Weekly Economic Update

24th January 2010

Summary

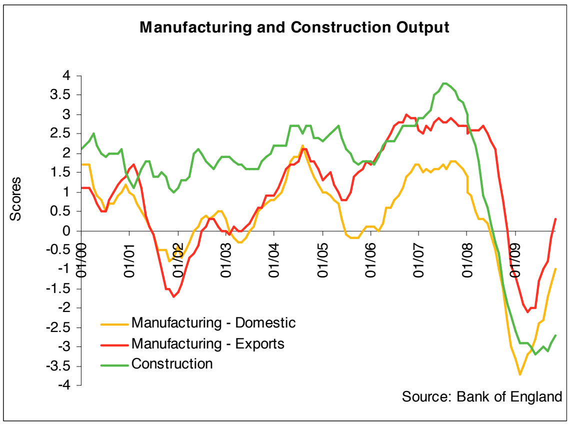
Once again there were mixed signals from the UK economy last week. On the upside, business surveys are revealing a better picture, credit conditions are easing and the labour market has not deteriorated as much as feared. However, inflation has surged last month and public finances are bleak. Next week's data should show that the UK economy finally exited recession in the final quarter of 2009, though economists are already covering themselves arguing that GDP could as likely surprise on the upside as on the downside.

Statistics

The World Bank predicts **global growth** will rebound to 2.7% this year and 3.2% in 2011, following a decline of 2.2% in 2009. Unsurprisingly, developing economies are expected to outperform industrialised ones, as they have already done in 2009. For industrialised countries and many emerging economies it will take time to recover to the levels of previous wealth. Risk aversion, regulatory changes and curbing risk practices could make capital scarcer and more expensive for developing countries, which could impact growth rates.

Bank of England

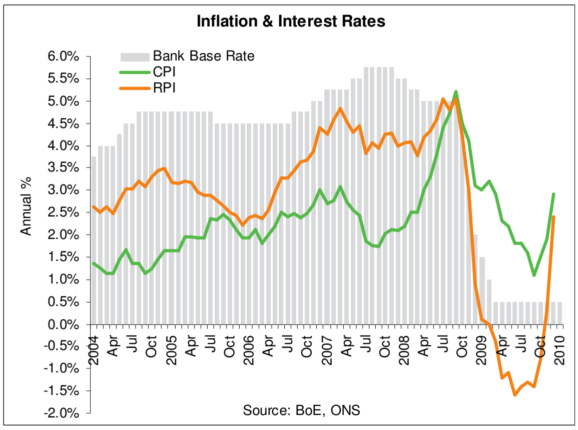
- The minutes of the Bank of England's Monetary Policy Committee meeting in January showed recognition that CPI would be well above target in the early part of 2010, but the Bank said as long as expectations were consistent with the 2% medium-term inflation target, the balance between demand and supply potential of the economy would bear down on inflation for a considerable period. The Bank also said the UK economy appeared to be expanding again, albeit weakly.



- The Bank of England's monthly **Business Conditions Survey** for December reveals that:
  - **Retailers** saw stronger demand over Christmas 2009 than a year earlier. There were widespread reports of growth in sales of big-ticket items, partly due to the pickup in housing market activity and customers bringing forward spending in anticipation of the rise in VAT in January 2010.
  - The gradual pickup in **housing market activity** continued, though first-time buyers remain scarce and the stock of properties for sale is low.
  - **Investment intentions** remain muted, but some **major retailers** plan to maintain their programmes of store expansion and refurbishment. Utility companies are planning to raise capital spending in line with the new regulatory investment cycle.
  - **Construction** remains severely depressed, with commercial property activity particularly weak. However, spending on repair and maintenance work rose in December and some house builders have resumed land purchase programmes.
  - **Credit conditions** eased during the 2nd half of 2009, though credit remains tight for smaller businesses, and those operating in the construction and property sectors.
  - **Material costs inflation** remained low, but was expected to rise over the next year. Diesel prices rose in the 2nd half of 2009, as well as the price of oil-based products, i.e. plastics. Cutbacks in global supply have led to increases in the price of some commodities, i.e. metals and Scandinavian timber.

