

Weekly Economic Update

28 November 2011

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Summary

Latest UK economic data continue to point to slowing activity and an increasingly challenging trading environment. Accordingly, the Bank of England's November inflation report shows that the bank has become much more pessimistic about UK growth prospects, due to deteriorating domestic and external factors. Meanwhile, the prospects for a viable solution to the ongoing Eurozone crisis was delivered another blow last week, after German Chancellor Merkel ruled out an introduction of a common Eurozone bond or unlimited use of the European Central Bank's balance sheet to stabilise sovereign bond markets. This led to a marked increase in bond yields in core countries such as Belgium, France and Austria.

Economy

MPC minutes

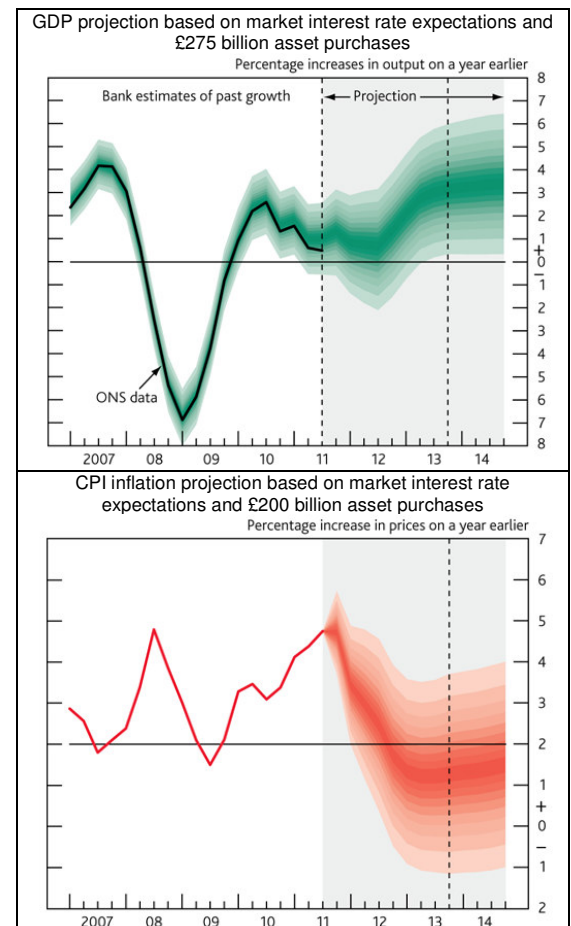
Minutes released from the Bank of England's Monetary Policy Committee (MPC) October meeting show that members are unlikely to inject another round of quantitative easing into the UK economy in the next three months. This was said to be due to the existing programme of asset purchases taking a further three months to complete, saturated market capacity and inflation remaining "materially above target".

Inflation report

Bank of England Governor Mervyn King delivered a more pessimistic view on the UK economy in the Bank's latest Quarterly Inflation Report, raising expectations that further quantitative easing is likely to be implemented in the months ahead.

According to the report, the prospects for the UK economy have worsened over the past three months, as global demand slowed and concerns about the solvency of several euro area countries intensified. In addition, household and business confidence has notably weakened, while the fiscal consolidation and squeeze on households' real incomes are weighing on UK growth. The Bank now forecasts the UK economy to stagnate until next summer. Thereafter, the UK economy should recover, helped by monetary stimulus and a modest increase in real incomes. However, the outlook for growth remains highly uncertain, reflecting the UK's exposure to developments in the Euro area.

At the same time, the Bank sharply downgraded its prediction for inflation. Currently, CPI inflation remains very high at 5%, reflecting the impacts of the past increase in VAT to 20% and in the prices of energy and other imported goods and



services. However, the Bank now expects CPI inflation to fall sharply over the course of 2012 to below the 2.0% target in 2013. CPI inflation is predicted to stay appreciably below the 2.0% target over the two-year policy horizon. How fast and how far CPI inflation will fall also remains very uncertain. It will depend on the extent to which the current weakness in demand leads to a widening margin of slack in the economy, whether the current sustained period of high inflation will eventually lead to upward pressure on wages and on whether companies attempt to restore their profit margins by raising prices.

