

Weekly Economic Update

24 October 2011

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Summary

The Eurozone crisis continues to dominate headlines, with swings in sentiment producing asset price volatility. This weekend's EU Summit – re-worded as intermediate step towards a 'comprehensive solution to the Eurozone debt crisis – has been met with a cautiously optimistic mood among market participants. A new summit on Wednesday is now supposed to finalise plans around three key issues: firstly, the next tranche of Greek aid, the size of the debt write-down and scope of private sector involvement for Greek debt holders; secondly, the recapitalisation of European banks; and thirdly, the creation of a credible safeguard mechanism to prevent crisis contagion.

Economy

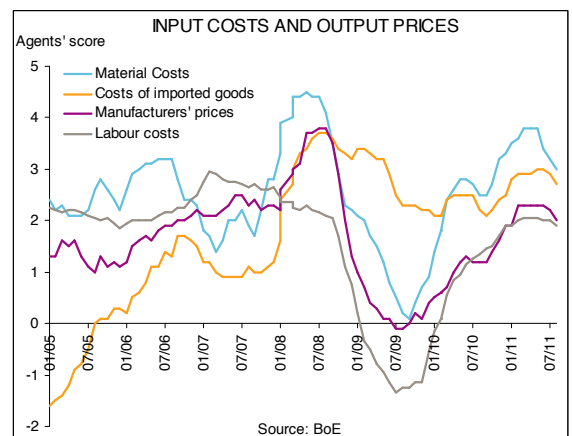
MPC minutes

Minutes released last week from the Bank of England's Monetary Policy Committee (MPC) October meeting show that all nine members voted to pump another £75bn into the UK economy, highlighting concerns that another economic downturn may just be around the corner.

Business conditions

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

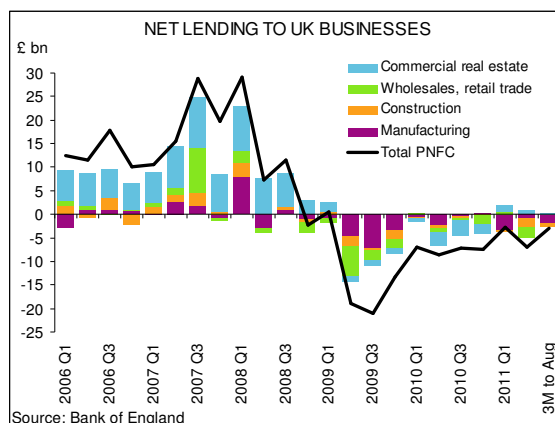
- Spending on **consumer goods and services** slowed further, signalling sluggish demand. Households remain focused on value for money, with discount and online retailers performing relatively well.
- **Housing market** activity remained depressed, as uncertainty surrounding job security and difficulty in accessing mortgage finance (particularly for first-time buyers) weighed on consumers' minds.
- Businesses planned to increase **investment** over the next year, but growth is expected to be slow. Some businesses had put investment decisions on hold due to economic uncertainty, while some of the capital spending which had resumed following the recession had been completed.
- Although the growth rate has been slowing in recent months, **manufacturing** output continued to expand.
- Year-on-year, **construction** output was flat in September. Activity levels were being supported by ongoing energy, utilities and transport infrastructure projects, as well as national retailers' expansion plans. However slowing public sector orders and weak private sector demand suggest a contraction in activity over the next year.
- **Material price inflation** continued to fall from recent peaks, as a range of commodities and processed input prices began to level off. However businesses continued to feel the effect of higher energy costs as fixed-term contracts expired.



Trends in Lending

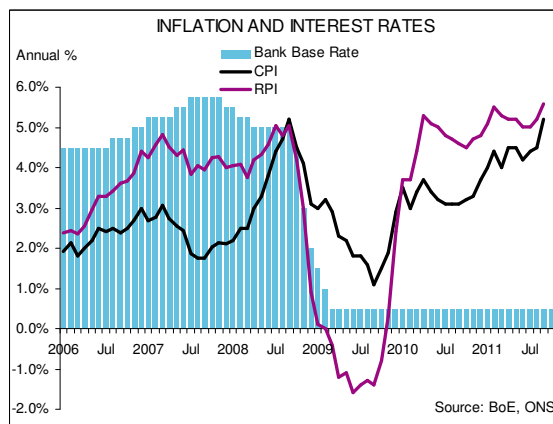
The recent Bank of England's quarterly 'Credit Condition survey' showed that credit availability remained broadly unchanged for businesses in Q3 2011. In the more detailed 'Trends in Lending' analysis, the Bank highlighted that:

- Larger firms continued generally to be able to access **bank lending** if required, but small businesses still reported that bank finance was difficult to obtain.
- **Credit demand** from businesses overall is subdued, reflecting general macroeconomic factors and a lack of confidence. Businesses in recent months have increased their deposits to de-leverage or postpone investment due to current economic conditions.
- Net lending to UK businesses fell in recent months across the majority of sectors.
- **Syndicated lending** facilities granted in the UK market fell back a little in Q3 2011. Some lenders noted that issuance in the syndicated lending market in September continued to be largely driven by companies' refinancing needs rather than by M&A.
- Some businesses are bringing forward their **refinancing plans**, partly in response to concerns about potentially higher pricing in the coming months.
- Conditions in **longer-term wholesale funding markets** tightened in September, according to major UK lenders, reflecting concerns about the vulnerabilities associated with the indebtedness of several Euroarea governments and banks. However, the impact on loan pricing for corporates and households is muted as yet. Indeed, UK lenders report that current developments in bank funding markets had not yet affected their lending plans for the corporate sector for the rest of the year.



Inflation

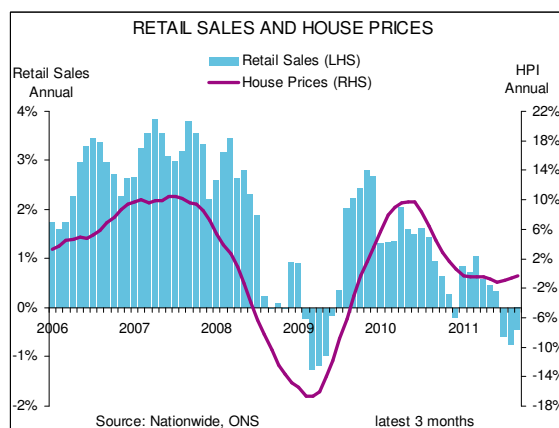
Annual consumer price inflation rose from 4.5% in August to 5.2% in September – a 19-year high (although it did hit the same level in September 2008). The largest upward pressure came from increases in gas and electricity prices, although rising cost of air travel and communication services also contributed. RPI inflation climbed to the highest level in over 20 years – increasing from 5.2% in August to 5.6% in September. The last time it was higher was in June 1991, when it stood at 5.8%.



Retail sales

In September, the volume of retail sales (excl. fuel) rose by an unexpected 0.8% month-on-month and up 0.4% on a year ago. However, the underlying trend points to slowing activity, with sales volumes in the third quarter down 0.2% on the preceding quarter and 0.5% down year-on-year.

Meanwhile the British Retail Consortium's (BRC) latest Retail Sales Monitor shows a 0.3% increase in like-for-like sales values, when compared with September 2010, with the small rise driven by food sales, while non-food sales struggled. The Confederation of British Industry's (CBI) retail sales survey shows that sales fell to their weakest level in 16 months, with the majority of those surveyed reporting lower sales in September compared to a year ago.



Labour market

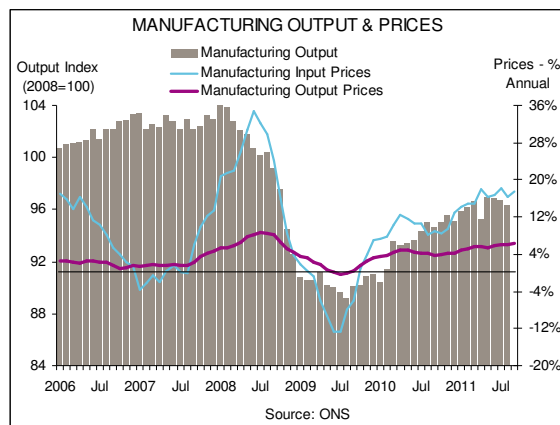
In the three months to August 2011, the unemployment rate hit 8.1%, as the total number of people out of work in the UK increased by 114,000 to 2.57m. This was recorded to be the highest level since 1994 and was mainly driven by a record cut in part-time workers – down 175,000. In September, the number of people out of work and claiming job seekers allowance rose by 17,500 to 1.6m. In the three months to August, average earnings including bonuses rose by 2.8% year-on-year, compared to a 2.3% increase in the preceding three months.

