

# Weekly Economic Update

14 November 2011

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## Summary

In Europe, the sovereign debt crisis is putting increasing pressure on individual governments and the Euro area real economy. Borrowing costs for Italy – the third largest economy in the Euro zone – reached unsustainable levels last week, forcing the government to push through an austerity package earlier than thought necessary. The European Commission now forecasts a mild recession for the Euro area in 2012 – which is more update than many other forecasters suggest. However the forced resignation of Berlusconi and a new government being formed in Greece provides some hopes of calming markets.

## Economy

### Interest rates

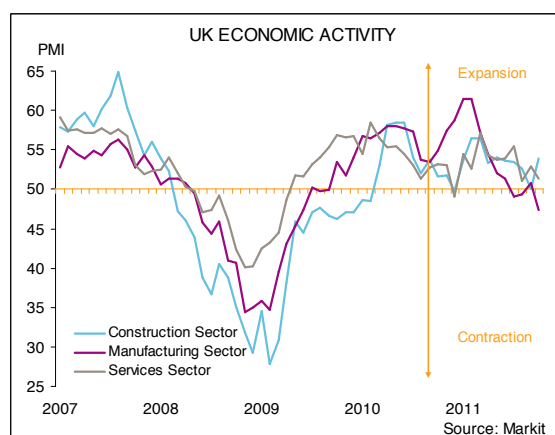
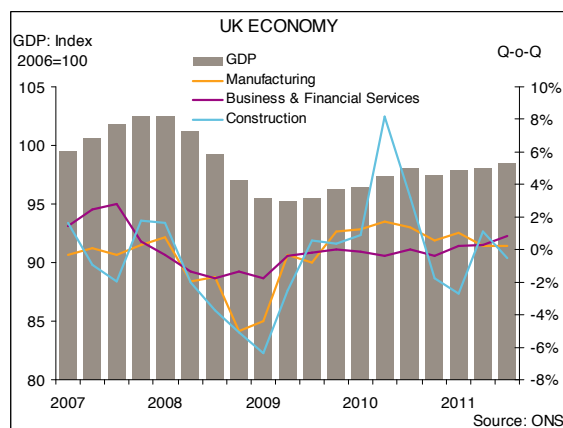
Against the backdrop of an ever increasing uncertain economic outlook, the Bank of England kept interest rates on hold at 0.5% during its November meeting. It also decided to leave its programme of bond purchases unchanged at £275bn, although the panel said that the ‘scale of the programme will be kept under review’ – suggesting the possibility of another round of stimulus if the situation deteriorates further.

### UK growth

Preliminary estimates show stronger than expected UK GDP growth in Q3 2011, with quarter-on-quarter growth quickening to 0.5% from 0.1% in the preceding three months. This was largely driven by the services sector, which picked up following a slump over the spring when the extra royal wedding bank holiday held back growth. Services output increased by 0.7% quarter-on-quarter, compared to 0.2% growth in Q2 2011. In the business services and finance sub-sector, the growth rate quickened from 0.3% in Q2 2011 to 0.8% in Q3 2011. Meanwhile the manufacturing and distribution sectors maintained their rates of expansion at 0.2% and 0.4%, respectively in the three months to September. Construction activity contracted 0.5%, after posting growth of 1.1% in the preceding quarter.

### Sector activity

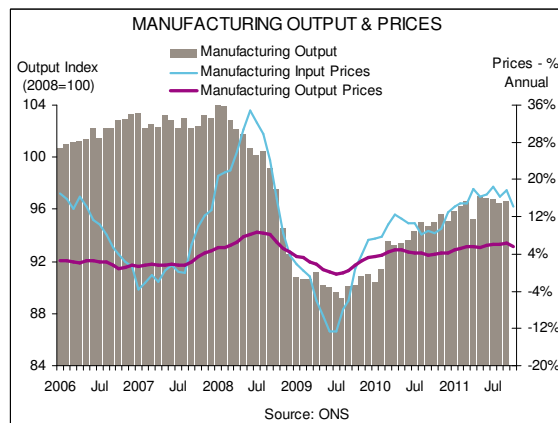
In October the manufacturing PMI posted a reading of 47.4, down from a revised figure of 50.8 in September. This suggests that sector activity fell back into negative territory (the PMI has been below the 50-point mark in three of the past four months). There was a substantial reduction in new order inflows, underpinned by low client confidence, market uncertainty and destocking. On a brighter



note, inflationary pressure was reported to have eased, as input costs and output prices rose at a slower pace. Meanwhile, services sector activity continued to increase for the tenth consecutive month in October, as the PMI remained above the no-change mark of 50. However, the figure fell back to 51.3 from 52.9 in September, suggesting modest growth. Despite a reduction in average output prices, incoming new business rose at a slower pace. Finally, companies continued to adopt a cautious attitude with regards to employment as staffing levels fell marginally.

