

Weekly Economic Update

26 September 2011

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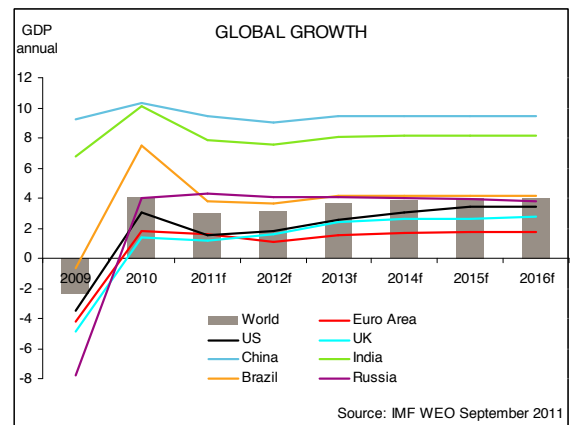
Summary

It was another tumultuous week for global asset markets, as stock markets tumbled on the back of fears that the world was slipping back into recession and governments were fast running out of options. Meanwhile, the latest UK economic data portray an increasingly difficult trading environment, with inflation and job losses putting pressure on households, while export demand appears to be waning.

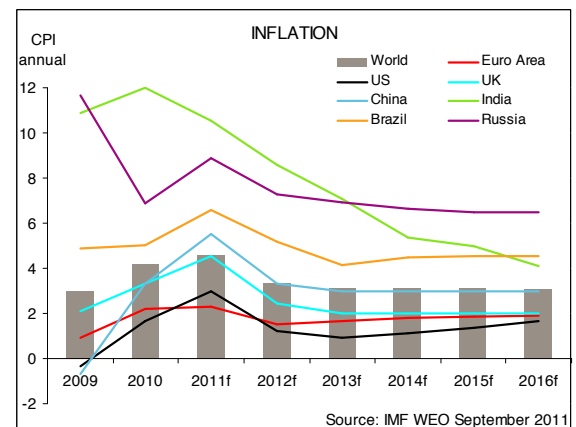
Economy

World Economic Outlook

After a stronger than expected rebound of the global economy in 2010, growth this year slowed markedly due to fiscal retrenchment in advanced economies and policy tightening in emerging markets. At the same time the downside risks to the world economy have risen over the course of this year. In particular, global financial conditions have deteriorated sharply in recent weeks, with markets spooked by weaker than expected economic activity, the Eurozone sovereign debt crisis and the downgrade of the US's AAA credit rating. These developments alone are having a substantial negative impact on the real economy and consequently the IMF has scaled back significantly its forecasts for world economic growth.

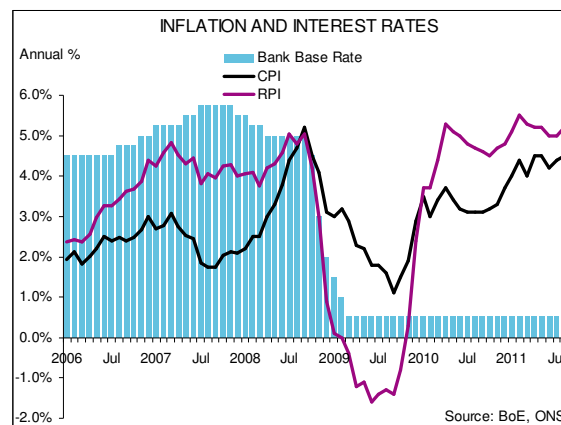


Global growth was expected to be uneven, with the recovery in the advanced economies much slower than in industrialising economies. However, the structural problems facing the advanced economies have proven even more difficult to deal with than expected, with policy-makers unable and/ or unwilling to implement necessary reforms. Consequently the outlook for these economies remains one of a bumpy, brittle and below-par recovery. Overall, the IMF predicts GDP in the advanced economies to expand by only 1.5% in 2011 and 2% in 2012, assuming that European policymakers will be able to contain the crisis in the Eurozone periphery, that US policymakers strike a balance between support for the economy and medium-term fiscal consolidation, and that volatility in global financial markets does not escalate. Emerging markets have – as expected - performed more robustly than advanced economies. Growth has eased in line with monetary tightening to dampen inflation pressures, but forecast downgrades have been more modest.



