theconstructionindex

Davis Langdon

# Weekly Economic Update

**30th May 2010**



## Summary


UK 1st quarter GDP growth was marginally revised up due to stronger business investment and manufacturing activity. However, retail sales growth dropped significantly in May, according to the latest industry survey. Meanwhile, Chancellor George Osborne set out a first round of fiscal cuts, detailing £6 billion of additional savings that the Government plans to make this financial year. More spending cuts and tax rises are likely to be announced in the emergency Budget on June 22. This has probably contributed to a fall in consumer confidence in May.


### Spending cuts

The new UK government outlined how it planned to cut spending by £6 billion in 2010/11. The measures will affect all levels of government and include a hiring freeze in the civil services and a cut in the number of government programmes. More specifically:

- The Department of Business, Innovation and Skills had its operating budget cut by £836m (1.1% of departmental budget);
- Cut of £780m from Communities and Local Government (3.8% of departmental budget);
- Cut of £683m from the Department of Transport (7.2% of departmental budget);
- Cut of £670m from the Department of Education (3.2% of departmental budget);

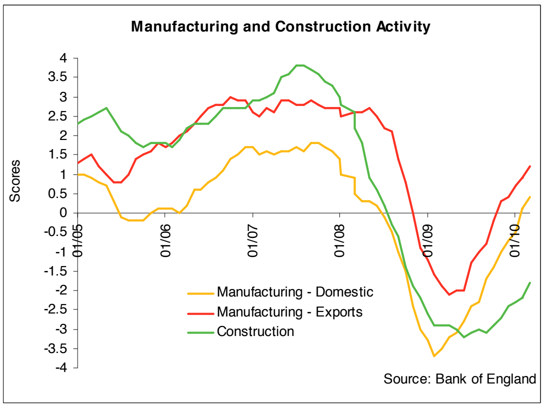
In addition, regional spending will be reduced, with Scotland, Wales and Northern Ireland asked to save some £704m. Local authorities are expected to save £1.165bn. Further public spending cuts will be announced on 22 June in the emergency Budget. A comprehensive three-year spending review is due to be published later in the year.

## Statistics

### Economy

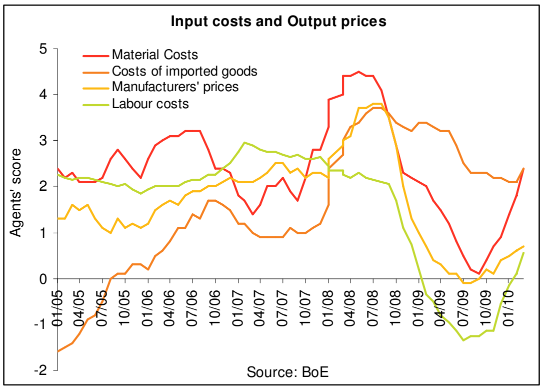
**Business conditions**

The Bank of England's survey of Business Conditions in April reveals that:



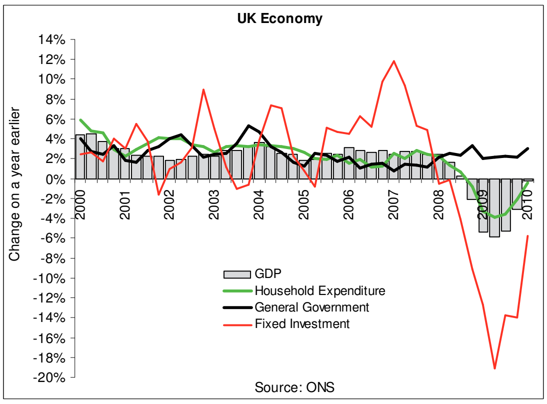

- Consumer spending growth appears to have stabilised, but retailers are concerned about the outlook for households' disposable incomes, given cost pressures and the possibility of tax increases.
- Housing market activity is stable, with house prices little changed in recent months.
- Investment intentions have stabilised and some businesses are planning to invest more in the year ahead.
  However, few companies plan to invest in additional capacity.
- Business services and manufacturing output continue to recover gradually.
- Construction activity also seems to be stabilising, after contracting for much of the past two years. New homebuilding is picking up, as well as repair and maintenance activity. However there are still weaknesses in commercial construction. Looking ahead, concerns surround the impact of the forthcoming fiscal consolidation on public projects.
- Credit conditions remain tight, but there are small improvements in credit availability.