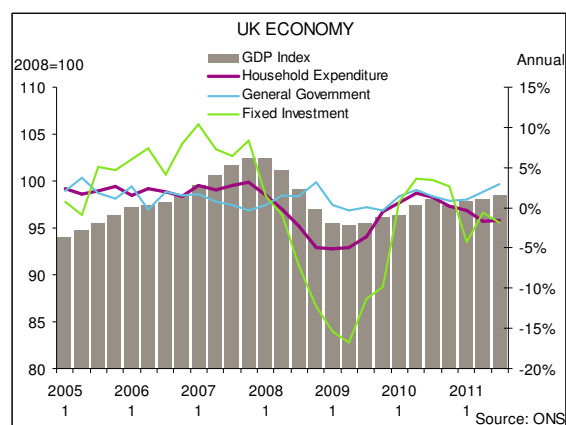
According to analysts, the latest Inflation Report implies that more quantitative easing will be enacted over the coming months on top of the additional £75bn injected recently, and that interest rates will stay at 0.5% until well into 2013.

UK growth

The second estimate for GDP confirmed that growth in the third quarter of this year was a reasonably solid 0.5% - an improvement from the 0.1% increase seen in the preceding three months. The expansion was driven primarily by the services industry. The 0.6% decline for construction output was revised up to a 0.2% fall in the new release.

On the expenditure side of the economy, consumer spending was flat in the third quarter compared to the preceding three months and down 1.5% year-on-year.

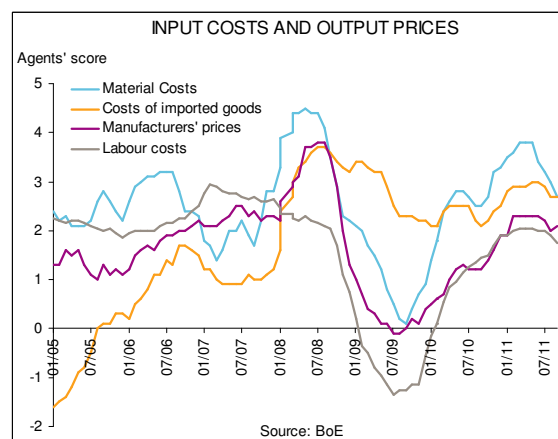
Government spending picked up over the last quarter, rising 0.5% and up 1.1% year-on-year. Fixed investment was 0.2% lower in Q3 2011 compared to Q2 and down 1.5% on a year ago. Within this, business investment fell by 1.4% to £30.2bn between the second and third quarter of 2011, but was up 0.3% year-on-year. The quarter-on-quarter fall was driven by total non-manufacturing investment falling by 3.4% to £26.5bn, with the rise of 15.7% to £3.7bn in total manufacturing investment unable to offset this. Businesses are increasingly likely to rein in their investment plans, given the uncertain demand outlook and risk of tighter credit conditions.



Business conditions

The Bank of England's survey of Business Conditions for October reveals that:

- Spending on consumer goods and services remains very weak as households were budgeting, trading down to avoid overspending, or simply going without.
- Housing market activity also remains subdued, with less of a seasonal pickup in transactions than usual after the summer. However, a small improvement in mortgage availability was noted to have encouraged a few first-time buyers back into the market, along with the Government's FirstBuy initiative and shared equity schemes on offer.
- Businesses planned a modest increase in investment over the coming year, although intentions had softened somewhat since the summer.
- Manufacturing output continued to increase, but the pace of growth continues to slow.
- Construction activity in October was lower compared to a year ago. This was due to large public sector projects coming to an end and falling repair and maintenance work by local authorities.
- Material price inflation continues to ease, as the cost of a wide variety of inputs had begun to level off in recent months. In some instances, material prices fell due to the



recent decline in the prices of many commodities, including some foodstuffs and base metals.