### Manufacturing output

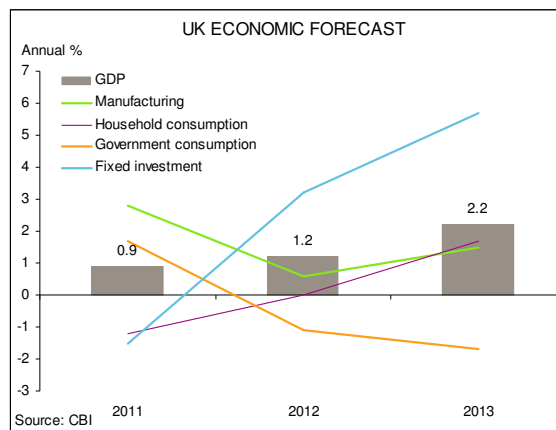
Manufacturing output in September was relatively static compared to August, up by just 0.2%, confirming recent survey evidence of a significantly slowdown in sector activity in recent months. Year-on-year, manufacturing output was up 2%. Manufacturers are being hit by lower domestic and export demand, while persistently elevated input costs are putting additional pressure on producers. In September, the output index for home sales of manufactured products was unchanged when compared with the previous month but was up 5.7% year-on-year. Meanwhile the total input price index rose by 14.1% - the lowest annual rate since December 2010.



### UK growth forecast

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

- The near term economic outlook has deteriorated markedly on the basis of heightened uncertainty around sovereign debt in the Euro Area and the slowdown in economic activity in some major trading partners. This has eroded business confidence and impacted on export prospects.
- UK GDP growth is forecast to be just 0.9% and 1.2% this year and next, respectively, before picking up to 2.2% in 2012.
- The inflation rate is thought to have peaked in the current quarter and is projected to fall back quite rapidly next year, as the upward pressure exerted by this year's VAT rise and commodity price increases drop out of the equation.
- The pressure on household budgets should ease gradually through next year, as the moderation in inflation allows real disposable incomes to recover modestly, at least in the latter half of the year.
- Economic surveys point to investment intentions being pared back, with uncertainty over future demand the main constraint on spending. This is not surprising considering business confidence has been hit by the ongoing turmoil in the Euro Area and resulting weakness in domestic economic prospects.



### Housing market activity

The October RICS Housing Market survey shows that UK housing market saw a modest increase in activity last month, as sales levels rose, and demand edged up. However, house price dynamics remain negative, with 24% more surveyors reporting house price falls than rises over the previous three months – giving a negative net price balance. More than half of all respondents reported seeing prices holding broadly steady, but of those that were seeing declines, almost three-quarters suggested it was in the range of 0-2%. However the price rises are entirely driven by the London market, with the region being the only one recording increases. Although Northern Ireland's price balance remains negative, it showed a marked

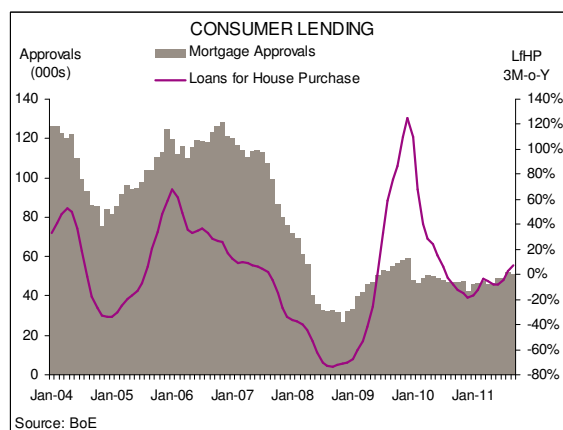
improvement, while the balance for Scotland lost all of its previous month's gains as it saw a sharp fall in October.

