

# WEEKLY ECONOMIC UPDATE

6<sup>th</sup> September 2010

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## Summary

The UK economy continues to expand, but at a markedly slower pace than during the first half of this year, as manufacturing, services and construction growth eased in August. Housing market activity also softened further in recent weeks. Mortgage lending remains subdued and house prices in August fell for a second consecutive month.

## Economy

### Correction note: VAT

In last week's edition, we said that VAT will rise from 15% to 17.5% in January 2011. This is incorrect. In fact, VAT had already risen back to 17.5% in January 2010 and will be raised further to 20% in January 2011.

### Business activity

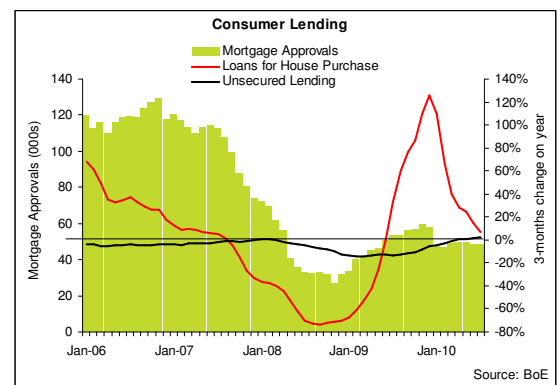
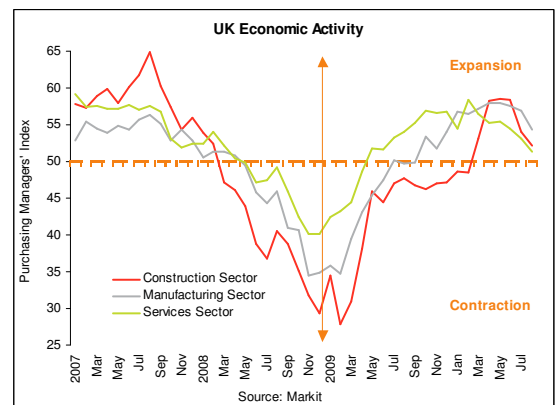
Latest survey evidence of business activity points to slower growth in key UK sectors in recent weeks. The CIPS/ Markit manufacturing PMI slipped to 54.3 in August, down from 56.9 in July. Whilst survey respondents reported that the volume of work continued to expand in August, new orders growth slowed sharply.

More positively, the survey shows that growth in the capital goods sector accelerated in August, which suggests that investment spending is still supporting growth. Looking ahead, growth is expected to slow further in the months ahead, as export demand and inventory re-stocking slow.

Services sector growth also lost further momentum in August, with the services sector PMI falling to 51.3, from 53.1 in July. Both activity and new business rose only modestly last month. Input costs continued to rise in August, due to higher salaries and increased utility bills. Efforts to pass on higher costs were generally thwarted by competitive pressures and, in some instances, the need to offer discounts to stimulate sales growth. Business confidence remained relatively low in August, as worries over the impact of government spending cuts and the scheduled rise in VAT early next year undermine sentiment.

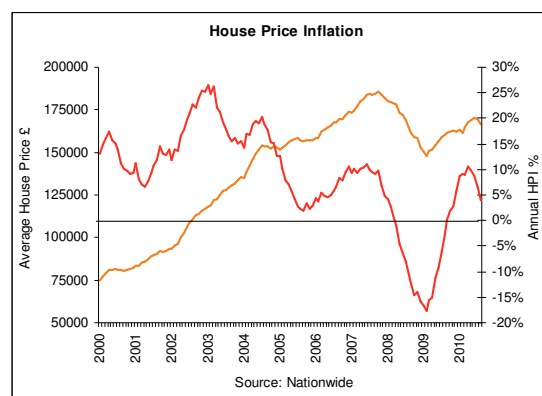
### Consumer lending

Total consumer net lending rose by £0.3bn in July, £0.2bn weaker than the increase in June, but £0.9bn stronger than a year ago. Mortgage approvals in July totalled 48,720, unchanged compared to June, but down 8% on last year. Whilst net consumer credit rose £0.2bn in July, credit growth remains weak, as households generally choose to pay down debt rather than increase borrowing.



