theconstructionindex

Davis Langdon

Weekly Economic Update

Summary

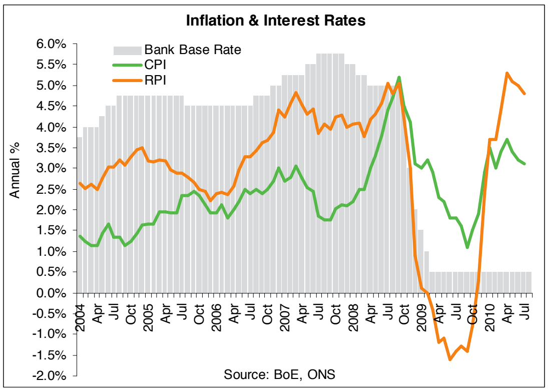
Official data show that the UK growth momentum built up during the second quarter of 2010 is being carried into the third quarter - at least on the consumer spending side. Despite concerns that fiscal consolidation will hit consumer confidence and limit household spending, retail sales in July were surprisingly strong. Manufacturing activity is holding up well and the UK's fiscal position is tentatively improving.

Survey evidence paints a more mixed picture of economic activity. In particular, the recent strong official data for construction growth are being contradicted by weak industry surveys.

Economy

Inflation

Consumer price inflation in July eased back to 3.1% from 3.2% in June, but since it remained above 3% it triggered another explanatory letter from Mervyn King to the Chancellor. He said that the MPC had been surprised by the strength of inflation and that there was a strong probability that CPI inflation will remain above 3% near term. However, he maintained his position that the strength of inflation was due to temporary effects, due to the impact of oil prices, VAT changes and the weaker Pound. RPI inflation eased to 4.8% from 5% in June.



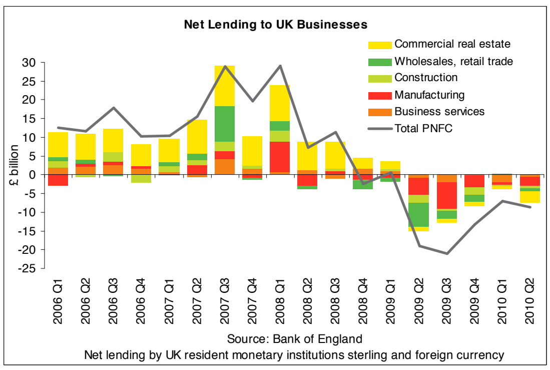
Bank of England minutes

August's MPC meeting minutes reveal that the committee voted 8-1 to keep interest rates and the APF on hold, indicating that the Bank of England remains in "wait and see mode". Andrew Sentance voted to raise interest rates for a third consecutive month, but was again in a minority.

Trends in Lending

The latest Bank of England lending survey shows that:

- Net lending to UK businesses remained negative in June. In Q2 2010, lending fell across all main sectors for the 5th consecutive quarter.
- Lending to real estate companies made the largest negative contribution to lending flows in Q2 2010, but since the start of 2008 the stock of real estate lending has contracted more slowly than for other sectors. Major UK lenders report that this relative resilience in parts reflects that real estate companies typically rely on loans of a longer maturity than other sectors. In addition, real estate



companies are said to be less able to reduce their working capital, i.e. though inventory management, to generate cash and pay down debt.

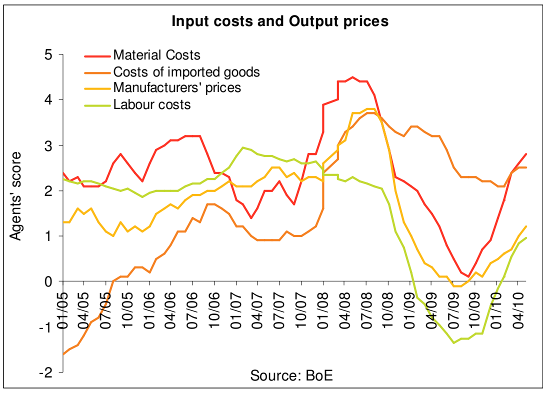
- Credit conditions for smaller businesses remain tighter than for larger corporates. Demand for bank finance remains weak, as companies continue to pay down debt.
- Spreads on lending to larger corporates fell, but at a smaller rate. Spreads on lending to SME's were little changed in June and July.
- The flow of net mortgage lending was little changed in June. Gross lending for house purchase in July was similar to that in June, but approvals for house purchase edged down. The flow of net consumer credit decreased in June and most lenders report no significant changes in credit availability or demand in July.