### House prices

According to Nationwide, house prices edged up by 0.4% month-on-month to £165,650 in October, lifting the annual house price growth into positive territory for the first time since April. When compared with October 2010, the price of a typical home was recorded to be 0.8% higher. Although the outturn was seen to be encouraging, concerns remain over the challenging economic backdrop and subdued transaction levels. Over the next year, the expectation is that prices will either remain flat or drift modestly lower.

### Consumer lending

According to the Bank of England, mortgage approvals for house purchases fell by 2.6% to just under 51,000 in September – the first monthly decline in five months. Since the start of the housing crisis in late 2007, mortgage approvals have been very low compared to historic norms (the number of mortgage approvals per month averaged more than 100,000 between 1997 and 2007). Unsecured consumer lending rose by just £150m in September, as consumers continue to reduce their debt levels in the face of an uncertain economic outlook.



### Retail sales

According to the British Retail Consortium, like-for-like retail sales values were down 0.6% in October, when compared with the same month in 2010. Although the value of total sales was up 1.5%, this still points to falling sales in real terms as inflation stood at 5.2% in September. The three-month weighted average shows that food sales rose by 1.8% on a like-for-like basis between August and October compared to the same period in 2010, but non-food sales fell 1.8%. Warm weather at the beginning of October appears to have helped to boost food sales to the detriment of clothing and other non-food sectors.

### Commodities

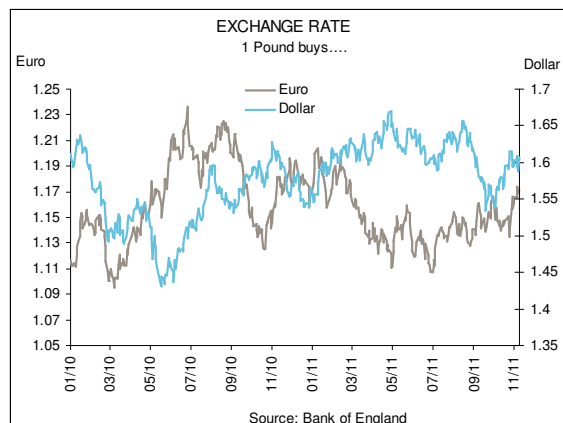
The situation in the Eurozone got significantly worse last week as Italy's 10-year bond yields reached 7.45% - above the levels where Greece, Ireland, and Portugal sought out bailout packages. Thus not surprisingly commodities prices fell, with the exception of oil – where prices were up 2% on the preceding week – due to stronger than expected US labour market data. In contrast, copper prices saw the steepest decline week-on-week, down 6%, while steel, nickel and aluminium prices fell 3%, 2% and 1%, respectively.

COMMODITY PRICES (11 NOVEMBER 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/barrel)	114.2	2%	4%	30%
Copper (\$/tonne)	7,451	-6%	3%	-17%
Aluminium (\$/tonne)	2,116	-1%	-3%	-14%
Nickel (\$/tonne)	18,150	-2%	-4%	-25%
Global Steel Price (Index 04/1994=100)	190.8	-3%	-6%	10%

Source: FT, LME, Cruspi

### Exchange rates

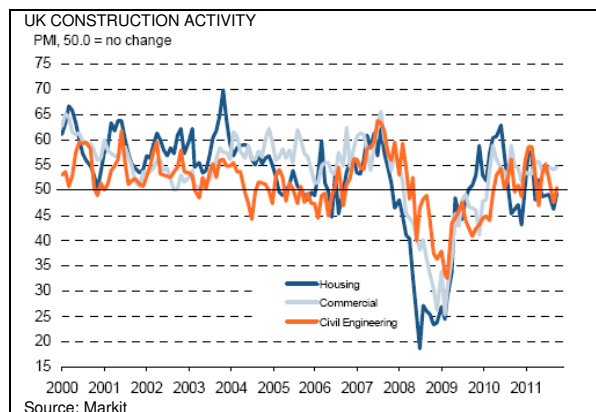
Over the week to Friday, the Pound rose 0.5% against the Euro to €/£1.171 and was up 0.3% against the Dollar to £/\$1.608.



## Construction

### Construction activity

According to the latest Markit construction PMI, sector activity accelerated in October as the index climbed to 53.9 – a five-month high. This was an improvement from September's reading of 50.1, which pointed to near-stagnation. This was supported by renewed growth of new business, consequently leading firms to recruit staff and raise their buying activities. On a sector level, the commercial and civil engineering sectors saw expansion in activity in October, while housing remained in negative territory (although the rate of decline did show signs of easing). On a less positive note, input cost pressures intensified.



