

# Weekly Economic Update

31<sup>st</sup> October 2010

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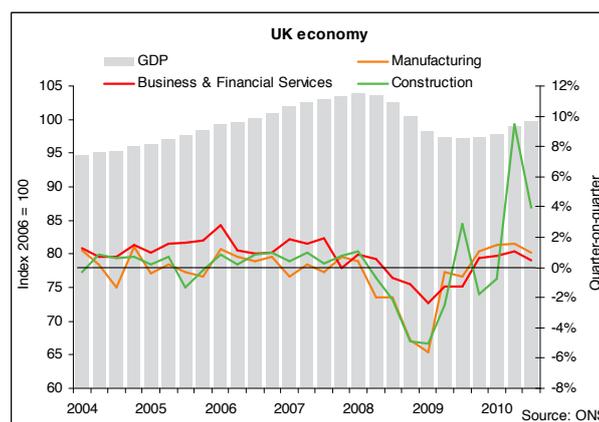
## Summary

UK GDP figures for the third quarter by far exceeded market expectations, with the economy expanding 0.8% quarter-on-quarter, which compares to a consensus estimates of 0.4%. Growth was broad based, but led by the construction and manufacturing sectors. This indicates that the UK economy may be in better shape than feared as it enters a period of severe budget cuts. The latest data reduce the likelihood that the Bank of England will decide to pump more money into the economy by expanding its QE programme during this week's MPC meeting.

## Economy

### UK growth

The UK economy grew faster than many had expected during the third quarter of this year, with growth at 0.8% double the 0.4% consensus forecast. GDP during the third quarter was up 2.8% on a year ago, though output remains 4% below its Q1 2008 peak. Growth was driven by strong construction activity, which expanded 4% quarter-on-quarter after rising 9.5% in the preceding three months. This implies that construction output is just 2.3% off its 2008 peak level of output, having grown by 10.9% over the past year. However, there is scepticism about these numbers, with most industry analysts suggesting that construction activity remains well below peak. Industry surveys point to slower activity ahead, with the sector set to be increasingly hit by public sector spending cuts. Manufacturing output grew 1% during the third quarter and up 5.3% on a year ago. The service sector saw 0.5% growth during the quarter, with sector activity up 2% year-on-year. Despite the firm third quarter data, UK growth is still expected to slow markedly over the course of next year, as the economy is likely to come under pressure from fiscal cuts, persistently tight credit conditions and subdued consumer demand. However, the stronger than expected Q3 GDP figures reduces the likelihood that the Bank of England Monetary Policy Committee will decide to extend its quantitative easing programme this month, in order to support growth.



### Consumer confidence

Consumer confidence in October improved slightly compared to September, but remained negative. Households were somewhat more confident about their personal financial situation, but confidence in the general economic outlook over the next twelve months remains particularly weak.

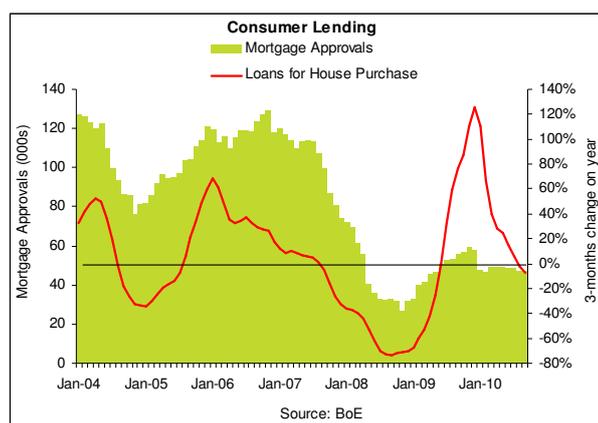
### Consumer lending

Housing market activity continues to slow. Mortgage approvals totalled 47,470 in September, falling for a fifth consecutive month. Approvals remain at half their 10-year average. Net consumer credit rose slightly in September following a net repayment in August. However

consumer credit remains very low compared to past norms, as households' appetite for new borrowing is limited and availability of unsecured credit from banks remains tight.

### House prices

House prices fell 0.7% in October, according to the Nationwide. Annual house price inflation slowed to 1.4%. At an average of £164,380 UK house prices in October were 11% below their September 2007 peak. Relatively high unemployment, subdued wage growth, the fiscal squeeze, tight mortgage lending and the housing supply-demand balance firmly in favour of buyers, all combine to put downward pressure on house prices.