Inflation and interest rates

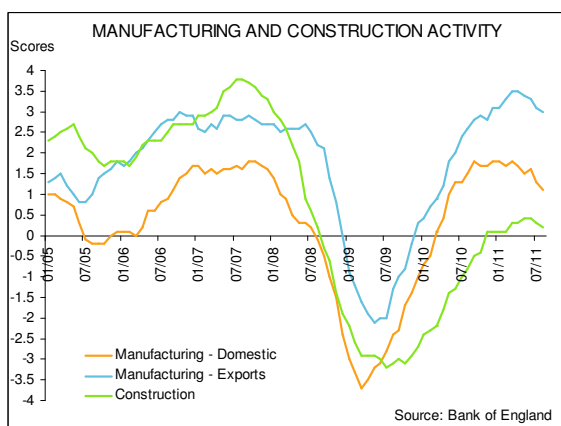
Consumer price inflation crept up to an annual 4.5% in August, compared to 4.4% in the preceding month. Broadly, the upward pressure came from higher prices for clothing and footwear, as well as from rising petrol and energy prices. The retail price index (RPI) measure of inflation rose from 5.0% in July to 5.2% in August. The Bank of England expects CPI to climb to 5% later this year, before easing to around 2% in 2012. Despite high inflation, the Bank of England's Monetary Policy Committee kept interest rates at their all-time low of 0.5% during their September meeting, citing temporary inflationary pressures and UK growth concerns as the main reasons for keeping interest rates on hold.



UK business conditions

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

- **Consumer spending** and **retail sales** growth weakened further, as trading conditions are becoming increasingly challenging.
- **Housing market** activity remains subdued, partly because of constrained mortgage finance, in particular for first-time buyers. Consequently, demand for rental property is increasing, contributing to a rise in the cost of rented accommodation. This in turn is attracting more buy-to-let investors and they account for an increasing share of demand. London remains a bright spot in the UK housing market.
- **Investment intentions** rose modestly in August, but generally firms are becoming more cautious, due to a more uncertain demand outlook. Investment is typically motivated by the need to replace existing kit, develop new products and to find efficiencies to offset rising input costs. Some firms are planning to expand capacity, particularly goods exporters, although intentions had been dampened somewhat by the worsening outlook for the global economy. Supermarkets and discount stores are continuing to expand their national footprints. In addition, there is investment in transport infrastructure and in the renewable energy sector.
- **Manufacturing output** continues to expand, but at a much slower pace than in the first half of the year. The **business services** sector also continues to post steady growth, with rising private sector activity offset to some degree by a fall in public sector work.
- **Construction** output is relatively unchanged compared to levels seen last year, as public work is holding up better than expected. Construction is being supported by some large projects in London and the south east related to infrastructure, the Olympics and some large commercial developments. Projects related to the energy sector, i.e. nuclear, traditional energy and renewables, are also supporting activity. House building in August has increased modestly compared with a year earlier, but contacts report that the current planning process and new energy reduction targets tend to slow the pace of growth.
- Private sector **employment intentions** weakened somewhat in recent months and now point to only modest job creation over the coming year.
- **Raw materials costs** appear to have levelled off, although some firms expect the cost of energy to pick up as contract renewals fall due. In addition, higher raw material costs continue to feed through to the price of **imported finished goods**, although there are tentative signs of a slowing in the pace of import prices. **Output price inflation** remains limited, putting pressure on firms' margins.