Business confidence

In November, new research carried out for the Confederation of Business Industry by Ipsos MORI showed that 70% of senior business figures' level of confidence in the economic outlook had fallen since the beginning of August. Despite this, only 30% of business leaders believed their company's prospects had deteriorated, while 57% felt there had been no change – leaving 11% as saying they had actually improved. The research also revealed that a third of those surveyed are reviewing investment plans and 30% are revising expansion plans.

Public sector finances

Public finances in October show a modest improvement compared with a year ago, due to higher VAT receipts and spending cuts. The government borrowed a net £6.5bn in October when excluding the temporary effects of financial interventions, down from £7.7bn in the same month of last year. Public sector net borrowing stood at £68.3bn in the first six months of the current fiscal year, down from £78.7bn last year. Looking forward however, the improvement in the public finances is likely to be limited by the economy's current weakness, which is hitting tax revenues and pushing up benefit claims.

Inflation

Annual consumer price inflation fell from 5.2% in September to 5% in October. Downward pressure was exerted by falls in the cost of food (due to significant and widespread discounting by supermarkets and good harvests for certain produce), air fares and petrol. Meanwhile, RPI inflation ticked down to 5.4%, as falling food and petrol prices offset rising clothing, furniture, electricity and gas costs.

Retail sales

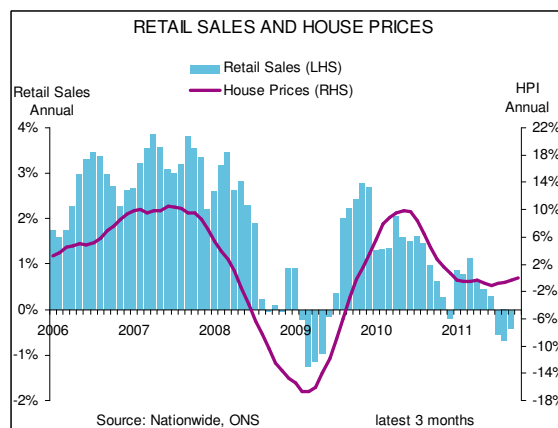
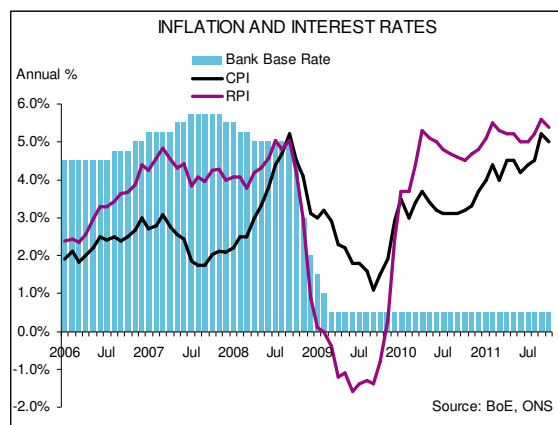
The volume of retail sales (excl. fuel) increased by 0.6% month-on-month in October and up 0.7% year-on-year. In the three months to October, sales were unchanged compared to a year ago, but up 0.5% compared to the preceding three months. Retail sales are benefiting from pre-Christmas sales and in-store promotions. Approximately £26.8bn was spent on retail goods over the last month, up from £25.4bn in October 2010.

Housing market activity

According to the Knight Frank/Markit House Price Sentiment Index (HPSI), prices in the UK are perceived to have fallen again in November for the 17th consecutive month, albeit by a smaller margin than in October. Around a fifth of the 1,500 households surveyed thought that the value of their property had fallen, while only 8% said that prices had risen. This gave a HPSI figure of 44.7 – up from 42.1 in October and matching September's reading. A value below 50 indicates that prices are falling.