Mortgage lending

Mortgage lending rose to £13.6bn in July, up 5% compared to June, according to the Council of Mortgage Lenders (CML). However, lending levels are still down 3% compared to a year ago and only at half the monthly averages seen between 2004 and end 2007. According to the CML, lending and transactions are likely to slow during the remainder of the year.

Business conditions

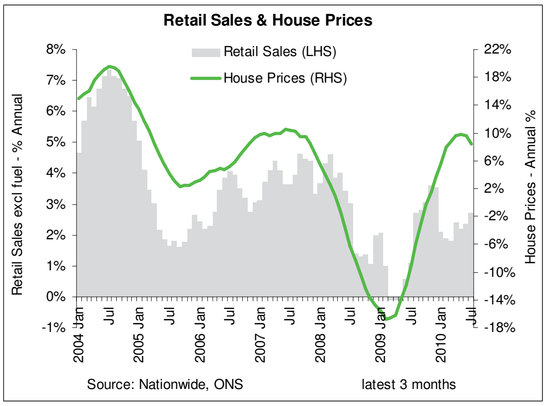
The Bank of England's survey of Business Conditions in July reveals that:



- Business confidence eased back in recent months, mainly attributed to the announcements made in the June Budget. However few contacts changed their plans for output, investment or employment as a result, reflecting uncertainty about the impact of fiscal consolidation, with businesses now waiting for the October Spending Review to provide greater detail about spending cuts.
- Consumer spending softened in July, reflecting weaker retail sales growth.
- Housing market activity eased, as demand is restrained by the availability of mortgage finance. With the supply of properties coming to market increasing since the suspension of Home Information Packs, market power is shifting towards buyers rather than sellers.
- The majority of investment plans remain focused on asset replacement and maintenance, with only a small number of exporters planning to increase investments.
- Manufacturing output growth remains firm, reflecting a pick up in export growth and, to a lesser extent, stronger domestic demand. Services turnover edged higher, although volume growth in the professional and financial sector was likely to be stronger than turnover growth, reflecting lower prices and fees than a year ago.
- Construction activity remained subdued in July. Repair and maintenance rose, but commercial construction activity remained weak. Some public sector projects were postponed or cancelled. The pace of new residential home building softened a little.
- Pay growth remains muted, albeit a little stronger than at the start of 2010. Materials cost inflation continued to rise further, but at a slower pace. Prices for metals (primarily steel), cotton, paper, cardboard, packaging and transport containers rose.
- Imported goods price inflation edged up, due to higher inflation and some emerging capacity constraints in the Far East. Consumer price inflation remained elevated in July.

Retail sales

Retail sales growth in July was stronger than expected. The volume of sales (excl. petrol) rose 0.9% on the month and up 2.5% year-on-year. So far, strong retail sales have defied concerns over falling consumer confidence in light of slow pay growth and public spending cuts, but most analysts still expect that consumer spending will be limited near term.

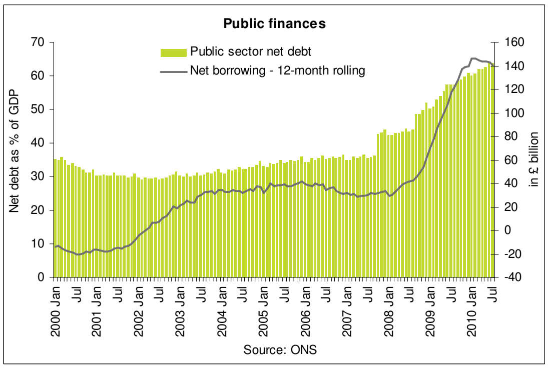


Manufacturing activity

The CBI's Industrial Trends Survey shows that the majority of manufacturers surveyed saw output rising in August, driven by both firm domestic and a strengthening in overseas demand. More than a fifth of manufacturers reported that total orders were above normal levels, though a majority of a third of those surveyed said they were below normal. Output expectations for the next three months are positive, with 30% of manufacturers predicting output will increase, while 20% anticipate a fall. Costs rose sharply in August and further increases are expected. Against this background, firms are predicting a faster rise in output prices over the next quarter.