### House prices

UK house prices fell for a second consecutive month, according to the Nationwide, with house prices down 0.9% in August compared to July. Annual house price inflation slowed to 3.9% in August, down from a 6.6% rise a month earlier. The average UK house price is now £166,507.



### Consumer confidence

The GfK/NOP consumer confidence index recorded a modest rise in August, but remained in deeply negative territory. The index rose to -18 in August from -22 in July, the first improvement in five months. Consumer are increasingly cautious about making major purchases, suggesting that the improvement in sentiment may not translate into higher consumer spending.

### Retail sales

Retail sales in August were higher than a year ago, which is the second consecutive year-on-year increase, according to the CBI's latest Distributive Trades survey. More than half of retailers surveyed report that sales rose last month. Better weather at the beginning of August, the summer sales and summer holidays have helped growth. With retailers more optimistic about the general business situation, the majority expects further strong sales in September. Nevertheless, the CBI remains cautious about the broader outlook for consumer spending in the year ahead, given the VAT rise next year, subdued pay growth and the feed-through of public spending cuts to job losses.

### Exchange rates

The Pound held stable against the Dollar last week at £/\$ 1.544, but weakened 1% against the Euro to £/€1.20.

### Commodities

Commodity prices rose firmly last week, in particular base metals. Copper increased 5% to \$7,631, while aluminium rose 7% to \$2,128. The global steel price index recorded a 4% rise. In contrast, oil prices were unchanged, with a barrel of Brent crude costing \$75.5 per barrel on Friday.

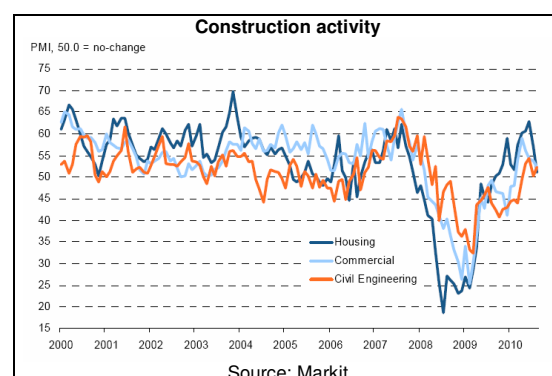
Commodity Prices (3rd September 2010)				
	Price	Weekly change	Monthly change	Annual change
*Brent* Oil (\$/ barrel)	75.5	0%	-10%	12%
Copper (\$/tonne)	7,631	5%	4%	22%
Aluminium (\$/tonne)	2,128	7%	-3%	10%
Nickel (\$/tonne)	21,875	6%	2%	18%
Global Steel Price (Index 04/1994=100)	182.2	4%	5%	11%

Source: FT, LME, Cruspi

## Construction

### Construction activity

The Markit/CIPS Construction Purchasing Managers' Index shows that sector activity slowed slightly in August, with the index easing to 52.1 from 54.1 in July. New orders growth weakened for a third consecutive month. The residential construction sector slowed sharpest in August, while commercial sector growth eased marginally. Civil engineering was the only sector that saw stronger growth. Confidence improved modestly in August, but concerns over public sector spending cuts remained. Input prices continued to rise during August, mainly driven by raw material price increases.