### Retail sales

Retail sales growth remains robust, with the CBI's distributive trade survey showing that 58% of retailers surveyed saw October sales ahead of a year ago. Clothing sales were particularly strong, whereas sales of durable household goods saw a slower increase. Hardware & DIY sales were lower than a year ago, reflecting more subdued housing market activity of late. Retailers expect another strong rise in sales in November in the run-up to Christmas and households bringing expenditure forward ahead of the VAT rise in January. However, weak prospects for average pay growth are likely to limit consumer spending in 2011.

### Exchange rates

During last week's G20 meeting in South Korea, a coordinated exchange rate policy intention to reduce imbalances and currency volatility was put forward by all participants. However it remains unclear how this is to be achieved. Sterling rose last week, up 2% both against the Dollar and the Euro, to £/\$1.588 and £/€1.1503 respectively. Sterling strength was helped by stronger than expected UK third quarter GDP and a slight improvement in consumer confidence.

### Commodities

Commodity prices, with the exception of oil, fell last week, despite expectations that a new round of quantitative easing by the US Federal Reserve would increase their appeal as a store of value. Oil prices rose 1% to \$83.1 per barrel of Brent. Copper fell 1% to 8,225/ ton, while aluminium dropped 13% to \$2,032/ ton. The global steel price index recorded a 1% decline.

Commodity Prices 29th Oct 2010				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	83.1	1%	5%	6%
Copper (\$/tonne)	8,225	-1%	3%	25%
Aluminium (\$/tonne)	2,032	-13%	-11%	7%
Nickel (\$/tonne)	22,700	-3%	-2%	23%
Global Steel Price (Index 04/1994=100)	177.7	-1%	-1%	15%

Source: FT, LME, Cruspi

## Construction

### Tender price inflation

Tender prices continued to fall in the third quarter of this year, and the downward trend is expected to continue at least until the end of 2010. In Q3 2010 prices fell a further 0.5%, which means average prices have fallen 2% in the past year. Whilst the pace of tender price falls has slowed compared to end of 2008 and in 2009, prices are now 17.5% below their peak in Q2 2008. In contrast, the building cost index has continued to rise this year, despite a continued freeze on labour rates. Provisional figures for Q3 2010 show an increase of 3.6% over the year, driven entirely by rises in materials prices. Month-on-month increases since the beginning of the year resulted in prices being 10% higher by midsummer than they were at the same time last year. Most increases in materials prices have been absorbed through the supply chain placing pressure on contractors' margins, but the scale of some, such as structural steelwork and reinforcement, means some price rises have surfaced in tenders. Tender prices in London are forecast to rise by 1-2% next year, but there is the possibility of a sharper increase if a number of larger schemes all go to site at the same time. In the provinces, inflation may be zero at best. The following year should see private sector activity recover, but the net effect on the size of the industry will still be small. In London, however, the increase should be enough to push

construction prices higher by 3-4%. Elsewhere, prospects remain much weaker and price increases are likely to be more subdued.

### **National Infrastructure Plan (NIP)**

The Prime Minister, David Cameron, announced the publication of the UK's first NIP, outlining the scale of the infrastructure challenge and major investments needed to secure sustainable UK economic growth over the next decades. The NIP focuses on networks and systems in energy, transport, communication, flood defences, water and sewerage, waste management and science. It also calls for more private funding in infrastructure construction. Overall, some £200bn could be invested in infrastructure in the next five years, 80% of which expected to come from private sources, and £40bn from government funding. This compares with £150bn infrastructure investment in the past five years. The government will complete the design of the proposed £1bn Green Investment Bank by spring 2011, with the bank supposed to take on early and risky construction phases of complex infrastructure projects. Meanwhile, following the Comprehensive Spending Review, Transport Minister Philip Hammond announced the postponing of Highways Agency schemes worth more than £1bn. A further 16 schemes would go ahead in addition to the 8 given the green light in the CSR. However construction on these projects would not start before 2012/13. In addition, 14 schemes will be delayed until beyond 2015 with another 34 schemes to be reviewed. Capital spending on roads by the Highways Agency will fall by 44% over the next four years.

### **Looking ahead**

Stronger than expected GDP growth during the third quarter is likely to convince the Bank of England's MPC to keep interest rates on hold at 0.5% and make no changes to the quantitative easing programme during its November meeting. The construction and services purchasing managers' indices are likely to show that the pace of sector growth is now moderating. The manufacturing PMI index is expected to reveal that the sector expanded in October, but the pace of growth is likely to have lost some momentum, as slower inventory re-stocking, fiscal cuts and slower global growth is weakening demand for products. Manufacturing input prices are likely to have risen in October, due to higher energy and transport costs. Producer output price inflation should have moderated somewhat in October, as manufacturers find it more difficult to raise their prices, given anticipation of slower demand.