Public finances

On the back of higher tax receipts and lower benefit spending, public sector net borrowing, at £3.8bn, was lower than expected in July. In the first four months of this financial year, borrowing stood at £42.6bn, slightly lower than the £46.4bn reached during the same period last year. Whilst the decrease in borrowing is certainly welcome, the improvement in public finances is still modest and the UK is forecast to have the highest deficit in the G20 countries this year. Net debt (excl. financial interventions) stood at £816.2bn in July or 56.1% of GDP (£927.4bn, or 63.7% incl. interventions)



Commodities

Commodity prices eased further last week, as weak US data dampened investor confidence. Oil prices slipped 1% to $74.3/ barrel of Brent crude. Copper held stable at $7,205/ ton, but aluminium fell 5% to 2,045/ ton. The global steel price index remained stable, with global steel prices relatively static since mid-July.

Commodity Prices (20th Aug 2010)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil ($/ barrel)	74.3	-1%	-2%	1%
Copper ($/tonne)	7,205	0%	15%	18%
Aluminium ($/tonne)	2,045	-5%	6%	7%
Nickel ($/tonne)	21,325	-1%	13%	11%
Global Steel Price (Index 04/1994=100)	175.1	0%	-2%	12%
Source: FT, LME, Cruspi				

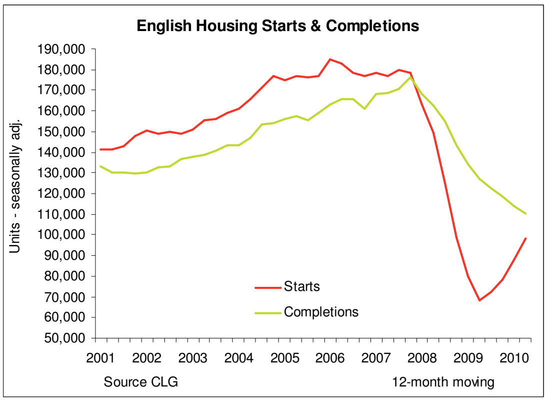
Exchange rates

Rising concerns about the pace of the global recovery triggered a rush into safe haven currencies like the Dollar and Yen last week. The Sterling fell 1% against the Dollar to £/$1.551, but held stable against the Euro at £/€ 1.223.

Construction

Housebuilding

The number of housing starts in England continued to rise in the second quarter of 2010. Private housing starts, at 22,480 dwellings, were up 10% on the preceding quarter and 58% higher compared to the same period a year ago. Public housing starts totalled 6,120 dwellings, up 24% both on the previous quarter and a year ago. Housing completions at 26,550 were 1% higher compared to the preceding three months, but remained 11% down on last year. Overall, housebuilding remains well below levels seen in recent years. On an annualised base, housing starts are still down by nearly half compared to their peak in Q1 2006.

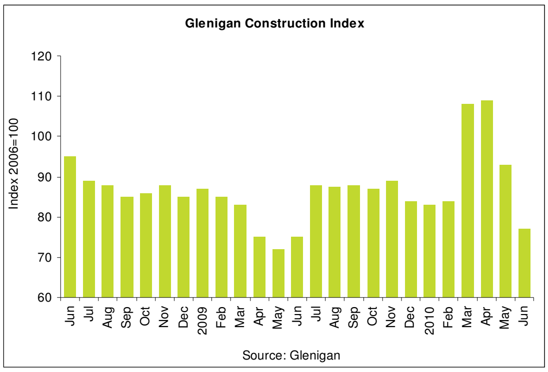


Housing starts

The NHBC housing market report reveals that private housing starts totalled 9,600 in July, up 4% on the month and 20% higher compared to a year earlier. In the year to end July there have been 102,300 homes started in the UK, compared to 82,250 in 2009. According to the NHBC, the growth in starts over the past 12 months has been driven by the larger builders, but growth has significantly slowed in recent months.

