Weekly Economic Update

28th March 2011

2011 Budget – Planning for Growth

After setting out its plans for fiscal consolidation in the June 2010 Emergency Budget and October 2010 Spending Review, the Government's 2011 Budget was trailed as "a Budget for Growth". With room for fiscal manoeuvre seriously constrained, the focus was on creating a friendlier and pro-business environment to improve the UK's competitiveness through planning reforms, enhanced R&D tax credits and reducing the burden on businesses.

Economy and public finances

GDP growth *% Annual*	2009	2010	2011	2012	2013	2014	2015
Emergency Budget 2010	-4.9	1.2	2.3	2.8	2.9	2.7	2.7
Budget 2011	**-4.9**	**1.3**	**1.7**	**2.5**	**2.9**	**2.9**	**2.8**

CPI inflation *% Annual*	2009	2010	2011	2012	2013	2014	2015
Emergency Budget 2010	2.1	2.7	2.4	1.9	2	2	2
Budget 2011	**2.1**	**3.3**	**4.2**	**2.5**	**2**	**2**	**2**

The UK recovery is expected to be weaker than after the previous recessions in the 1980s and 1990s, according to the Office of Budget Responsibility (OBR), due to still tight credit conditions and public sector cuts. Consequently, the forecast for GDP growth was downgraded, with the OBR now expecting the economy to grow by 1.7% in 2011 and 2.5% in 2012. The business sector is expected to drive growth in the years ahead, while consumer spending is anticipated to remain subdued and government spending is set to fall in real terms over the five years to 2015.

The increase in VAT to 20%, higher global food and commodity prices, and a weaker Pound have all contributed to a marked up-tick in consumer price inflation, which is now expected to remain above the 2% target this year and next. More specifically, CPI inflation is forecast to be between 4%-5% in 2011, before easing to 2.5% in 2012.

Public sector net borrowing *£ billion*	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Emergency Budget 2010	155	149	116	89	60	37	20
Budget 2011	**156**	**146**	**122**	**101**	**70**	**46**	**29**

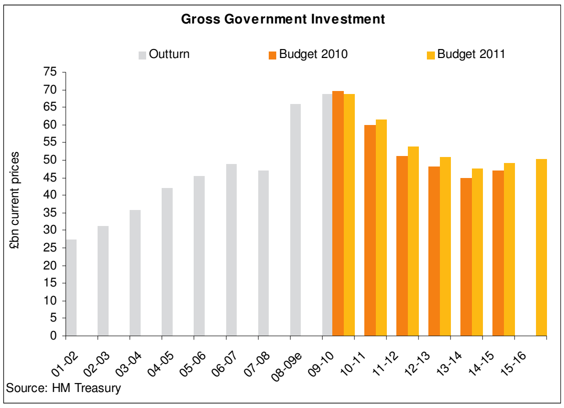
Chancellor Osborne had already made it clear that he will stick to public finances targets set out previously, including the aim to eliminate the structural budget deficit by 2014/15. Public sector net borrowing is expected to come in at £146bn in 2010/11, equivalent to 9.9% of GDP, somewhat less than previously expected. However, the fiscal outlook is less optimistic than outlined in the Budget last year, with borrowing to fall to £122bn, or 7.9% of GDP in 2011/12 and decreasing over the years to 2015/16 to reach £29bn.

Capital spending

Capital funding *£ billion*	2010/11	2011/12	2012/13	2013/14	2014/15
Health	4.5	4.4	4.4	4.4	4.6
Education	7.3	5.1	4.2	3.3	3.4
CLG Communities	6.4	3.5	2.3	1.8	2
Transport	7.1	7.7	8.1	7.5	7.5
Energy & Climate change	2	1.5	2	2.2	2.7
Total	**50**	**44.5**	**42.6**	**39.2**	**40.3**

The Budget did not alter the scale and timing of the planned capital spending cuts set out in the 2010 Comprehensive Spending Review. Key measures:

- *Housing:* The government announced a new £210m shared-equity programme to assist first-time buyers, with the aim to assist 10.000 households. This should translate into new development as some of the demand constraints are removed. In addition, the Homes and Communities Agency is expected to help make public land available free to developers on a "build now, pay later" bases. Government departments will also have to publish land release schedules. In addition, there will be a trial of land auctions to encourage development, restricted to public land.