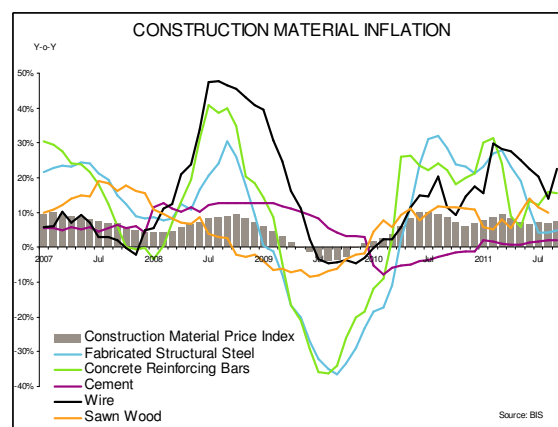
### Commercial development activity

According to Savills October 2011 Commercial Development Activity report:

- Commercial development activity declined for the fourth successive month in October, and the latest decline was reported to be the worst since February 2009. Work on public projects fell at the steepest rate since December of last year, while the contraction in private activity also accelerated. Overall, around 34% of commercial developers reported a fall in activity, compared to 17% indicating a rise.
- Commercial developers were quite pessimistic about prospects regarding the next three months. Depressed client confidence and difficulties in accessing finance were cited as the main reasons for a difficult final quarter, with approximately 28% of respondents expecting activity to decrease, compared to 14% forecasting a rise.

### Building material prices

After marginal deflation in August, building material prices rose by 0.6% in September month-on-month. When compared with September 2010, prices were up 7.5%. Fabricated structural steel prices fell 0.7% on August but were up 4.8% year-on-year. Although wire prices were also down on a monthly basis (-0.5%) in September, they increased by 22.4% when compared to a year ago. For cement, prices were up marginally (0.1) when compared with August and rose by 2.1% year-on-year – the biggest increase since the beginning of the year.



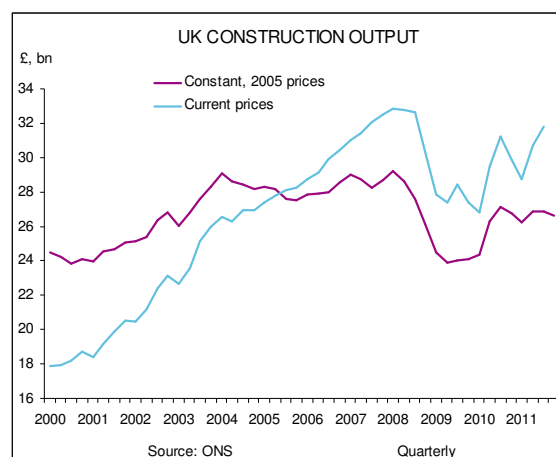
### Construction output

After a bounce back in the second quarter of 2011, construction activity returned to negative territory in the three months to September. Total output declined by 0.2% (in real terms) quarter-on-quarter to £31.8bn (current prices). When compared with the third quarter of 2010, output was down 1%. On a quarterly basis, new work was entirely responsible for the overall fall, declining 0.6%, while the repair and maintenance sector grew by 0.7%. In new work, the public housing sector saw the largest fall of 8.2%, not a surprising result considering the significant cut in funding for social housing. Staying with the public sector, non-residential construction rose 0.5% after three consecutive quarterly declines. Since there is little else in the pipeline, the suggestion is that legacy Building Schools for the Future projects, possibly supported by some Olympics work, pushed output back into positive

	CONSTRUCTION OUTPUT - Q3 2011	
	Value £ million, current	Volume, sa %, Q-o-Q
Public Housing	1,192	-8.2%
Private Housing	4,206	-2.5%
Infrastructure	4,067	-0.3%
Public non-residential	3,548	0.5%
Industrial	806	-8.4%
Commercial	6,560	2.4%
Total new work	20,378	-0.6%
Total R&M	11,425	0.7%
Total Construction	31,803	-0.2%