Economy

- According to official figures, **retail sales** volumes rose by 0.4% in December, while retail values were up 0.9%. Year-on-year sales volumes were up 2.1%, while sales values rose 2.5%. The biggest rise was seen in the amount of money spent on food, up 5% on a year earlier, while non-food spending only rose by 0.5%. The rise in sales volumes in the run-up to Christmas was lower than expected, indicating that domestic consumption may not be sufficient to drive a strong economic recovery. Indeed, retailers are likely to continue to face challenging market conditions this year, with the UK likely to post slow growth in 2010, potential renewed fall in house prices, unemployment and a fiscal tightening ahead.



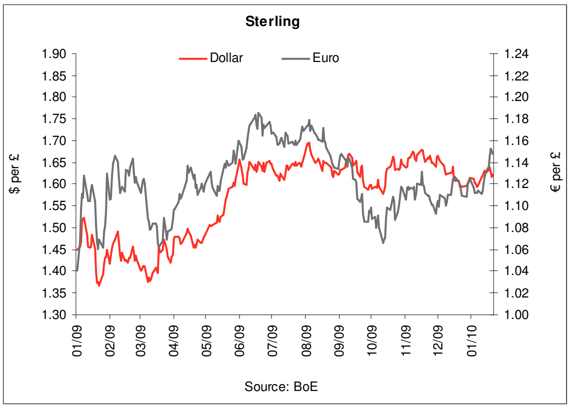
- **Consumer price inflation** jumped a record 1% in December 2009 to an annual rate of 2.9%. The jump had been expected largely because of the low base effects of the VAT cut and low fuel costs, but December's increase was much higher than the Bank of England had predicted. Some analysts suggested that retailers may have set prices in December higher than they would otherwise in order to pre-empt the impact of VAT reversal this month, while others think that the amount of spare capacity in the economy is lower than the Bank thinks. Annual **retail price inflation**, which includes housing costs, rose to 2.4%. Despite the jump in price levels, inflation is expected to fall back later in 2010, as base effects become less unfavourable and underlying pressures are contained. Nevertheless, given that inflation could prove stickier than thought, the Bank of England is unlikely to extend its quantitative easing programme further and there is an increased risk that the Bank could start increasing interest rates before the end of 2010.

- The **number of unemployed** people in the UK fell for the 1st time in 18 months between September and November 2009 and now stands at 2.46 million. The number of people claiming unemployment benefits showed an even bigger fall of 15,200. However, the figures also show that the number of people unemployed for more than 12 months increased by 29,000 and now reaches 631,000, which is the highest figure since 1997. At the same time, the number of people in employment also fell, indicating that people are dropping out of the labour force. Overall, the rise in unemployment during this recession has been smaller than expected, but the flipside of a smaller-than-expected adjustment in labour market quantities has been greater adjustment in terms of prices, with earnings growth weakening markedly.

Commodity Prices (22nd January 2010)	Price	Weekly change	Monthly change	Annual change
"Brent" Oil ($/ barrel)	73.8	-5%	2%	69%
Copper ($/tonne)	7,346	-1%	7%	133%
Aluminium ($/tonne)	2,229	-2%	1%	70%
Nickel ($/tonne)	18,800	3%	6%	69%
Global Steel Price (Index 04/1994=100)	159.78	4%	7%	1%

Source: FT, LME, Cruspi

- News from China continue to impact on **commodity markets**. Oil prices fell for a second week, despite the Chinese economy reporting 8.9% growth in 2009. The big rise in inflation raised expectations that the Chinese authorities will start hiking interest rates, which could slow growth and harm demand for fuel and metals. Crude oil prices tumbled 6% to $73.8 for a barrel of Brent.