Source: HM Treasury

- *Planning:* A number of changes were announced to planning laws. For example, the government will consult on allowing changes of use from industrial and office space to residential space without specific planning permission.

- *Transport:* No significant changes to the capital spending programme were announced, but an extra £200m of new funding for railways and £100m for local authority roads were allocated.

- *Education:* No details on specific programmes were released, but this is expected to be announced in the Sebastian James review – a review of all capital investment in schools, early years, colleges and sixth forms, to be published this spring.

Budget measures

The Budget contained some limited measures to ease pressure on households, improve business confidence and encourage "green investment".

Fuel duty changes were the headline catching item for consumers. Fuel duty was expected to rise by 1p above inflation per litre from 6 April. The Chancellor now cut the rate by 1p and a Fair Fuel Stabiliser (FFS) will be implemented. The FFS will be paid for by an increase in tax on North Sea oil and gas production.

Key measures for companies

- *Corporation tax:* To improve the competitiveness of the UK and attract investments, the main rate of corporation tax will be decreased by a further 1% in April 2011 to 26% from a current level of 28%. It will then be reduced by 1% each year over the next three years to 23% in 2014.

- *Capital allowances - short life assets:* A welcome surprise for many companies was the announcement to extend disposal time limits of short life assets from four to eight years. Legislation will be included in the Finance Act 2011.

- *R&D:* The enhanced R&D tax relief for SMEs is being increased from 175% to 200% from 1 April 2011, and then to 225% in April 2012. Legislation is subject to EU State Aid approval. Also, subject to consultation, further changes will be made to simplify the relief for expenditure incurred on or after 1 April 2012:
    - The rule limiting the payable tax credit for SMEs to the amount of their PAYE and NIC liability will be abolished;
    - The £10,000 minimum expenditure requirement for both regimes will be abolished; and
    - Changes will be made to the rules governing work done by subcontractors under the large company regime.

- *REITS:* The government announced to undertake an informal consultation with the real estate industry and representative bodies on proposed changes to the UK REIT regime. The potential changes are aimed at reducing barriers to entry and investment in REITs, and reducing the regulatory burden. They include relaxing the requirement for REITs to be listed on a recognised stock exchange, and that its shares must be publicly, rather than closely, held. It could also include relaxing the close company condition in certain situations, and abolishing the 2% conversion charge for companied entering the regime. Some of these changes would be radical and impacts could be far-reaching, potentially increasing the attractiveness of the REIT to a wider investor pool. Legislation will be included in the Finance Bill 2012.

Key Enterprise measures

- 21 new Enterprise zones aim to boost investment in specific locations, mainly in the North. EZs offer enhanced tax relief on capital costs, reduced businesses rates and a simplified planning regime.

Key "green" measures

- *Green Investment Bank (GIB):* Initial capitalisation levels for the GIB, previously set at £1bn have been increased to £3bn. Its implementation has been brought forward by a year to 2012/13. Whilst details are still sketchy, it was announced that joint government and private investment should mean that there is an additional £18bn of investment in green infrastructure by 2014/15 as a result of GIB. From 2015/16, the Bank is expected to receive borrowing powers to enable it to further increase investment levels, but only if national debt targets have been met as GIB borrowings are included in national debt.

- *Land Remediation Tax Relief:* Following a review of reliefs undertaken by the Office of Tax Simplification, the Government announced that it intends to abolish Land Remediation Tax Relief (LRR) after 2012 in future Finance Bills or other legislative vehicles, with a final date set out after a consultation with industry. The LRR currently gives a 150% deduction from corporation tax for qualifying expenditure (both capital and revenue) incurred by companies in cleaning up contaminated land.

