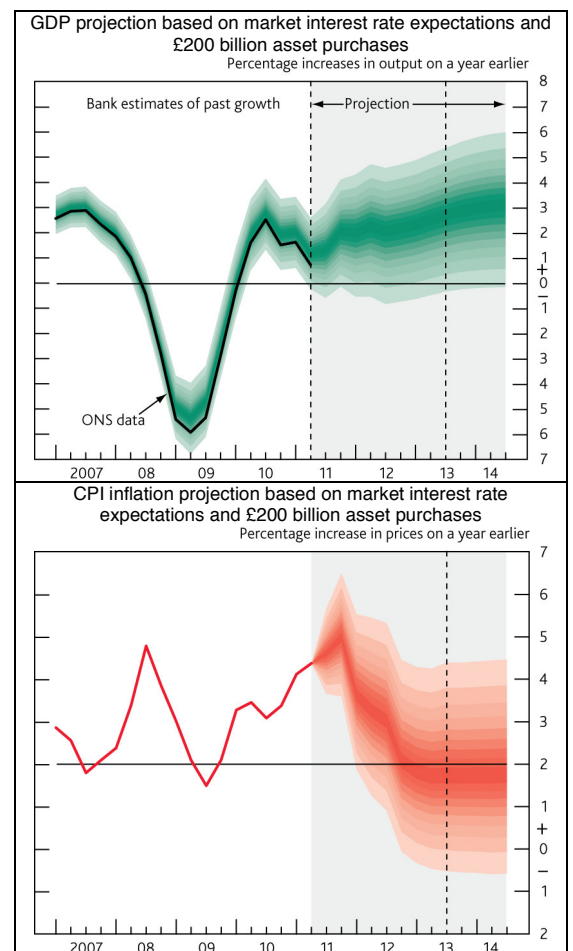
Inflation report

The Bank of England, in its latest Quarterly Inflation Report, further downgraded its UK GDP growth forecasts, but still predicts inflation to rise above 5% later this year.

The Bank cut its growth forecast for 2011 from 1.9% to 1.7%, and that for 2012 to 2.1% from around 2.5%, as a fragile global economic outlook and the squeeze in household incomes weigh on domestic demand. The outlook for UK growth remains highly uncertain, in particular due to the public debt crisis in the eurozone, which is threatening the stability of banking systems. Domestically, UK growth will depend on the ability of households to adjust to lower real incomes, the fiscal consolidation, and companies' business investment.

CPI inflation is expected to rise further in 2011, due to increases in utility bills. Previously, inflation had been forecast to fall to 2% by the end of 2012 after a series of interest rate increases, but this decline is now expected without rate hikes, as the upward impact from VAT changes, high commodity prices, and Sterling's past weakness wanes, and as spare capacity and a subdued labour market limit price pressures. However, the precise timing and extent of the expected decline in inflation remain highly uncertain.

Against this background, the Bank of England has signalled that interest rates are set to stay at 0.5% for the time being. It declined to comment on whether it might seek to stimulate growth through further rounds of quantitative easing, but did not exclude this option either.



Manufacturing activity

In line with industry surveys that showed a marked softening in manufacturing activity in recent months, official data recorded a 0.3% fall in sector output in June, with the annual rate of growth easing to 2.2%. In addition to slower sector activity, manufacturers are being hit by input cost pressures.

Retail sales

The BRC's latest retail sales monitor shows that like-for-like sales values in July were 0.6% higher year-on-year. On a total basis, sales were up 2.5% on a year ago. Despite this stronger than anticipated growth in retail sales, the industry still expects to see slower activity in the year ahead, as consumers are expected to remain cautious in their spending in light of squeezed purchasing power and the uncertain economic outlook.

Housing market activity

UK housing market activity stagnated in July amid a fragile economic outlook and low consumer confidence, according to the latest RICS housing market survey. House prices declined, credit conditions remained tight and new instructions to sell fell back. There was a slight increase in new buyer enquiries during the month, but overall interest from potential buyers has been subdued since the start of the year. London is the only region to report rising house prices and the capital recorded a solid rise in new buyer enquiries in July. The majority of those surveyed expect prices to continue to decline in the three months ahead. However, a shortage of properties coming onto the market is providing some support to house prices.

Commodities

Commodities continued their decline last week, with Brent crude down 2% at \$107.8/barrel and copper falling 4% to \$8,851/tonne. In contrast, the global steel price index recorded a 1% rise over the past week. Steel input costs have been relatively stable in recent months compared to last year and the beginning of 2011, but the uptick in iron ore prices more recently may have convinced producers to try pushing through price increases to consumers.