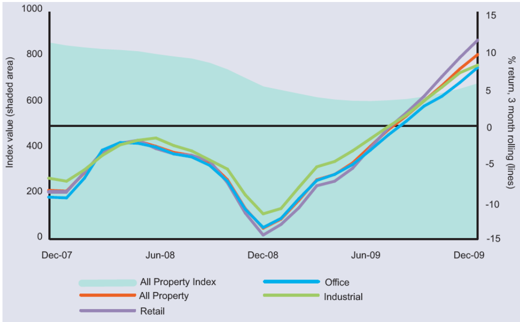
- The **Sterling** appreciated 3% against the Euro since the start of this year, mainly due to Euro weakness on the back of worries about the impact of Greek debt. Chinese monetary tightening led to an increase in risk aversion last week and the Dollar rose, as investors flocked to the relative safety of the greenback. One Pound bought $1.622 and €1.148 at the end of last week.

- The UK's **public finances** are still worsening. Although tax revenues were just 0.4% lower last month than a year earlier, the smallest yearly drop in receipts since September 2008, the government's net borrowing in the first nine months of this financial year stood at £120bn, almost double the total for the same period in 2008-2009. Net debt as a percentage of GDP rose to 61.7%, the highest since records began in 1974. Looking ahead, significant fiscal tightening is needed to bring public finances back to health, which will be a drag on future economic growth.

Construction

- **UK commercial property** capital values rose firmly in December, up 3%, the largest monthly capital growth in IPD's two-decade history. This was the 5th consecutive monthly gain, which lifted returns on UK commercial property into positive territory for the calendar year 2009. Overall, the total return in 2009 was 2.2%, despite a 5.6% fall in capital values. At the start of the 2nd half of 2009, the key driver of capital growth flipped, with the yield impact turning positive. A subsequent easing in rental pressure led to a first positive monthly capital growth figure in August. Offices capital values fell in the first eight months of 2009, down 14%, before starting to recover from September, to end the year down 8.4%. Retail capital values fell 14% in the first six month, but the sector returned to positive growth in July, to end the year down 4.3%. The Industrial sector's initial capital depreciation was the shallowest, at -11% over the seven months to July, before a compounded 7.3% capital growth over latter part of 2009 led to a fall of 4.5% overall last year. UK commercial property annual investment returns, at 2.2%, outperformed bond markets, which fell by 0.3% but significantly underperformed the equity markets, which delivered 30%.

IPD Property Index
Sector Performance – 3 months total returns



Source: IPD

Looking ahead

- The first estimate for **4th quarter 2009 GDP** will probably show that UK have started growing again after 18 months of recession, but doubts remain about the sustainability of any upturn, with many economists predicting growth to remain lacklustre for months to come. **CBI's latest distributive trends survey** is expected to show a slowdown in retail sales growth following the New Year rise in VAT. **Gfk Consumer Confidence** is likely to remain in negative territory as worries about the employment outlook and the prospects for the economy weight on sentiment. The Nationwide is likely to report that **house prices** continued their tentative recovery in January. Relatively low housing market activity and still unfavourable economic fundamentals could mean that house prices will suffer a relapse in 2010.