- *Capital allowance – feed-in tariffs and renewable heat incentives:* The FIT scheme was introduced in April 2010 to increase low carbon electricity generation by subsidising small scale plant generating electricity from renewable sources. The renewable heat incentive (RHI) scheme is to be introduced in summer 2011 and will sit alongside the FIT regime to incentivise heat generation from renewable sources. Consultation will commence in May as to the appropriate capital allowances treatment of plant and machinery assets attracting tariffs under the feed-in tariffs or Renewable Heat Incentives (RHI) schemes.

- *Capital allowances – business premises renovation allowance:* The business premises renovation allowance is a 100% first-year allowance available for expenditure on converting or renovating unused business premises in disadvantaged areas, incurred between April 2007 and April 2012. The Government plans to extend the measure for a further five years from 2012, subject to EU approval.

Plan for Growth

Alongside the Budget, the government published its *Plan for Growth;* a strategy that focuses on eight sectors of the economy where the government sets out to remove barriers to growth: healthcare and life sciences, digital and creative industries, retail, professional and business services, space industry, tourism, advanced manufacturing and construction.

To boost advanced manufacturing 11 measures to stimulate growth were announced, including:

- Extension of capital allowances short life asset regime for plant and machinery from 4 to 8 years from April 2011;
- Expansion of the University Technical Colleges programme to establish some 24 new colleges by 2014 to provide leading edge technical training for 11-19 year olds;
- Establishment of a High Value Manufacturing Technology and Innovation Centre to enable UK businesses to access state-of-the-art equipment and technical skills which they could not invest in on their own;
- Nine new university-based Centres for Innovative Manufacturing by 2012 to support new sciences in areas of strategic opportunity in manufacturing.

The Growth Plan also sets out current limitations to UK construction industry growth, including the lack of a clear view of future workflow, poor and inconsistent procurement practices in the public sector, low levels of standardisation and fragmentation of the public sector client base, as well as the burden of industry regulation and a slow planning system. Measures the government set out to tackle these barriers include:

- Publication of a long-term view of projects and programmes as part of the National Infrastructure Plan 2011 from autumn this year;
- Quarterly publication of a two-year programme of infrastructure and construction projects where public funding has been agreed from autumn;
- Review of public sector construction procurement to reduce costs by up to 20%;
- Release of public sector land to encourage house building;
- Introduce measures to remove barriers to entry for new Real Estate Investment trusts.

The jury is out whether this really is a “Budget for Growth”, in particular as the economic backdrop remains challenging. The test this year will be whether the economy can make progress in light of the strong headwinds it faces, including high inflation which could convince the Bank of England into raising interest rates at a time when sustained growth is yet to be established. Whilst the manufacturing industry is doing well, services sector growth remains patchy, while the pressure on consumers and the construction industry remains real.

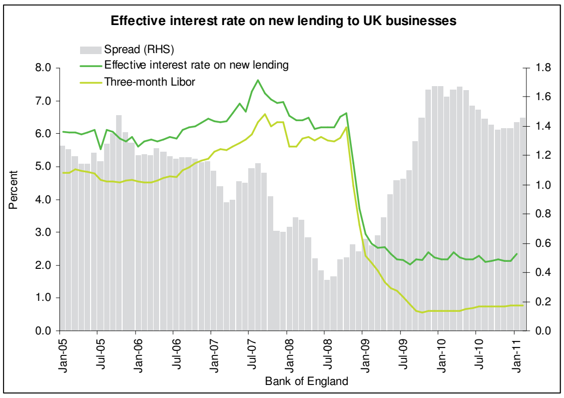
Economy

Inflation

Annual consumer price inflation climbed to a 28-month high of 4.4% in February from 4% in January. This is more than double the Bank of England's target rate of 2%. Higher oil and commodity prices once again put pressure on CPI inflation, leading to higher petrol prices and fuel bills. In addition, the VAT rise from 17.5% to 20% in early January had an impact. According to the latest OBR forecasts, inflation will average more than 4% this year, before dipping to 2.5% early in 2012.