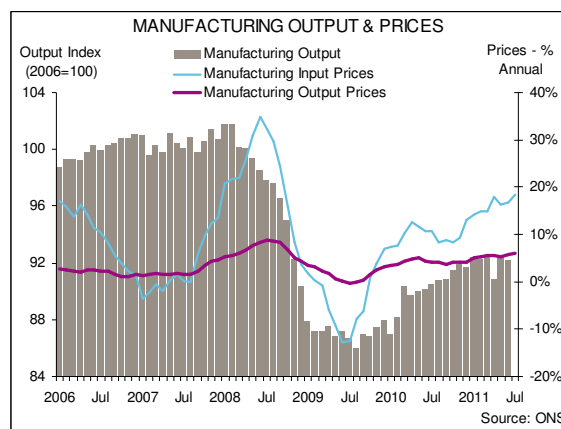
Exchange rates

Despite the Dollar and the Euro under pressure last week, the Pound weakened against both currencies, falling 0.8% against the Euro to £/€1.145 and 0.7% against the Dollar to £/\$1.6275. The Pound fell partly because of the rioting and looting in London and other UK cities, but probably mostly due to the lower growth and inflation forecasts by the Bank of England.

Construction

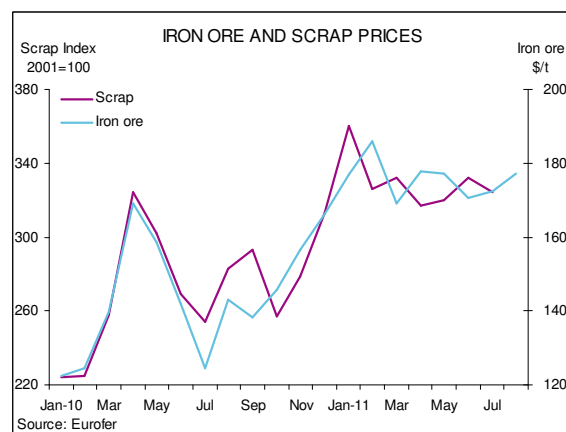
Construction output

Construction output in Q2 2011 totalled £29.45bn, up 0.5% on the preceding quarter, but 1.6% lower compared to the same period last year. The impact of the government spending cuts is becoming increasingly visibly, with public non-residential work falling by 8.1% year-on-year to £3.33bn. Social housing is holding up, rising 4.1% compared to last year to £1.27bn. The anticipated



COMMODITY PRICES (12 AUGUST 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/barrel)	107.8	-2%	-8%	44%
Copper (\$/tonne)	8,851	-4%	-7%	23%
Aluminium (\$/tonne)	2,379	-2%	-3%	11%
Nickel (\$/tonne)	21,780	-6%	-6%	1%
Global Steel Price (Index 04/1994=100)	202.4	1%	-1%	16%

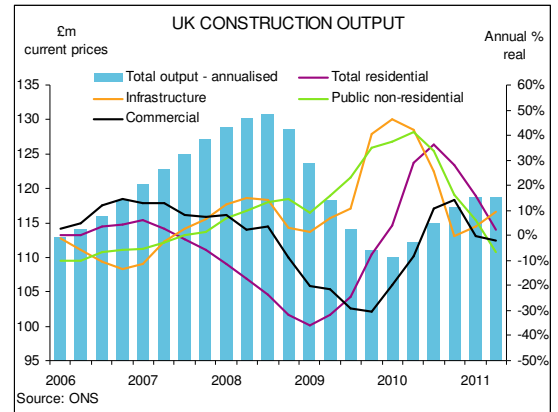
Source: FT, LME, Cruspi



CONSTRUCTION NEW ORDERS - Q2 2011			
	Value	Volume	
	£ million, current	% Q-o-Q	% Y-o-Y
Public Housing	1,273	2.8%	4.1%
Private Housing	3,901	5.2%	1.5%
Infrastructure	4,142	7.8%	8.8%
Public non-residential	3,332	-4.8%	-8.1%
Industrial	853	-4.0%	-8.4%
Commercial	5,725	2.9%	-2.2%
Total new work	19,225	2.4%	-0.6%
Total R&M	10,222	-3.2%	-3.6%
Total Construction	29,447	0.5%	-1.6%

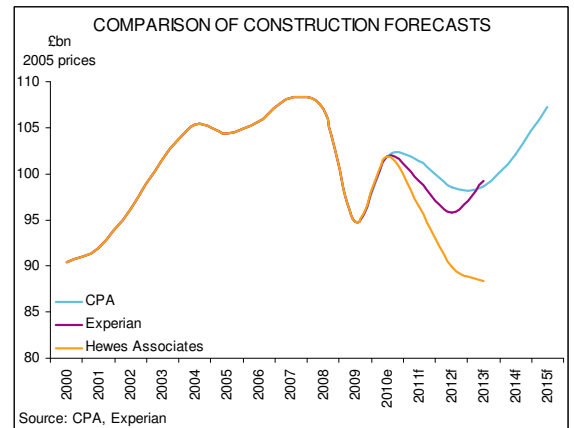
Source: ONS

sustained recovery in private construction work is yet to be established. Private residential work rose by 5.2% quarter-on-quarter and recorded a modest 1.5% increase on a year ago. In contrast, at £5.73bn, commercial work dropped 2.2% in Q2 2011 compared to a year earlier, though output was up 2.9% quarter-on-quarter. Industrial construction fell 8.4% year-on-year and down 4% on the preceding quarter. Infrastructure was once again the best performing sector. Infrastructure work at £4.14bn in Q2 2011 was up 7.8% during the quarter and 8.8% higher compared to a year ago.