Market Watch

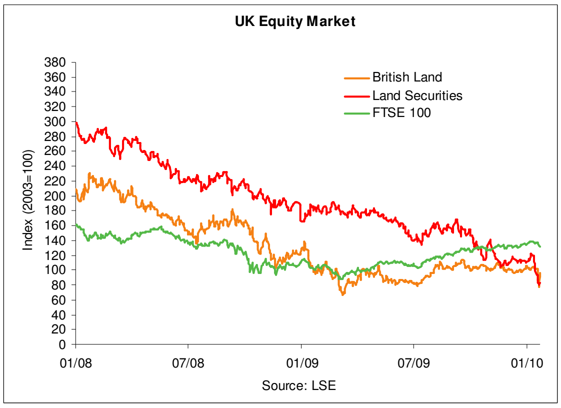
Share prices	Market Cap, £mn	Friday 22nd January 2010 Week	Month	Year
FTSE100		-2.8%	-0.5%	30.9%
Real Estate				
British Land	3,730	-5.0%	-4.4%	14.7%
Hammerson	2,710	-2.5%	-2.1%	32.4%
Land Securities	4,920	-5.2%	0.7%	8.2%
Liberty Intl.	2,860	-4.9%	-7.2%	10.7%
Shaftesbury	869.6	-1.8%	4.9%	74.3%
Great Portland Est.	892.7	-2.3%	2.0%	68.3%
Derwent London	1,350	-0.5%	8.2%	108.3%
Segro	2,340	-3.9%	-4.2%	3.5%
Quintain Estates & Development	316.0	-9.0%	11.0%	377.3%
St. Modwen Properties	391.3	-6.5%	8.4%	115.4%
TR Property Investment Trust	574.8	-2.3%	-0.4%	39.1%
Unite Group	444.2	-4.0%	1.5%	302.1%
Workspace Group	247.1	-6.5%	0.0%	-22.7%
Minerva	112.0	-3.5%	-10.6%	234.9%
Average*		***-4.1%***	***-1.2%***	***38.4%***
Contractors				
Balfour Beatty	1,900	-0.5%	9.4%	-9.1%
Carillion	1,200	-2.5%	0.6%	25.3%
Morgan Sindall	236.7	-2.2%	-11.8%	-3.4%
Kier Group	374.1	-5.6%	1.5%	16.5%
Lend Lease Corp*	2,348	1.8%	1.3%	41.6%
Average		***-0.4%***	***3.2%***	***19.2%***
Material Suppliers				
Wolseley	4,030	-4.7%	16.4%	14.7%
SIG	717.3	-7.6%	11.1%	11.4%
Marshalls	170.5	0.6%	2.9%	49.0%
Kingspan	921	-2.9%	6.7%	161.1%
BSS	339.4	-4.6%	13.8%	4.2%
Average		***-4.6%***	***13.8%***	***36.5%***
House Builders				
Persimmon	1,360	-6.0%	0.0%	60.5%
Taylor Wimpey	1,270	-4.4%	11.5%	238.4%
Barratt	1,230	-5.9%	9.8%	144.0%
Bovis Homes	558.9	-4.1%	6.1%	11.1%
Bellway	905.3	-4.2%	-1.5%	41.4%
Berkeley	1,100	-2.9%	-0.7%	0.0%
Average		***-4.7%***	***4.3%***	***94.3%***

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

Stock markets retreated last week, as investors mulled the consequences of the US President's announcement of new restrictions on the US banking sector aimed at preventing future financial crises. There are no details on the proposals as yet. At the same time concerns over an overheating Chinese economy weighed on markets.

The **FTSE100** ended the week to Friday down 2.8% at 5,302.99. **Property companies** fared worse overall, down by 4.1% on average. St. Modwen and the Workspace Group were among the biggest losers last week, shedding 6.5%. British Land lost 5% and Land Securities was down 5.2%.

Land Securities confirmed plans that it is to re-start work on its development pipeline in order to produce buildings in time for the next cycle. This includes three major London projects: Park House, off Oxford Street, Selborne House and Wellington House, both in Victoria, are estimated to have a combined value of just under £655m. It is also considering the start of a retail-led scheme in Leeds.



Great Portland Estates reported an 8.7% rise to £1.2bn in the value of its portfolio during the 3rd quarter to end December 2009. NAV per share rose 11.6% to 251p. Rental values are still under pressure, with GPE reporting a fall of 1.1% in the quarter. The firms announced plans to start three developments this year, including Marcol House redevelopment in Regent Street, a 111,000 sq ft scheme. GPE's shares closed the week down 2.3%, though shares gained almost 70% over the last year.