Source: ONS

territory. Quarter-on-quarter, infrastructure construction output slipped by 0.3% to £4.1bn after two strong quarters. However when compared with the same period of 2010 the figure was up 13.4%. Private housing output continued to fluctuate. In the first quarter it declined by 6.3%, before growing by 8.6% in the second quarter and declining by 2.5% in the third quarter. Rising unemployment, inflation outpacing wage growth, falling house prices across all regions with the exception of London and difficulty in accessing mortgage finance continue to weigh on house buyer confidence. Meanwhile, the industrial sector was the worst performing, with a quarter-on-quarter decline of 8.4% to £806m and a year-on-year fall of 26.5%. In contrast, the commercial construction sector continued on an upward path with output growth output of 2.4% in the three months to September, albeit the pace of increase decelerated from 5.8% in the second quarter.



### Construction forecasts

The CPA's autumn 2011 construction forecasts show that total output will fall by 1.1% in 2011 and a further 3.6% during 2012, as a subdued private sector fails to provide the growth necessary to offset sharp falls in the public sector. In 2013, construction activity is predicted to remain stagnant and therefore the recovery will be delayed until the following year, with infrastructure and commercial activity driving growth. With government capital funding constrained and PFI not considered value for money by the government, social housing, education and health construction are expected to suffer considerable falls in output. Capital expenditure for the Department for Communities and Local Government (DCLG) is set to fall from £6.4 billion in 2010/11 to only £1.8 billion in 2013/14 and, as a consequence, public housing starts are projected to fall from 30,100 in 2010 to only 19,100 in 2013. Likewise, education and health construction are set to fall 41% and 45%, respectively by 2014 with funding constraints and a refocus towards maintenance on the agenda. According to the CPA, there are still opportunities for the industry in sectors such as rail and energy infrastructure. The rail sector has doubled in the past five years and is expected to grow by another 77% over the next three years. Furthermore, the first new nuclear power stations to be built since 1995, in addition to work on renewables, is predicted to lead to energy-related construction rising by 191% in the next four years. Between 2010 and 2015, construction output is expected to rise 3.5% overall. Within this, public sector construction is set to fall from £39bn in 2010 to only £30bn by 2013, whereas private sector construction is set to rise from £65bn in 2010 to £77bn in 2015.

CPA CONSTRUCTION FORECASTS - AUTUMN 2011						
£m, constant 2005 prices	2010	2011e	2012f	2013f	2014f	2015f
<i>Annual % change</i>						
Public housing	4,350	4,437	3,549	3,336	3,270	3,368
	54%	2%	-20%	-6%	-2%	3%
Private housing	12,778	13,289	13,688	14,509	15,525	16,767
	17%	4%	3%	6%	7%	8%
Infrastructure	12,032	12,597	12,736	12,889	13,914	14,816
	26%	5%	1%	1%	8%	6%
Public non-residential	13,331	12,214	10,067	8,126	7,381	7,377
	31%	-8%	-18%	-19%	-9%	0%
Industrial	3,848	3,713	3,887	4,093	4,262	4,386
	20%	-3%	5%	5%	4%	3%
Commercial	23,401	22,664	21,811	22,278	23,291	24,236
	-2%	-3%	-4%	2%	5%	4%
Total New Work	69,739	68,914	65,738	65,232	67,642	70,949
	15.3%	-1.2%	-4.6%	-0.8%	3.7%	4.9%
Total RM&I	34,729	34,378	33,880	34,351	35,647	37,147
	-3.8%	-1.0%	-1.4%	1.4%	3.8%	4.2%
Total Work	104,468	103,292	99,618	99,583	103,290	108,096
	8.2%	-1.1%	-3.6%	0.0%	3.7%	4.7%

Source: ONS, CPA

## Market Watch

European markets ended a turbulent week with a strong rally as hopes that the euro zone crisis could be contained encouraged investors to pick up riskier assets once more.

New governments forming in both Italy and Greece gave markets the impetus to bounce back, leading the former country's 10-year bond yields to fall back below the 7% mark – the point at which borrowing costs are seen as unsustainably high.

In the week to Friday, the FTSE 100 rose 0.3% to 5545.4 points, while the real estate index was up by a larger magnitude of 1% to 365.8 points. In real estate, Capital and Counties and Segro saw the largest rises – of 3.5% and 2.6%, respectively. In contrast, Quintain Estates and Development, St Mowden Properties and Unite Group saw falls of 3.2% each over the week.