## Market Watch

The FTSE 100 index lost 1.2% last week, falling to below 5,680 points, despite much stronger than expected UK GDP figures.

On the back of firm UK growth, S&P, the credit rating agency, affirmed the UK's triple-A rating and upgraded its outlook to "stable" from "negative".

Real estate stocks outperformed the wider index, with the real estate index falling 0.7%. Performance within the sector was mixed. The Workspace Group performed best, rising 6.7% in the week to Friday.

British Land gained slightly, rising 0.5%. It last week announced that it has agreed Heads of Terms with Oxford Properties, the real-estate arm of Ontario Municipal Employees Retirement System (Omers) pension fund, to build the Leadenhall Building in London on a 50:50 JV basis. Demolition and preliminary basement works are complete, and construction work is expected to start in July 2011.

Meanwhile, Land Securities and Canary Wharf Group announced that they have formed the 20 Fenchurch Street Ltd Partnership, a 50:50 JV to develop the 20 Fenchurch Street tower ("Walkie-Talkie"). Work is planned to start immediately, with ground works and substructure expected to be done by February 2012. Final completion is planned for Q2 2014.

Further signs of a weakening UK housing market are weighing on the housebuilding sector, with all bar Berkeley ending the week in red. Bellway shed 4.6%, while Persimmon fell 4.4%. Housebuilders on average declined 12% over the last month. Barrat (-21.9%) and Taylor Wimpey (-22.4%) showed the steepest declines.

Stock Market		Friday 29th October 2010			
Index	Index	Week	Month	Year	
FTSE100	5,675.2	▼ -1.2%	1.9%	10.5%	
EPRA/NAREIT UK	383.0	▼ -0.7%	3.9%	2.4%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,480	▲ 0.5%	8.0%	8.6%	
Hammerson	2,970	▲ 1.6%	6.1%	3.3%	
Land Securities	5,210	▼ -0.2%	5.4%	3.5%	
Capital & Counties	928	▲ 1.1%	11.6%		
Capital Shopping Centres	2,390	▼ -0.3%	3.3%		
Shaftesbury	1,010	▲ 0.5%	1.5%	19.3%	
Great Portland Est.	1,080	▲ 1.6%	0.9%	38.8%	
Derwent London	1,540	▼ -0.4%	1.3%	23.1%	
Segro	2,200	▲ 0.5%	8.4%	-18.4%	
Quintain Estates & Development	206	▼ -5.4%	-1.9%	-55.9%	
St. Modwen Properties	325	▼ -10.5%	-2.4%	-27.1%	
Unite Group	333	▼ -3.3%	-6.7%	-25.7%	
Workspace Group	274	▲ 6.7%	10.5%	14.5%	
Minerva	144	▼ -6.0%	-6.5%	165.2%	
<b>Average*</b>		▲ 0.2%	5.3%	3.4%	
Building Contractors					
Balfour Beatty	1,900	▲ 2.0%	3.9%	3.2%	
Carillion	1,380	▼ -2.0%	7.9%	16.4%	
Morgan Sindall	291	▼ -1.0%	0.4%	18.3%	
Kier Group	496	▲ 6.1%	12.7%	35.1%	
Lend Lease Corp*	2,361	▼ -4.0%	-7.1%	-19.6%	
<b>Average</b>		▼ -0.9%	1.2%	0.8%	
Building material suppliers					
Wolseley	4,730	▲ 0.7%	4.5%	27.0%	
SIG	671	▲ 1.9%	16.1%	-5.3%	
Marshalls	212	▲ 1.4%	1.7%	9.4%	
Kingspan	868	▼ -0.7%	7.5%	3.3%	
BSS	551	▲ 2.6%	-1.0%	68.4%	
<b>Average</b>		▲ 0.8%	5.5%	23.7%	
Housebuilders					
Persimmon	1,030	▲ -4.4%	-15.3%	-18.0%	
Taylor Wimpey	713	▲ -3.6%	-22.4%	-42.7%	
Barrat	754	▲ -2.6%	-21.9%	-43.9%	
Bovis Homes	464	▲ -2.3%	-9.4%	-16.7%	
Bellway	645	▲ -4.6%	-7.5%	-29.2%	
Berkeley	1,100	▲ 1.3%	1.1%	-3.9%	
<b>Average</b>		▲ -2.5%	-11.9%	-24.0%	

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