Construction activity

Glenigan also reports a slowing in housing activity in recent months. According to its *Residential Index*, the value of private housing construction projects starting on site fell in the three months to July after six months of growth. 1950 projects worth £1.4bn started on site between May and July, compared to 2450 projects worth £2.5bn in the previous three months. In particular, new social housing projects have fallen sharply, down 40% in the three months to July on a year ago. Social housing starts are likely to remain under pressure over the coming months, but a mild recovery in private housing starts is expected at the end of the year as housebuilders capitalise on gradually improving market conditions.



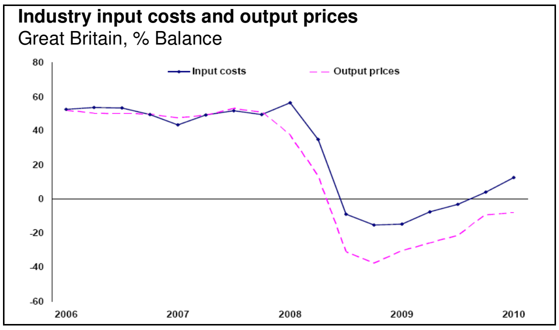
The Glenigan *Total construction index* recorded a 12% fall in the value of construction projects starting on site in the three months to July compared to a year ago. Economic and political uncertainties have disrupted the flow of projects in recent months.

The spending review in autumn will reveal where the government cuts will impact the construction industry most. Lower government investment is expected to weigh heavily on education, social housing, community and health projects over the next two years. The removal of government stimulus and deep public spending cuts is placing increased responsibility on the private sector to generate new construction work.

The value of non-residential construction project starts fell 14% in the three month to July compared to a year earlier, as the office and industrial sectors remain relatively weak and community & amenity, health and education have suffered from public funding cuts. More positively, a number of stalled offices and industrial schemes are once again being taken forward and an increase in project starts is expected by the end of the year. The flow of retail and hotel projects has also picked up in recent months.

Civil engineering construction remains firm, with the Glenigan *Civil Engineering Index* for July 19% up year-on-year. Whilst new utility projects, i.e. wind farms and power lines, have driven sector growth in much of 2010, recent growth was boosted by investment in new railway work.

Construction survey



In sharp contrast to official figures, the RICS construction survey for Q2 2010 shows a fall in activity. Workload fell in all sectors bar private commercial and private housing, where it remained relatively unchanged. The sharpest declines were seen in public housing and other public works. At the regional level, workload fell across the UK except in London/South East. Key issues facing the sector are the continued lack of development finance; public spending cuts, most notably the suspension of the Building Schools for the Future programme; insufficient clarity provided by the new government on existing projects creating uncertainty amongst developers; and an increase in competition, as larger firms are now bidding for smaller contracts. Looking to the year ahead, the industry turned more pessimistic with respect to output, employment and profit margins.

Looking ahead

This week's data are likely to show a further easing in UK housing market activity and consumer confidence. The second estimate of 2nd quarter GDP could show a slight upward revision, if construction activity was stronger than previously estimated.

WEEKLY ECONOMIC UPDATE

Market Watch

Downbeat economic news from the US cast a shadow over growth prospects and meant that equity markets ended the week in a subdued mood.