Household finances

The Markit Household Finance Index (HFI) reached 34.6 in November, down from 35 in the preceding month – the sharpest deterioration in current financial perceptions of consumers for three months. Any figure below 50.0 indicates worsening household finances. The latest reading was weaker than the survey average of 37.6 and signals sharply deteriorating household finances when compared with the overall trends seen in 2009 and 2010.



Labour market

Between July and September 2011, the unemployment rate hit 8.3% – up 0.4% compared with the preceding quarter and the highest since 1996. The number of unemployed people in the UK increased by 129,000 (the largest quarterly increase since July 2009) to reach 2.62m. Furthermore, there were 1.6m people claiming Jobseeker's Allowance (JSA) in October 2011 – up 5,300 on September. Average earnings growth (excl. bonuses) softened in September from already very weak levels, due to a weak labour market and uncertain business environment. Average earnings growth stood at 1.7% in the three months to September, down from 2.3% growth in the preceding three months.

Commodities

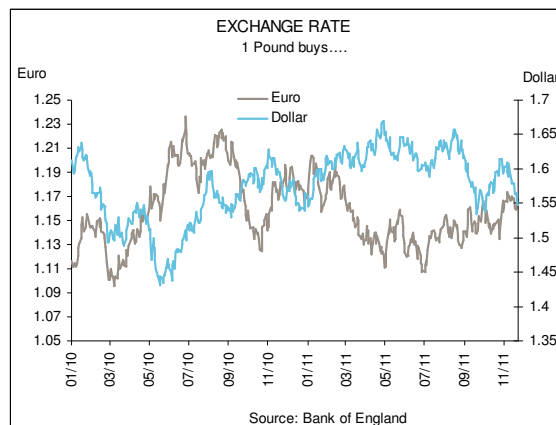
Commodity prices fell last week, due to the tensions rising from the Eurozone crisis and a stronger US dollar. Global steel prices held steady on a week earlier, but were down 5% month-on-month. The prices of copper, aluminium and nickel fell by 5% each compared with the previous week, while oil fell by a smaller magnitude of 1%. Although the price of the latter was also down 5% on a month earlier, it remained 23% up compared to a year ago.

COMMODITY PRICES (25 NOVEMBER 2011)				
	Price	Weekly change	Monthly change	Annual change
"Brent" Oil (\$/ barrel)	106.4	-1%	-5%	23%
Copper (\$/tonne)	7,197	-5%	-5%	-13%
Aluminium (\$/tonne)	1,988	-5%	-9%	-16%
Nickel (\$/tonne)	17,095	-5%	-14%	-24%
Global Steel Price (Index 04/1994=100)	190.8	0%	-5%	10%

Source: FT, LME, Cruspi

Exchange rates

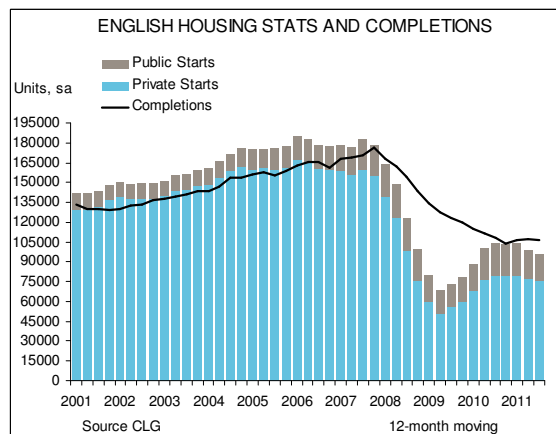
Over the week to Friday, the Pound fell by 0.1% against the Euro to €/£1.167 and was up 2% against the Dollar to £/\$1.548.



Construction

House building

In the third quarter of 2011, private housing starts increased by 4% to 19,240 (seasonally adjusted), but remained 3% below the level seen in the same part of last year. Private completions totalled 20,390, down 1% quarter-on-quarter and an 8% year-on-year decrease. The number of public housing starts reached 4,170 between July and September, down 19% compared with the previous three months and a significant 30% below the level seen in the same part of 2010. Meanwhile public completions were down 13% quarter-on-quarter to 5,800, but up 16% on last year.