- Materials costs continue to rise. Higher steel, plastic, timber and fuel prices are putting upward pressure on costs. The pickup in prices over the past six months is primarily due to a rise in demand from emerging economies, but some prices are also being pushed up following a reduction in global capacity during the recession. In addition, a number of firms are either already faced or are expecting to face significant increases in business rates, which would further increase their overall costs. Import prices have also risen, reflecting continued pass-through of sterling's depreciation. Retail price inflation remains elevated.




### UK growth

The UK economy grew marginally faster than originally thought in the first quarter of this year, racking up 0.3% growth, compared to the first estimate of 0.2%. The underlying figures reveal a more subdued picture. Much of the growth has come from re-stocking inventories and increased Government spending, and this boost is very likely to prove temporary. Consumer spending was flat in the first quarter and down 0.5% year-on-year. Fixed investment grew 1.5% quarter-on-quarter, but remained 5.7% down on a year ago.

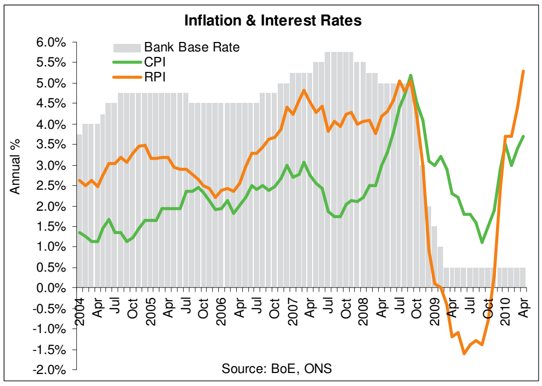



### Business investment

Business investment recorded the first quarterly rise in nearly two years, with spending up 6% quarter on quarter in the first three months of 2010. Investments remained down 11% compared to a year ago. The services sector invested 8% more in the first quarter and construction spending also improved. In contrast, manufacturing investment fell a further 0.9% in the first quarter and was nearly 30% down year-on-year.

### Inflation

Consumer price inflation jumped to 3.7% in April, up from 3.4% in March. The upward pressure came from energy costs and clothing. Retail price inflation surged to 5.3%, the highest level since July 1991. In his letter to Chancellor Osborne, Bank of England governor King explained why inflation has deviated from its 2% target by more than a percentage point and how it will be brought back down. King argued that the rise in inflation was due to the weakness of the Pound, the restoration of VAT to 17.5% and higher oil prices – all of which seen as temporary factors.




### Bank of England MPC minutes

The minutes of the Monetary Policy Committee's May meeting highlight the dilemma facing the Bank of England. After another "surprise" hike in consumer price inflation, some members of the MPC appear to doubt that the spare capacity in the economy would result in lower inflation near term. However, others argue that the downside risk to growth and inflation from recent developments in the eurozone is the more important factor.

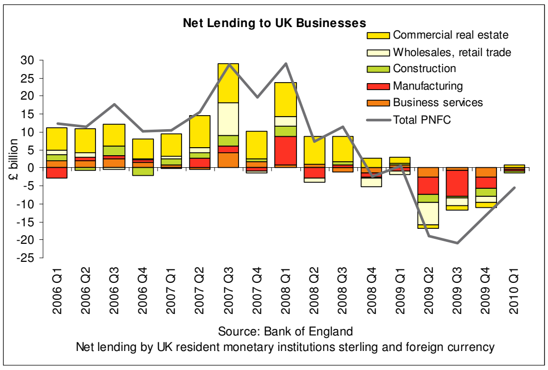
### Retail sales

According to official data, the volume of retail sales (excluding petrol) rose by 0.2% in April compared to March and up 3.1% year-on-year. However, more up-to-date survey findings point to a marked – and unexpected - slowdown in sales growth in May. The CBI Distributive Trades

Survey shows that a majority of retailers reported sales volumes in May lower than a year ago, compared with a majority reporting higher sales in April.

**Trends in Lending**

The latest Bank of England lending survey shows that:




- Net lending to UK businesses fell in March overall, though some sectors fared better than others. Conditions in the real estate sector remain fragile. Investor demand, and recent increases in property valuations, are said to be largely limited to prime properties. The major UK lenders point to the large amount of refinancing required in the next couple of years, although some lenders reiterate that as long as cash flows were secure, they would expect to refinance their loans, even if some loan covenants are being breached.
- Loan spreads for large businesses continue to narrow, mainly due to competitive pressures. Loan availability also increased moderately, but this varies depending on the size of business, sector and lenders' perceptions of risk. Demand for new corporate borrowing remained weak.
- Net mortgage lending slowed slightly in March. Total net consumer credit also eased in March. Effective interest rates on consumer credit fell slightly in March, though spreads over Bank Rate and Libor remain significantly wider than in late 2008.