Interest rates

Three-month Libor rates, the benchmark for interbank lending, held relatively stable since the start of the year. At the same time, the average interest rate for new lending to private non-financial companies ticked-up slightly since end-2010, rising from 2.12% in November to 2.33% in January. Consequently, the spread between Libor and lending rates rose.



Retail sales

Retail sales in February fell significantly, after bouncing back in January. Retail sales volumes (excluding fuel) fell by 1% month-on-month and year-on-year growth slowed to 1.2%. Consumer spending is widely expected to be subdued this year, due to a squeeze on spending power from high inflation and low earnings growth, elevated debt levels and high unemployment.

Commodities

Commodity prices remain volatile in light of political developments in the Middle East and the aftermath of the earthquake/ tsunami/ nuclear drama in Japan. Oil prices rose 1% to \$115.8/ barrel of Brent crude. Metals prices also advanced. Copper rose 2% to \$9,715, while aluminium was up 4% at \$2,608. The global steel price index held stable.

Commodity Prices (25th Mar 2011)				
	Price	Weekly change	Monthly change	Annual change
“Brent” Oil ($/ barrel)	115.8	1%	5%	43%
Copper ($/tonne)	9,715	2%	0%	30%
Aluminium ($/tonne)	2,608	4%	3%	19%
Nickel ($/tonne)	27,060	3%	-2%	14%
Global Steel Price (Index 04/1994=100)	222.8	0%	1%	28%
Source: FT, LME, Cruspi				

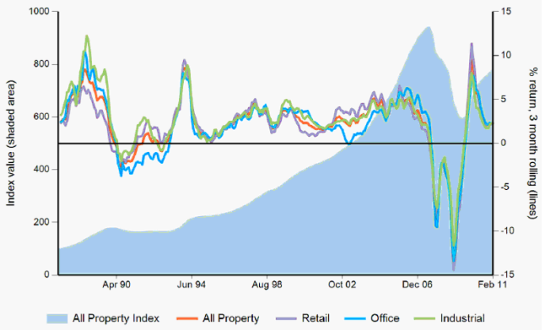
Exchange rates

The Pound weakened to £/€1.139 against the Euro last week, as the single currency shrugged of two Portuguese government debt downgrades and the resignation of José Sócrates, Portugal’s prime minister, after he failed to get parliamentary approval for his plans to cut the fiscal deficit. The US Dollar fell against major currencies, but advanced against the Pound, rising 0.9% to £/\$1.6043.

Construction

Commercial property returns
UK commercial capital growth stood at 0.2% in February, up from 0.1% growth in January, according to the IPD UK Monthly Index. Income return of 0.6% contributed to a monthly total return of 0.7%. The annual rate of capital growth eased to 4.8%, down from 6% at the end of January. The offices segment recorded capital growth of 0.2% and rental growth of 0.3%. Retail returned 0.2% capital growth, but rents fell 0.1%. Industrial capital values fell 0.1%, while rental growth stagnated.

IPD Property Index



Source: IPD

Looking ahead

The latest housing market data are expected to show that sector activity remains subdued, with mortgage approvals for house purchase way below long-term averages and house prices falling. The UK housing market is likely to remain under pressure for the time being due to high unemployment, a squeeze on real income growth, the increasing fiscal squeeze, and ongoing tight credit conditions in the mortgage market. The CBI's distributive trades' survey for February is expected to be weaker, as households limit their spending. The manufacturing purchasing managers' index is expected to show that the sector continues to see robust growth, due to firm overseas and domestic demand, as well as a competitive Pound. However, sharply higher input costs are squeezing manufacturers' margins, putting pressure on companies to raise factory gate prices.