Manufacturing

Manufacturing output fell by 0.3% in August; this is the third consecutive month-on-month decrease. Year-on-year, manufacturing activity was up 1.5%, which is substantially below the growth rates seen earlier this year.

Trade deficit

The UK's trade deficit in goods narrowed to £7.8bn in August, compared with a revised figure of £8.2bn in July. This was driven by total exports hitting a new high – rising by 0.6% to £25.5bn, while the value of imports fell by 0.7% to £33.3bn. The volume of exports was up 1.3%, while the volume of imports rose by 0.3% when compared with July.



Public finances

In September, public sector net borrowing (PSNB) was £14.1bn, £1.3bn less compared to the same period last year. The ONS also revised down August's PSNB figure by £2bn to £13.7bn. Consequently, in the six months to September, PSNB stood at £63.5bn, compared to £71bn last year, indicating that the government is more or less on track to cut borrowing from £145.9bn to £122bn by the end of this financial year. However, the recent soft patch in the economy could jeopardise meeting the deficit reduction plans, as slower growth is hitting tax revenues and pushing up unemployment benefit claims. The country's public sector net debt now stands at £966.8bn, which is equivalent to 62.6% of GDP.

Housing market activity

According to the RICS's latest housing market survey, sector activity remains sluggish. The majority of those surveyed continued to report that house prices fell across the board, with the exception of London. New buyer enquiries edged up slightly in September, but new vendor instructions fell.

Commodities

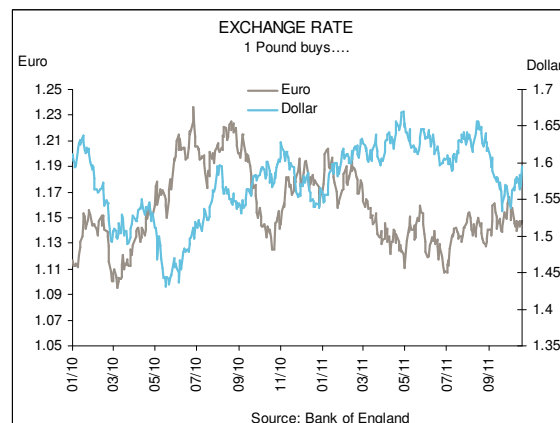
Commodity prices fell last week, as Eurozone debt concerns and expectations about slower global growth prompted investors to withdraw funds from commodities. Oil prices fell by 4% to \$109.6 per barrel, while copper and aluminium saw declines of 6% and 3% respectively. Meanwhile, nickel prices fell by 1% to \$18,675/ tonne. Global steel prices held steady last week.

| COMMODITY PRICES (21 OCTOBER 2011) | | | | |
|--|--------|---------------|----------------|---------------|
| | Price | Weekly change | Monthly change | Annual change |
| "Brent" Oil (\$/ barrel) | 109.6 | -4% | -6% | 35% |
| Copper (\$/tonne) | 7,062 | -6% | -14% | -16% |
| Aluminium (\$/tonne) | 2,110 | -3% | -7% | -10% |
| Nickel (\$/tonne) | 18,675 | -1% | -10% | -21% |
| Global Steel Price (Index 04/1994=100) | 199.9 | 0% | -2% | 12% |

Source: FT, LME, Cruspi

Exchange rates

Over the week to Friday, the Pound rose 0.7% against the Euro to €/£1.148 and was up 0.9% against the Dollar to £/\$1.595.



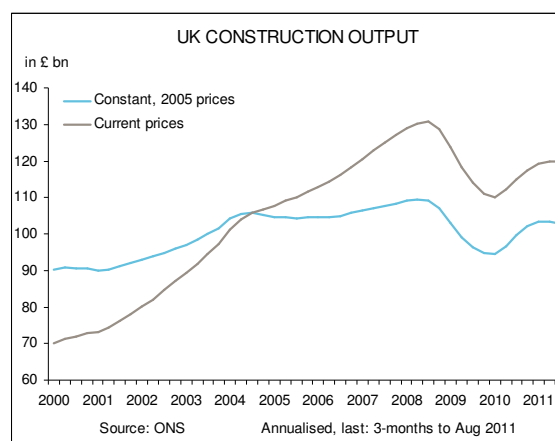
Construction

Construction output

In August, the value of total construction output, at £10.38bn, was marginally stronger than in July (£10.31bn). In volume terms, this is a 0.4% month-on-month increase, but compared to a year ago, output was down 4.1%. In the three months to August, construction output was rose 1% on the preceding three months, but was down 2% year-on-year. The public sector is now showing clear signs of weakening. Public housing output fell 8% in the three months to August compared to the preceding three months and was down 5% year-on-year. Over the same period, public non-residential work declined by 2% and 8%, respectively. Repair and maintenance activity also fell both compared to the previous three months and a year ago. Commercial work, at £6.33bn in the three months to August strengthened compared to the previous three months, but activity was still lower than last year in real terms. Infrastructure and industrial output were unchanged in the past three months, though infrastructure work remains significantly up on last year's levels.