Comparison of construction forecasts

The latest round of UK construction industry forecasts, which show a wide spread of views, highlights the uncertainty and range of risks surrounding the outlook for the sector in the years ahead. Hewes & Associates, which published their latest forecasts last week, predict a deeper fall back into recession for the industry, with output to fall over the next three years. Hewes expect output to decline by almost 14% between 2011-2013, due to a sharp drop in public sector work and no recovery in the private sector. This is in contrast to the CPA and Experian, who both expect a private sector recovery in 2013. Experian and the CPA both expect the commercial sector to show significant growth from 2013, while Hewes forecasts a modest decrease.



Market Watch

S&P's downgrade of the US long-term sovereign rating sent equity prices down further last week and contributed to wild swings in global asset markets. With the market fearing that the debt crisis in the Eurozone and the debt ceiling crisis in the US will lead to a renewed global economic crisis, asset price volatile is likely to remain high near term.

In the Eurozone, the ECB last week tried to calm markets by announcing that it would buy Italian and Spanish debt, which pushed their bonds higher and tightened spreads. However, markets remain unconvinced whether the bank's intervention will be sufficient to prevent a further escalation of debt crisis.

Meanwhile, markets received a short-term boost from the Federal Reserve's announcement that it would hold interest rates at current near-zero levels for two years and would be prepared to take further steps (QE3) should the economic outlook worsen.

After four days of stock market losses and a rally in "safe-haven bonds" (Gilts, Treasuries and Bunds), equities posted strong gains on Friday, after four Eurozone countries – France, Italy, Spain and Belgium, banned short-selling of more than 60 financial stocks in order to prevent further slides in share prices.

After further losses earlier last week, the FTSE 100 closed at 5,320 points on Friday, up 1.4% on the preceding week. However, the index is still down 12% off recent highs at the beginning of July. The real estate index rose in line with the wider index, up 1.5% last week. Most real estate stocks recovered some of the losses sustained over the past two weeks, with the exception of Segro, St. Modwen Properties, the Unite Group and Workspace Group, who continued to see declines.

Performance among building contractors, material suppliers and housebuilders was mixed.

EQUITIES						Friday 12th August 2011			
Index	Index		Week	Month	Year				
FTSE100	5,320.0	▲	1.4%	-9.4%	1.0%				
EPRA/NAREIT UK	394.0	▲	1.5%	-11.0%	13.2%				
Stocks		Market Cap, £m	Share Prices						
			Week	Month	Year				
Real Estate									
British Land	4,970	▲	6.1%	-4.9%	24.8%				
Hammerson	3,050	▲	4.9%	-6.4%	17.7%				
Land Securities	6,180	▲	3.4%	-4.7%	33.6%				
Capital & Counties	1,180	▲	4.6%	-10.4%	51.3%				
Capital Shopping Centres	2,870	▲	1.4%	-11.5%	3.4%				
Shaftesbury	1,230	▲	7.2%	-4.2%	24.5%				
Great Portland Est.	1,210	▲	4.6%	-8.8%	26.7%				
Derwent London	1,780	▲	7.0%	-1.7%	28.0%				
Segro	1,860	▼	-2.8%	-17.8%	-7.7%				
Quintain Estates & Development	249	▲	3.2%	-18.3%	17.8%				
St. Modwen Properties	284	▼	-9.0%	-25.5%	-15.5%				
Unite Group	264	▼	-10.1%	-24.8%	-7.0%				
Workspace Group	345	▼	-1.3%	-9.7%	18.3%				
Minerva	193	▶	0.0%	-0.6%	28.2%				
Average*		▲	3.6%	-7.5%	21.9%				
Building Contractors									
Balfour Beatty	1,790	▼	-1.5%	-14.9%	0.5%				
Carillion	1,320	▲	1.4%	-12.5%	11.2%				
Morgan Sindall	267	▲	1.9%	-6.0%	17.2%				
Kier Group	445	▲	4.2%	-14.3%	18.0%				
Lend Lease Corp*	2,824	▼	-1.2%	-7.5%	17.6%				
Average		▼	-0.3%	-10.9%	11.8%				
Building material suppliers									
Wolseley	4,560	▲	3.7%	-15.6%	17.5%				
SIG	680	▲	4.3%	-15.7%	17.6%				
Marshalls	188	▼	-2.8%	-11.9%	12.6%				
Kingspan	928	▲	7.0%	-8.3%	10.4%				
Average		▲	4.1%	-14.4%	16.3%				
Housebuilders									
Persimmon	1,270	▲	4.0%	-11.1%	21.0%				
Taylor Wimpey	1,070	▲	2.1%	-9.7%	16.2%				
Barratt	786	▼	-0.6%	-25.1%	-15.1%				
Bovis Homes	480	▼	-1.5%	-17.4%	1.7%				
Bellway	739	▼	-2.0%	-10.8%	8.5%				
Berkeley	1,480	▲	2.2%	-9.5%	41.8%				
Average		▲	1.4%	-12.8%	17.4%				

**Sector averages are weighted according to current market capitalisations