**Exchange rates**

Concern about the health of the eurozone continues to weigh on the Euro. Reports suggesting that China was reviewing its policy of diversifying its Dollar holdings to the Euro last week added to pressure on the single currency. However, later in the week the Euro recovered some ground after China issued a statement denying the report. Overall, the Pound gained 2% against the Euro last week, rising to £/€1.1763. Against the Dollar the Sterling held stable at £/$1.4457.

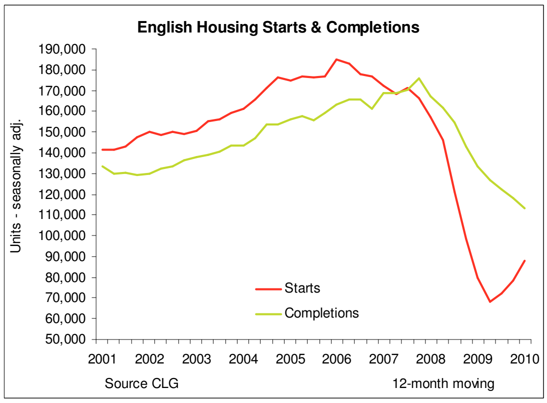
**Commodities**

Commodities bounced back last week, after heavy losses earlier in May. Oil prices rose 3% to $74.4 per barrel of Brent crude. Copper prices rose 4% to $6,926/ tonne, while aluminium and nickel increased 2% in the week to Friday. The global steel price index held stable last week.

| Commodity Prices (28th May 2010) | | | | |
|---|---|---|---|---|
| | Price | Weekly change | Monthly change | Annual change |
| "Brent" Oil ($/ barrel) | 74.4 | 3% | -13% | 16% |
| Copper ($/tonne) | 6,926 | 4% | -7% | 49% |
| Aluminium ($/tonne) | 2,037 | 2% | -4% | 49% |
| Nickel ($/tonne) | 21,555 | 2% | -15% | 62% |
| Global Steel Price (Index 04/1994=100) | 204.8 | 0% | 5% | 58% |
| Source: FT, LME, Cruspi | | | | |

## Construction

**House building**




English housing starts, at 24,930 dwellings, jumped by 60% in the 1st quarter of 2010 compared to a year earlier and up 13% on the final quarter of 2009. However, starts remain sharply down on pre-crisis levels. The 12-month moving average in the 1st quarter is still 53% lower compared to levels seen in 2006. Completions in the 1st quarter, at 26,090 units, were 16% lower year-on-year and down 6% on the 4th quarter 2009.

**Construction activity**

The latest RICS UK construction market survey shows that a small majority of those surveyed saw an increase in workload in the 1st quarter of 2010 compared to a year earlier. This is the first increase in two years. The fortunes among sectors remain mixed. Private commercial, housing and public housing workloads rose during the first quarter. In contrast, the survey shows that activity remains weak in the industrial and – perhaps surprisingly – in the infrastructure sector. Lack of finance for development appears to be a major constraint on current industry activity. Looking ahead, survey respondents are cautious on the industry's prospects, with the now widely cited public spending cuts the main factor.

## Looking ahead

The purchasing managers' surveys for the services, manufacturing and construction sectors are likely to show that the UK economy continued to recover moderately in May. The latest consumer lending and mortgage data for April from the Bank of England are likely to confirm the softening trend in housing market activity in recent months. On the back of somewhat weaker housing market activity, the Nationwide is expected to report that house prices in May rose more slowly than in April.

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UPDATE

# Market Watch

Global financial markets began the last week in a jittery mood, as investors remained nervous about the strains within the Eurozone. The Bank of Spain was forced to take over CajaSur, a small savings bank in Cordoba. Markets believe that many Spanish savings banks are struggling with high levels of bad loans due to the housing market crash and a deep recession. Fitch downgraded Spain's debt, which sent markets sharply lower. However in the true roller coaster fashion seen in much of May, markets recovered later in the week, in parts due to statements from China's foreign exchange regulator, which indicated continued demand for Euro assets.

The FTSE 100 ended the week up 2.5% at 5,188 points.