| CONSTRUCTION OUTPUT - 3M to AUG 2011 | | | |
|--------------------------------------|--------------------|-----------|------------|
| | Value | Volume | |
| | £ million, current | %, Q-o-Q | %, Y-o-Y |
| Public Housing | 1,223 | -8% | -5% |
| Private Housing | 4,248 | 4% | 3% |
| Infrastructure | 4,147 | 0% | 11% |
| Public non-residential | 3,522 | -2% | -8% |
| Industrial | 847 | 0% | -25% |
| Commercial | 6,330 | 6% | -3% |
| Total new work | 20,316 | 2% | -2% |
| Total R&M | 10,904 | -1% | -2% |
| Total Construction | 31,221 | 1% | -2% |

Source: ONS



Commercial development activity

According to Savills October 2011 *Commercial Development Activity* report:

- The Total Commercial Development Activity Index (a net balance monitoring the overall performance of the UK commercial property sector) registered -10.5% in September, up slightly on the previous month's -12.1%. This suggests that commercial development activity continued to contract in September, albeit at a lesser pace. A quarter of the developers surveyed recorded a contraction in September, while around 15% were experiencing rising activity levels.
- Public sector development activity reduced sharply in September and was declining at the fastest pace in nine months. Private sector activity also declined, but at a slower pace.

Construction forecasts

Experian's Autumn forecasts show a small overall change from the Summer edition for this year and next. The decline for total construction output in 2011 has been revised up from 2.6% to 2.1% on the basis of public sector work holding up better than anticipated. Public housing is expected to continue to fare badly given funding is around half the 2008-2011 level, while private housing sector should continue to be under pressure from declining house prices (on most measures) and mortgage lending remaining well below pre-recession levels. Infrastructure construction continues to do well on the back of projects such as Crossrail and prospects should continue to improve as work starts in earnest on the new generation of power stations. Although public non-residential activity has held up (broadly as a result of work continuing on Building Schools for the Future programme), this is not expected to last long, as work generated by education projects and Olympics work fall out of the equation. Industrial construction is expected to see a decline this year, but growth should return in 2012 and 2013. Commercial construction is expected to contract for two years before bouncing back in 2013.

| EXPERIAN CONSTRUCTION FORECASTS - AUTUMN 2011 | | | | |
|---|---------|---------|--------|---------|
| £m, constant 2005 prices | 2010 | 2011e | 2012f | 2013f |
| <i>Annual % change</i> | | | | |
| Public housing | 4,350 | 4,132 | 3,099 | 2,789 |
| | 54 | -5 | -25 | -10 |
| Private housing | 12,778 | 13,034 | 13,685 | 14,653 |
| | 17.3 | 2 | 5 | 7 |
| Infrastructure | 12,032 | 12,994 | 12,994 | 14,034 |
| | 25.7 | 8 | 0 | 8 |
| Public non-residential | 13,331 | 11,998 | 9,118 | 8,206 |
| | 31.4 | -10 | -24 | -10 |
| Industrial | 3,848 | 3,540 | 3,731 | 4,093 |
| | 19.6 | -8 | 5 | 10 |
| Commercial | 23,401 | 22,465 | 22,218 | 24,173 |
| | -1.8 | -4 | -1 | 9 |
| Total New Work | 69,739 | 68,163 | 64,846 | 67,939 |
| | 15.3 | -2.3 | -4.9 | 4.8 |
| Total RM&I | 34,729 | 34,082 | 33,985 | 34,505 |
| | -3.8 | -1.9 | -0.3 | 1.5 |
| Total Work | 104,468 | 102,245 | 98,831 | 102,444 |
| | 8.2 | -2.1 | -3.3 | 3.7 |

Source: ONS, Experian

Market Watch

Financial markets gained some ground last week on hopes that European leaders may come to an agreement on how best to tackle the debt crisis in the region.