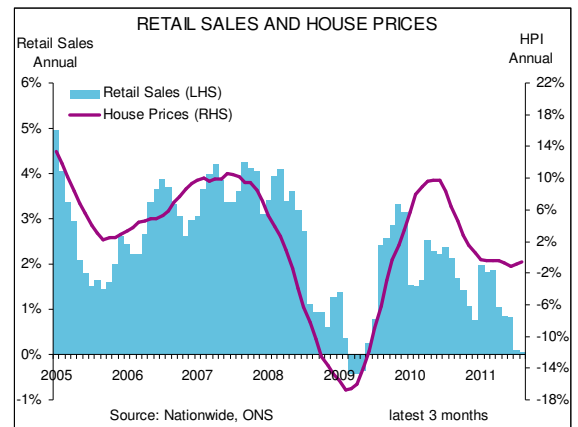


Manufacturing activity

The CBI's Industrial Trends Survey for September reveals that order books weakened over the last month, with the majority of manufacturers reporting order levels "below normal" levels. Both domestic and export orders weakened. Despite lower order books, manufacturers expect output to increase over the next three months. Manufacturers' profit margins remain under pressure from higher input cost inflation and firms are seeking to pass on price increases, though the increasingly challenging business environment will limit manufacturers' ability to do so.

Retail sales

Retail sales volumes in August fell by 0.2% compared to July and remained relatively unchanged compared to a year ago. According to retailers, last month's riots across parts of England resulted in early closures (thus reduced opening times), while some stores were directly affected by the violence, hurting sales. Retail sales are set to remain under pressure given the squeeze on purchasing power from subdued earnings growth and high inflation, as well as an unsupportive housing market and fragile labour market conditions.

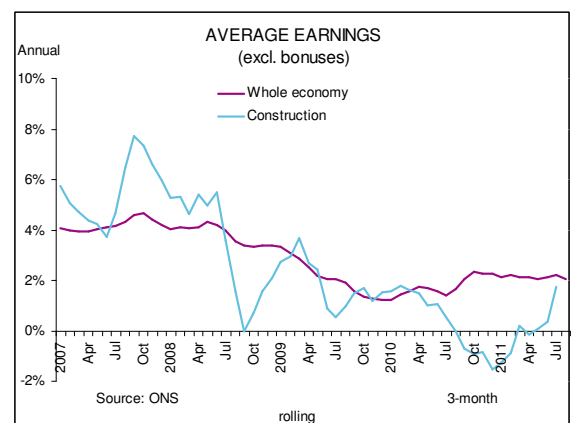


Housing market activity

Housing market activity in August remained subdued, according to the latest RICS housing market survey, as economic uncertainty and mortgage constraints adversely impact on activity. The majority of those surveyed are reporting that house prices continue to fall across the UK, with the exception of London. New buyer enquires declined in August, while new vendor instructions remained flat during the month. The average amount of housing stock on surveyors' books fell in August, with anecdotal evidence suggesting that many vendors are taking their properties off the market until autumn.

Labour Market

The total number of people unemployed in the UK rose by 80,000 in the three months to July 2011 to reach 2.51 million – the largest increase since between June and August 2009. The unemployment rate now stands at 7.9%, up 0.3% on the quarter. Over the same period, the number of people in employment decreased by 69,000 on the preceding three months, but increased by 24,000 year-on-year, to reach 29.17 million. Average earnings (excl. bonuses) remains subdued, rising by 2% in the three months to July, compared to an average of 2.1% in the first half of 2011.