### Construction new orders

Construction new orders totalled £12.36bn in the second quarter of 2010, down 14% on the preceding quarter and 9% lower compared to last year. Within this, public new housing orders fell 23% on the quarter, but remained up 12%

Construction new orders			
Q2 2010	Value, £m current	Volume, constant 2005 prices Q-o-Q	Y-o-Y
Public housing	703	-23%	12%
Private housing	1,862	-24%	7%
Infrastructure	2,675	-22%	-22%
Public non-resi	3,133	-13%	-17%
Industrial	622	26%	-13%
Commercial	3,361	-7%	4%
All Work	12,357	-14%	-9%

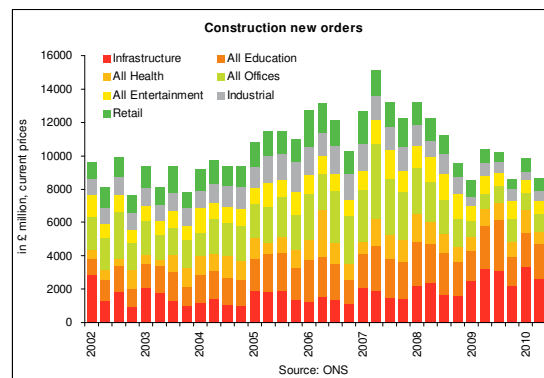
Source: ONS

on last year. Private housing new orders were 24% down on the quarter, but 7% higher year-on-year. Industrial new orders were up 26% on the previous quarter, but remained down 13% compared to a year ago.

Commercial orders were 7% down on Q1 2010, but up 4% year-on-year. Within the sector, offices related work totalled £871m in Q2 2010, up 10% on the previous three months and 25% higher compared to last year. Retail new orders totalled £735m, down 6% on Q1 2010 and 13% lower compared to a year ago. The flow of PFI education and health related projects also fell during Q2, down 30% and 63% on a year ago.

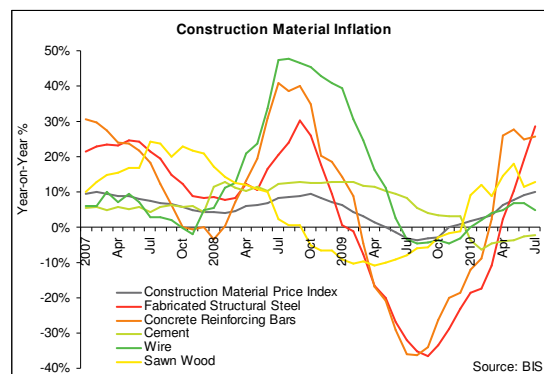
Infrastructure orders declined 22% both on the preceding quarter and a year ago. Within this, roads and rail related work fell sharply, down 4% and 46% respectively compared to a year ago. Water and sewerage related new orders totalled £760m, up 18% quarter-on-quarter, but a fifth lower compared to last year. The value of electricity related contracts jumped to £817m, compared to £232m in the preceding quarter.

New orders for public non-residential work fell 13% in Q2 compared to the preceding three months and down 17% year-on-year. Orders for schools and colleges declined by 5% during the quarter and down 33% compared to a year ago. In contrast, university related orders, at £533m, were up 30% compared to the preceding three months and doubled year-on-year. The flow of traditionally financed health projects dropped in Q2 2010 to £535m, down by 50% on the previous quarter and 8% down on last year.



### Construction materials

Construction material prices rose 0.8% in July and up 10% on a year ago. This is the strongest annual increase since February 2007. Material costs rose sharpest for non-residential work, up 10.8% year-on-year. Fabricated structural steel prices jumped 5% during the month and up 29% compared to a year ago. Concrete reinforcing bars were unchanged in July, but up 26% year-on-year. Pre-cast concrete prices were down 1% in July, but unchanged compared to last year. Cement prices were flat in July, but down 2% year-on-year. Sawn wood prices were up 2% during the month and rose 13% on last year.



## Looking ahead

The Bank of England's Monetary Policy Committee is expected to keep **interest rates** unchanged at 0.5% during its September meeting. The British Retail Consortium's **retail sales monitor** is likely to show that sales growth was relatively firm in August, supported by good weather early in the month and discounting on the high street. **Manufacturing output** is likely to have increased in July, but at a more modest pace as survey evidence points to slower sector growth ahead. Producer **input price** growth is expected to have slowed sharply in August. **Output price** growth is also likely to have stalled, given a more moderate pace of expansion and an ease in input cost pressures.