In the week to Friday, the FTSE 100 rose 0.4% to 5488.6 points. In contrast, the real estate index underperformed the wider market, falling 2.2% to 371.1 points. In real estate, Segro, St. Modwen Properties and Workspace Grop were the only ones to see rises – of 1.1%, 2.1% and 0.2%, respectively, while Land Securities did poorly with a 5.8% fall over the week.

All of the building contractors suffered declines over the same period, with Balfour Beatty (-5.5%) and Carillion (-6.4%) the worst performing. In building materials, the biggest upward movement was for Wolsely (up 5.9%), while Kingspan saw the largest fall (-7.2%).

Inter Ikea Holding SA, the parent company of the Ikea retail franchise, announced plans to expand into the UK housebuilding and real estate development market. The subsidiary responsible for the work, LandProp, has reportedly acquired several hundred hectares of land near London to build 10,000 homes and purchased a 50-hectare (124-acre) site in Suffolk for a non-residential project.

| EQUITIES | | Friday 21st October 2011 | | | |
|--------------------------------|----------------|--------------------------|--------|--------|--|
| Index | Index | Week | Month | Year | |
| FTSE100 | 5,488.6 | ▲ 0.4% | 3.8% | -4.7% | |
| EPRA/NAREIT UK | 371.1 | ▼ -2.2% | 0.3% | -2.3% | |
| Stocks | Market Cap, £m | Share Prices | | | |
| | | Week | Month | Year | |
| Real Estate | | | | | |
| British Land | 4,550 | ▼ -2.5% | 0.6% | 1.1% | |
| Hammerson | 2,860 | ▼ -3.1% | 8.5% | -2.6% | |
| Land Securities | 5,210 | ▼ -5.8% | -1.5% | -1.0% | |
| Capital & Counties | 1,170 | ▼ -2.4% | -5.0% | 16.4% | |
| Capital Shopping Centres | 2,860 | ▼ -2.9% | 9.4% | -13.8% | |
| Shaftesbury | 1,250 | ▼ -1.6% | -0.6% | 12.3% | |
| Great Portland Est. | 1,130 | ▼ -0.6% | -3.5% | 5.8% | |
| Derwent London | 1,670 | ▼ -0.2% | 6.5% | 7.9% | |
| Segro | 1,780 | ▲ 1.1% | 2.4% | -19.5% | |
| Quintain Estates & Development | 200 | ▼ -3.8% | -8.9% | -7.8% | |
| St. Modwen Properties | 264 | ▲ 2.1% | -1.3% | -26.8% | |
| Unite Group | 280 | ▼ -0.6% | 1.2% | -19.1% | |
| Workspace Group | 340 | ▲ 0.2% | 1.4% | 9.1% | |
| Average* | | ▼ -2.7% | 2.1% | -1.6% | |
| Building Contractors | | | | | |
| Balfour Beatty | 1,690 | ▼ -5.5% | -3.3% | -8.6% | |
| Carillion | 1,460 | ▼ -6.4% | -0.7% | -3.0% | |
| Morgan Sindall | 225 | ▼ -3.9% | -0.8% | -23.7% | |
| Kier Group | 525 | ▼ -0.1% | 11.4% | 10.2% | |
| Lend Lease Corp* | 2,789 | ▼ -1.1% | -0.8% | 1.5% | |
| Average | | ▼ -3.4% | -0.4% | -2.2% | |
| Building material suppliers | | | | | |
| Wolsley | 5,120 | ▲ 5.9% | 19.7% | 8.6% | |
| SIG | 588 | ▲ 3.6% | 7.7% | -10.6% | |
| Marshalls | 173 | ▼ -2.2% | -10.0% | -17.4% | |
| Kingspan | 867 | ▼ -7.2% | -3.4% | -3.2% | |
| Average | | ▲ 3.8% | 14.9% | 4.7% | |
| Housebuilders | | | | | |
| Persimmon | 1,470 | ▲ 0.2% | 7.0% | 36.4% | |
| Taylor Wimpey | 1,160 | ▼ -1.6% | 8.3% | 57.4% | |
| Barratt | 850 | ▼ -2.5% | 4.4% | 5.4% | |
| Bovis Homes | 612 | ▲ 0.9% | 13.9% | 28.8% | |
| Bellway | 847 | ▲ 3.0% | 15.4% | 25.2% | |
| Berkeley | 1,560 | ▼ -0.2% | -1.7% | 43.3% | |
| Average | | ▼ -0.1% | 6.6% | 35.6% | |

**Sector averages are weighted according to current market capitalisations