Market Watch

Stock indices rose last week, amid expectations that the global economic recovery is robust enough to deal with Japan's troubles, the Eurozone's fiscal dilemma and the spreading Middle East unrest.

The FTSE-100 rose to 5,900.8 points, up 5.4% on last week's post-Japan earthquake low, but still 3.1% below its recent peak in February.

Real estate stocks gained across the board (Quintain Estates & Developments being the exception), with the sector buoyed by some positive measures in the 2011 Budget to increase the attractiveness of REITs. St. Modwen Developments jumped 8.1% and the Unite group rose 6.2%. Among the large real estate companies, Hammerson gained 4.8% and Capital Shopping Centres was up 3.5%.

Stock Market			Friday 25th March 2011		
Index	**Index**		**Week**	**Month**	**Year**
FTSE100	5,900.8	▲	3.2%	-1.7%	3.0%
EPRA/NAREIT UK	415.2	▲	2.5%	2.8%	9.1%
Stocks	**Market Cap, £m**		**Share Prices**		
			Week	**Month**	**Year**
Real Estate					
British Land	5,040	▲	2.1%	-0.1%	21.1%
Hammerson	3,260	▲	4.8%	2.0%	19.2%
Land Securities	5,640	▲	1.7%	-2.1%	7.8%
Capital & Counties	1,030	▲	3.1%	11.6%	
Capital Shopping Centres	3,300	▲	3.5%	-1.0%	-23.4%
Shaftesbury	1,190	▲	0.5%	2.2%	25.8%
Great Portland Est.	1,210	▲	1.3%	1.3%	26.7%
Derwent London	1,680	▲	1.3%	-0.2%	21.9%
Segro	2,450	▲	5.0%	4.2%	2.8%
Quintain Estates & Development	221	▼	-0.6%	-3.4%	-26.1%
St. Modwen Properties	364	▲	8.1%	7.1%	-4.4%
Unite Group	352	▲	6.2%	9.6%	-12.2%
Workspace Group	297	▲	1.0%	2.0%	6.2%
Minerva	144	▲	0.6%	-8.7%	1.7%
Average*		▲	2.8%	0.8%	8.9%
Building Contractors					
Balfour Beatty	2,360	▲	1.5%	-0.3%	17.7%
Carillion	1,500	▲	1.6%	-0.9%	14.1%
Morgan Sindall	284	▲	1.2%	-2.5%	18.6%
Kier Group	491	▲	4.4%	-3.5%	20.2%
Lend Lease Corp*	3,168	▲	1.7%	-3.3%	0.0%
Average		▲	1.8%	-1.9%	10.0%
Building material suppliers					
Wolseley	5,920	▲	0.2%	-3.2%	29.7%
SIG	830	▲	6.6%	8.2%	20.7%
Marshalls	227	▲	0.9%	0.0%	24.0%
Kingspan	966	▼	-1.6%	-4.4%	1.1%
Average		▲	0.7%	-2.1%	25.1%
Housebuilders					
Persimmon	1,410	▲	4.0%	1.0%	-0.4%
Taylor Wimpey	1,340	▲	5.2%	11.0%	8.0%
Barratt	1,090	▲	9.4%	8.3%	-13.0%
Bovis Homes	605	▲	2.7%	0.9%	12.2%
Bellway	846	▲	3.9%	5.0%	-8.5%
Berkeley	1,360	▼	-0.2%	2.9%	24.8%
Average		▲	4.1%	5.1%	4.5%

**Sector averages are weighted according to current market capitalisations

Housebuilders' stocks also benefited from measures announced in the 2011 Budget to help the UK housing sector. In particular, the reinstatement of financial support for first-time buyers under a new £210m shared-equity programme (Firstbuy) was welcomed by the housebuilding industry. Barrat gained 9.4% last week, while Taylor Wimpey advanced 5.2% and Persimmon rose 4%.