Stock Market			Friday 20th August 2010		
Index	**Index**		**Week**	**Month**	**Year**
FTSE100	5,195.30	▼	-1.5%	1.1%	9.2%
EPRA/NAREIT UK	343.2	▼	-0.1%	-0.2%	-5.7%
Stocks	**Market Cap, £m**		**Share Prices**		
			Week	**Month**	**Year**
Real Estate					
British Land	3,950	▼	-0.2%	1.3%	-4.3%
Hammerson	2,550	▼	-1.4%	-1.5%	-7.8%
Land Securities	4,610	▲	0.9%	4.0%	-1.1%
Capital & Counties	715	►	0.0%	1.2%	
Capital Shopping Centres	2,020	▼	-0.3%	-1.3%	
Shaftesbury	903	▼	-0.1%	3.4%	6.2%
Great Portland Est.	972	▲	0.9%	5.0%	16.8%
Derwent London	1,400	▲	1.8%	6.4%	20.5%
Segro	2,050	▲	1.0%	2.0%	-19.7%
Quintain Estates & Development	204	▼	-4.3%	-1.9%	-53.0%
St. Modwen Properties	324	▼	-3.7%	5.8%	-35.3%
Unite Group	286	▼	-0.5%	2.1%	-4.3%
Workspace Group	231	▼	-3.6%	0.0%	-9.1%
Minerva	151	▼	-4.6%	4.2%	368.8%
Average*		▲	0.1%	2.0%	-3.3%
Building Contractors					
Balfour Beatty	1,710	▼	-2.4%	0.5%	-16.1%
Carillion	1,190	▲	2.1%	-5.5%	1.2%
Morgan Sindall	237	▼	-0.8%	-1.2%	-14.7%
Kier Group	368	▼	-2.1%	-1.9%	0.7%
Lend Lease Corp*	2,143	▼	-2.0%	-6.0%	-20.2%
Average		▼	-1.2%	-3.5%	-12.8%
Building material suppliers					
Wolseley	3,640	▼	-3.7%	-3.7%	-10.3%
SIG	547	▼	-2.1%	-6.5%	-30.7%
Marshalls	175	▲	2.9%	2.3%	-20.5%
Kingspan	846	▼	-6.8%	-7.4%	-3.3%
BSS	438	▼	-2.0%	0.9%	50.4%
Average		▼	-3.7%	-4.0%	-6.9%
Housebuilders					
Persimmon	1,020	▼	-2.4%	-4.1%	-32.2%
Taylor Wimpey	857	▼	-4.1%	7.5%	-41.6%
Barratt	909	▼	-0.7%	0.4%	-40.4%
Bovis Homes	464	▲	0.1%	4.2%	-34.9%
Bellway	625	▼	-6.3%	-7.6%	-37.1%
Berkeley	1,060	▲	0.3%	-1.4%	-13.2%
Average		▼	-2.1%	-0.3%	-32.1%

**Sector averages are weighted according to current market capitalisations

In the UK, the FTSE 100 slipped 1.5% to end the week below the 5,200-mark. The real estate index held up better, remaining broadly static.

Sector performance was helped by a 0.9% rise in Land Securities. Derwent London (1.8%), Segro (1%) and Great Portland Estates (0.9%) also rose last week. Minerva saw the sharpest losses, down 4.6%, followed by Quintain Estates and Development, down 4.3% and St. Modwen, down 3.7%.

In wider industry news, healthcare investor Primary Health Properties posted an 8.6% increase in net asset value per share to 304.2p in the six months to 30 June. Its portfolio value rose £17.8m to £460.8m, representing an equivalent yield of 6% and an initial yield of 5.8%. Pre-tax profit stood at £16.7m, compared with a loss of £1.8m last year. PHP completed thirty three acquisitions in H1 2010.

Building contractors saw their share prices fall across the board last week with the exception of Carillion which rose 2.1%.

Building material suppliers also fell, with Kingspan shedding 6.8% and Wolseley down 3.7%.

Housebuilders also dropped on average last week, amid further evidence that activity in the UK housing market is easing. According to Jones Lang Lasalle (JLL), UK house prices could fall 3.9% from their current levels in the remainder of 2010, eroding some of the gains made throughout the year. The simultaneous impact of weakening buyer demand and the increased level of property available for sale is likely to place downward pressure on capital values. Looking ahead, JLL expects stagnant house prices for 2011 overall, but predicts significant house price growth by 2012.