## Market Watch

Global equity markets bounced back last week, helped by positive economic news from the US, including more encouraging labour market data and surprisingly firm manufacturing growth.

The FTSE 100 index rose 4.4% to 5,428.1, ending a three-week losing streak. The real estate index outpaced the wider FTSE index last week, rising by 4.9%.

Within the sector, Capital and Counties, and the Unite Group were the top performers last week, gaining 7.8%.

Capital Shopping Centres was up 6.3%, while Land Securities advanced 6.1%. British Land gained 5%.

Quintain Estates and Developments performed worst, falling 7.7% in the week to Friday. The Workspace Group and Minerva also fell back.

Building contractors, material suppliers and housebuilders gained across the board.

In particular material suppliers saw strong gains, with Marshalls up 11.9%, Wolseley up 9.4% and SIG 7.6% higher.

Stock Market		Friday 9th July 2010			
Index	Index	Week	Month	Year	
FTSE100	5,428.1	▲ 4.4%	0.6%	13.2%	
EPRA/NAREIT UK	361.8	▲ 4.9%	1.6%	-0.7%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,200	▲ 5.0%	1.6%	3.0%	
Hammerson	2,670	▲ 4.1%	-4.0%	-5.5%	
Land Securities	5,000	▲ 6.1%	3.3%	7.8%	
Capital & Counties	777	▲ 7.8%	10.2%		
Capital Shopping Centres	2,190	▲ 6.3%	3.6%		
Shaftesbury	978	▲ 3.3%	5.4%	19.2%	
Great Portland Est.	1,020	▲ 2.6%	2.8%	28.1%	
Derwent London	1,450	▲ 1.8%	2.6%	28.6%	
Segro	2,050	▲ 2.9%	0.0%	-17.7%	
Quintain Estates & Development	187	▼ -7.7%	-10.0%	-56.0%	
St. Modwen Properties	341	▲ 2.8%	-5.2%	-29.1%	
Unite Group	318	▲ 7.8%	1.2%	-12.0%	
Workspace Group	225	▼ -2.5%	-6.0%	-7.1%	
Minerva	141	▼ -3.1%	-15.1%	214.4%	
<b>Average*</b>		▲ 4.5%	1.6%	1.2%	
Building Contractors					
Balfour Beatty	1,690	▲ 2.9%	-5.1%	-15.1%	
Carillion	1,260	▲ 0.9%	0.0%	7.6%	
Morgan Sindall	267	▲ 4.8%	10.2%	-3.1%	
Kier Group	386	▲ 3.7%	-1.4%	-8.0%	
Lend Lease Corp*	2,321	▲ 5.9%	-3.2%	-21.7%	
<b>Average</b>		▲ 3.8%	-2.3%	-11.8%	
Building material suppliers					
Wolseley	3,910	▲ 9.4%	-5.9%	-0.2%	
SIG	596	▲ 7.6%	-2.6%	-25.4%	
Marshalls	200	▲ 11.9%	12.8%	-14.7%	
Kingspan	772	▲ 5.9%	-0.9%	-4.6%	
BSS	542	▲ 2.8%	-4.2%	48.5%	
<b>Average</b>		▲ 8.2%	-4.1%	0.6%	
Housebuilders					
Persimmon	1,180	▲ 7.0%	3.4%	-17.4%	
Taylor Wimpey	912	▲ 7.7%	-8.3%	-41.3%	
Barratt	1,000	▲ 7.5%	0.2%	-32.2%	
Bovis Homes	494	▲ 5.3%	1.6%	-25.4%	
Bellway	671	▲ 4.9%	-7.6%	-34.2%	
Berkeley	1,100	▲ 2.5%	1.6%	-9.1%	
<b>Average</b>		▲ 5.9%	-1.1%	-25.4%	

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