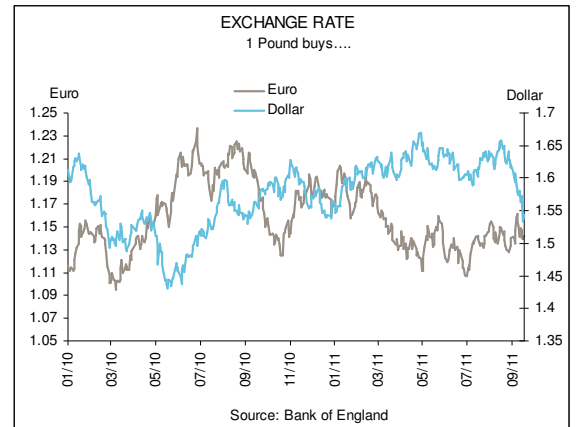


Public sector finances

Public finances in August were weaker than had been expected. Government borrowing reached a new high for that month - £15.9bn (excl. temporary effects of financial interventions). This was almost 14% higher when compared with the £14bn figure seen in August 2010. Meanwhile the public sector's net deficit came in at £13.8bn and net debt (excl. financial interventions) reached £944.5bn, equivalent to 61.4% of GDP. The improvement in public finances is likely to be hampered by the current slowdown in UK growth, which is set to impact on tax revenues and unemployment benefit claims. This raises doubts whether Chancellor Osborne will be able to achieve his target of reducing PSNBR (excl. financial interventions) to £122 billion in fiscal year 2011/12 from £142.6bn in 2010/11.

Exchange rates

The US Dollar strengthened last week, as a weaker global economic outlook and uncertainty in the Eurozone hit risk appetite, increasing demand for "safe havens". Weaker UK economic data caused the Pound to weaken last week, with Sterling down 0.3% against the Euro at £/€1.142 and 2.3% down against the Dollar at £/\$1.5438. The Pound has now fallen by more than 7% against the Dollar since mid-August.



Commodities

Commodities prices dropped sharply last week amid a general fall-out in global market confidence. Oil prices fell by 8% to \$106.6/ barrel of Brent crude. Base metals saw even sharper price declines, with copper prices – seen as the bellwether for global commodities – falling 17% to \$7,290/ tonne, their lowest level in a year. Nickel prices also fell 17% over the week to Friday, while aluminium spot prices dropped 8% to \$2,170/ tonne. In contrast, the global steel price index held stable last week, with global steel prices up 13% year-on-year.

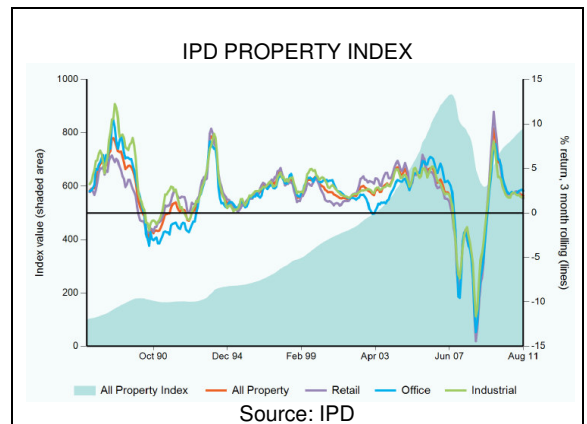
COMMODITY PRICES (23 SEPTEMBER 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	106.6	-8%	-5%	37%
Copper (\$/tonne)	7,290	-17%	-18%	-8%
Aluminium (\$/tonne)	2,170	-8%	-7%	-4%
Nickel (\$/tonne)	17,925	-17%	-15%	-22%
Global Steel Price (Index 04/1994=100)	204.4	0%	1%	13%

Source: FT, LME, Cruspi

Construction

Commercial property returns

UK commercial capital growth stood at 0.1% in August, according to the IPD UK Monthly Index. Income return of 0.5% contributed to a monthly total return of 0.6%. 25 consecutive months of positive capital growth has seen values recover by 17.7%. However, on a twelve-month rolling annual basis, capital growth has slowed to just 1.8%. Retail capital values were flat at best in August, as the outlook for consumer spending remains poor. Overall retail income returns totalled 0.5%. Similarly, industrial property capital values were unchanged in August. Offices were again the best performing sector in August, but returns remain significantly weaker than at the beginning of the year. Office capital values rose by 0.2% in August, with rental values up 0.5%. London offices outside of the City saw an increase in capital growth of 0.5%, comparable with the rate of growth seen in the Central London office segment. In contrast, while retail capital values grew by 0.6% in Central London, values declined in the rest of the Capital.



Market Watch

In another tumultuous week, global asset markets tumbled on the back of ongoing concerns over the Eurozone, despite a Greek official insisting that the country will not default.

This was in addition to the negative tone set by both the Bank of England and the US Federal Reserve last week, with the Fed announcing plans to extend the average maturity of its securities through "Operation Twist", while the MPC gave its strongest indication as yet that it was ready to embark on another round of quantitative easing should the economic outlook not improve over the coming months.