With the exception of Kier Group (where shares rose by a marginal 0.1%), all of the building contractors suffered declines over the same period. In building materials, share prices for Kingspan, SIG and Marshalls fell by 6.9%, 3.7% and 1.4%, respectively, leaving Wolseley as the only one to see a rise – albeit of just 1.7%.

McDonald's – the fast-food chain – is looking to capitalise on the depressed commercial property market by buying more land and property in areas which it operates. On Thursday, the company revealed that it was ramping up its capital expenditures to \$2.9bn next year, with plans to open 1,300 restaurants and remodel 2,400.

Great Portland Estates announced their trading results for the six months ended 30 September 2011. They showed that pre-tax profit excluding changes in asset values declined by 30.4% to £10.4m, or 3.4p a share. Net assets of £1,167.9m are up 5% from March 2011, and are 378p per share. The company currently has three schemes on site (305,500ft<sup>2</sup>), where 34.9% of floorspace is pre-let. The expectation is that the first of the projects will be completed in the autumn of 2012.

Land Securities also presented their half-year results for the six months ended 30 September 2011. They revealed that profit before tax fell almost 17% to £378.9m compared with six months earlier, although trading profits were up 17.2% to £159.3m. The company is building an office tower known as the Walkie-Talkie in the City of London financial district as part of a joint venture. JPMorgan Cazenove estimated that the value of the site fell 6% in the first half – the only one of Land Securities' development sites to decline.

EQUITIES						Friday 11th November 2011		
Index	Index	Week	Month	Year				
FTSE100	5,545.4	▲ 0.3%	2.8%	-4.6%				
EPRA/NAREIT UK	365.8	▲ 1.0%	0.8%	-3.1%				
Stocks		Market Cap, £m	Share Prices					
			Week	Month	Year			
Real Estate								
British Land	4,540	▲ 0.9%	1.2%	0.6%				
Hammerson	2,840	▼ -1.7%	0.2%	-4.9%				
Land Securities	5,230	▲ 0.5%	2.2%	0.1%				
Capital & Counties	1,220	▲ 3.5%	3.8%	18.2%				
Capital Shopping Centres	2,730	▼ -0.1%	-6.5%	-17.6%				
Shaftesbury	1,270	▲ 1.7%	3.0%	16.8%				
Great Portland Est.	1,140	▼ -0.7%	3.6%	7.2%				
Derwent London	1,700	▼ -0.3%	7.2%	13.7%				
Segro	1,760	▲ 2.6%	2.6%	-20.3%				
Quintain Estates & Development	197	▼ -3.2%	-4.4%	-1.3%				
St. Modwen Properties	244	▼ -3.2%	2.9%	-21.2%				
Unite Group	296	▼ -3.2%	-1.1%	-16.9%				
Workspace Group	350	▼ -1.7%	7.5%	5.2%				
<b>Average*</b>		▲ 0.4%	1.3%	-1.2%				
Building Contractors								
Balfour Beatty	1,630	▼ -3.5%	-11.7%	-16.8%				
Carillion	1,390	▼ -2.8%	-8.6%	-7.2%				
Morgan Sindall	244	▼ -2.0%	4.3%	-16.1%				
Kier Group	540	▲ 0.1%	4.9%	10.0%				
Lend Lease Corp*	2,717	▼ -2.6%	-2.8%	4.6%				
<b>Average</b>		▼ -2.6%	-5.3%	-3.6%				
Building material suppliers								
Wolseley	5,370	▲ 1.7%	9.4%	7.9%				
SIG	546	▼ -3.7%	-4.1%	-21.7%				
Marshalls	175	▼ -1.4%	-3.0%	-17.4%				
Kingspan	855	▼ -6.9%	-3.1%	-1.5%				
<b>Average</b>		▲ 0.2%	6.5%	3.8%				
Housebuilders								
Persimmon	1,470	▼ -3.2%	0.3%	35.1%				
Taylor Wimpey	1,200	▲ 0.1%	1.9%	42.6%				
Barratt	879	▲ 1.9%	2.3%	12.0%				
Bovis Homes	601	▼ -5.7%	1.1%	31.8%				
Bellway	859	▼ -0.6%	3.8%	29.5%				
Berkeley	1,630	▼ -0.5%	3.7%	48.7%				
<b>Average</b>		▼ -1.2%	2.2%	35.7%				

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