Property groups performed in line with the wider index, with all but Capital & Counties posting gains last week. Top performer was Quintain Estates and Developments, up 16.1%. Minerva rose 6.6% and St. Modwen was up 5.8%.

Shaftesbury reported its results for the six months ended 31 March 2010. Profits rose to £122.8m from a H1 loss of £159.8m in 2009. The increase in profits was mainly due to a rise in the portfolio value, but rental income also rose. Net asset value per share rose from 335p in September 2009 to 383p. According to a press statement, Shaftesbury is looking to continue to secure new investments and initiate a number of new schemes.

Building contractors also gained, above all Lend Lease, which jumped 8.2% in the week to Friday.

Building material suppliers rose firmly last week, boosted by BSS, which jumped by over two fifths. BSS' share price has been pushed up by the announcement that Travis Perkins was in talks over a cash and share offer for the Group. The indicative offer by Travis Perkins for BSS is 433p per BSS share, which values the entire issued and to be issued share capital of BSS at approximately £553m The move would consolidate the merchants' sector in the UK plumbing supplies market, where both firms have substantial market shares.

| **Share Prices** | | **Friday 28th May 2010** | | |
|---|---|---|---|---|
| | **Index** | **Week** | **Month** | **Year** |
| **FTSE100** | 5,188 | 2.5% | -7.1% | 18.3% |
| | **Market Cap, £m** | **Week** | **Month** | **Year** |
| **Real Estate** | | | | |
| British Land | 3,930 | 2.8% | -3.3% | 18.0% |
| Hammerson | 2,550 | 2.2% | -4.8% | 25.5% |
| Land Securities | 4,580 | 0.8% | -6.5% | 23.4% |
| Capital & Counties | 646.7 | -3.3% | - | - |
| Capital Shopping Centres | 2,040.0 | 5.3% | - | - |
| Shaftesbury | 848.9 | 0.6% | -3.2% | 24.3% |
| Great Portland Est. | 962.1 | 3.6% | -0.7% | 33.8% |
| Derwent London | 1,350 | 0.7% | -6.6% | 57.2% |
| Segro | 2,120 | 3.7% | -6.9% | 12.0% |
| Quintain Estates & Development | 244.6 | 16.1% | -14.9% | 91.7% |
| St. Modwen Properties | 348.4 | 5.8% | -0.1% | -2.2% |
| Unite Group | 307.7 | 2.2% | -13.6% | 59.0% |
| Workspace Group | 232.8 | 3.9% | -12.0% | 39.7% |
| Minerva | 181.7 | 6.6% | -3.2% | 664.4% |
| ***Average*** ** | | ***2.5%*** | ***-4.6%*** | ***27.9%*** |
| **Building Contractors** | | | | |
| Balfour Beatty | 1,740 | 1.9% | -7.7% | -15.0% |
| Carillion | 1,260 | 1.5% | -7.5% | 20.9% |
| Morgan Sindall | 235.3 | 2.8% | -4.7% | -16.4% |
| Kier Group | 396.1 | 0.0% | -7.2% | 3.1% |
| Lend Lease Corp* | 2,439 | 8.2% | -9.2% | 16.1% |
| ***Average*** | | ***4.3%*** | ***-8.1%*** | ***6.1%*** |
| **Building material suppliers** | | | | |
| Wolseley | 4,680 | 6.0% | 3.4% | 64.2% |
| SIG | 700.7 | 9.2% | -5.9% | -2.6% |
| Marshalls | 190.1 | 2.9% | -6.1% | -2.2% |
| Kingspan | 1,009 | 4.4% | 4.1% | 53.4% |
| BSS | 543.4 | 42.4% | 42.8% | 60.1% |
| ***Average*** | | ***8.8%*** | ***5.3%*** | ***54.0%*** |
| **Housebuilders** | | | | |
| Persimmon | 1,230 | -1.5% | -15.4% | 18.1% |
| Taylor Wimpey | 1,090 | 4.6% | -17.4% | 17.0% |
| Barratt | 1,040 | 0.7% | -14.7% | 1.4% |
| Bovis Homes | 513.7 | 1.6% | -9.8% | -1.1% |
| Bellway | 836.7 | 0.8% | -9.1% | 8.9% |
| Berkeley | 1,080 | 1.9% | -4.6% | -8.8% |
| ***Average*** | | ***1.3%*** | ***-12.2%*** | ***6.8%*** |

*Lend Lease Corporation Limited is listed on the Australian and NZ stock exchange
**Sector averages are weighted according to current market capitalisations