Meanwhile, finance ministers and central bankers from the G20 gathered in Washington for the semi-annual meeting of the IMF and World Bank. Given the subdued forecasts from the IMF, this is likely to result in more downbeat commentary.

The FTSE100 dropped 5.6% in the week to Friday to 5,066.8 points. The real estate index fell by an even larger 7.8%. Within the sector, St. Modwen properties (-10.7%), Capital Shopping Centres (-9.7%), The Unite Group (-9.1%) and Workspace Group (-9.1%) saw the largest declines, though all others also saw heavy losses.

In industry news, the Financial Times reports that Debenhams signed a pre-let agreement with British Land to take up 145,000 sq ft of offices space as a new headquarters at Regent's Place in London. Work started on the development in October last year. Construction is expected to finish in summer of 2013.

Building contractors, building material suppliers and the majority of house builders saw their share prices plunge last week as well. Persimmon and Bellway bucked the trend, posting an increase of 1.3% and 0.7% respectively in the week to Friday.

EQUITIES		Friday 23th September 2011			
Index	Index	Week	Month	Year	
FTSE100	5,066.8	▼ -5.6%	-1.2%	-8.7%	
EPRA/NAREIT UK	370.0	▼ -7.8%	-7.7%	-5.8%	
Stocks		Market Cap, £m	Share Prices		
			Week	Month	Year
Real Estate					
British Land	4,240	▼ -6.6%	-10.3%	2.7%	
Hammerson	2,610	▼ -7.2%	-6.8%	-5.8%	
Land Securities	4,920	▼ -6.4%	-14.4%	1.5%	
Capital & Counties	1,160	▼ -5.4%	4.6%	28.9%	
Capital Shopping Centres	2,550	▼ -9.7%	-5.9%	-18.7%	
Shaftesbury	1,160	▼ -5.7%	-0.5%	5.3%	
Great Portland Est.	1,100	▼ -8.1%	-1.0%	5.2%	
Derwent London	1,560	▼ -6.1%	-2.1%	-0.2%	
Segro	1,610	▼ -7.5%	-12.4%	-18.9%	
Quintain Estates & Development	211	▼ -6.9%	-1.8%	1.9%	
St. Modwen Properties	250	▼ -10.7%	-6.7%	-25.6%	
Unite Group	262	▼ -9.1%	0.2%	-20.8%	
Workspace Group	314	▼ -9.1%	-5.2%	6.6%	
Average*		▼ -7.1%	-7.8%	-1.8%	
Building Contractors					
Balfour Beatty	1,700	▼ -0.8%	5.4%	-7.5%	
Carillion	1,420	▼ -2.5%	2.5%	4.1%	
Morgan Sindall	224	▼ -3.8%	-14.1%	-22.4%	
Kier Group	467	▼ -2.3%	2.6%	7.0%	
Lend Lease Corp*	2,612	▼ -4.5%	-10.0%	-3.1%	
Average		▼ -2.9%	-2.4%	-2.6%	
Building material suppliers					
Wolseley	4,060	▼ -7.6%	-0.7%	-4.3%	
SIG	538	▼ -9.0%	-14.6%	-7.6%	
Marshalls	193	▼ -5.8%	0.8%	-9.5%	
Kingspan	864	▼ -9.7%	-2.6%	5.1%	
Average		▼ -8.0%	-2.3%	-3.4%	
Housebuilders					
Persimmon	1,390	▲ 1.3%	12.6%	13.2%	
Taylor Wimpey	1,080	▼ -1.7%	14.9%	17.1%	
Barratt	773	▼ -1.0%	12.7%	-23.1%	
Bovis Homes	541	▼ -1.0%	19.5%	4.7%	
Bellway	737	▲ 0.7%	6.6%	1.7%	
Berkeley	1,620	▼ -1.4%	16.0%	48.4%	
Average		▼ -0.5%	13.8%	16.5%	

**Sector averages are weighted according to current market capitalisations