Government affordable housing plan

The government is expected to announce plans to allow first-time buyers to borrow up to 95% of the value of a house. The mortgage indemnity scheme will involve the government underwriting part of the risk to lenders and is part of a wider strategy to tackle the shortage of affordable homes and boost home ownership. The new plans include a £400m 'Get Britain Building Fund' which will help to kick-start shovel-ready projects that lack the necessary finance. It is projected that the scheme will deliver 16,000 new homes and will come into fruition in July.

Market Watch

The downgrade of Belgium's and Portugal's sovereign debt rating, Italian bond yields climbing over the 8% mark and Spain looking shaky, meant that equity markets fell last week.

Amid the ongoing crisis, investors continue to shun the Euro, while banks find it increasingly difficult to get funding as lending between nervous institutions dries up. There are now also fears that the contagion could spread to core Euro countries such as France and Germany.

In the week to Friday, the FTSE 100 fell 3.7% to 5,164.6 points, while the real estate index declined by a slightly larger magnitude of 4%. In real estate, all of the companies saw falls, with St. Modwen Properties (-7.6%) and Derwent London (-6.9%) the worst performing.

London & Stamford have plans to raise the value of its residential portfolio from £170m to £300m and take advantage of the government's proposal expected to be announced next month, which allows

residential property investors to avoid stamp duty on bulk purchases and capital gains tax if the assets are held in an income-yielding Reit vehicle. It is expected to develop one and two-bedroom properties on the outskirts of London on the expectation that demand to rent homes will continue to rise. The company is also in talks with an unnamed international investor to help fund the expansion and become a partner in the residential Reit. Last week the company posted a half-year loss of £5.3m, compared to a profit of £16.3m last year, due to a £10.2m downward movement in derivatives and a slowdown in the growth of property values. Net assets stood at £645.5m, down from £658.5m last year.

All of the building contractors and housebuilders also suffered declines over the week. In the former category, Kier Group saw the largest fall, down 6.3%, while in the latter, it was Persimmon and Taylor Wimpey which were hit hardest – with declines of 6.4% and 7.9%, respectively. In building materials, it was falls across the board – except for Kingspan, which saw a 2.6% rise in the week to Friday.

EQUITIES		Friday 25th November 2011			
Index	Index	Week	Month	Year	
FTSE100	5,164.6	▼ -3.7%	-6.5%	-9.4%	
EPRA/NAREIT UK	337.0	▼ -4.0%	-8.2%	-8.9%	
Stocks	Market Cap, £m	Share Prices			
		Week	Month	Year	
Real Estate					
British Land	4,040	▼ -3.2%	-8.9%	-7.7%	
Hammerson	2,520	▼ -4.3%	-9.7%	-12.8%	
Land Securities	4,940	▼ -3.9%	-4.9%	-2.9%	
Capital & Counties	1,160	▼ 0.0%	-2.0%	13.2%	
Capital Shopping Centres	2,490	▼ -4.4%	-12.0%	-24.2%	
Shaftesbury	1,160	▼ -4.6%	-5.1%	4.9%	
Great Portland Est.	1,010	▼ -3.5%	-8.8%	-4.6%	
Derwent London	1,530	▼ -6.9%	-7.7%	3.4%	
Segro	1,530	▼ -5.9%	-12.8%	-28.7%	
Quintain Estates & Development	177	▼ -5.9%	-12.8%	-28.7%	
St. Modwen Properties	207	▼ -7.6%	-20.4%	-28.9%	
Unite Group	252	▼ -2.7%	-11.8%	-20.3%	
Workspace Group	320	▼ -4.3%	-5.8%	0.3%	
Average*		▼ -4.1%	-8.2%	-8.3%	
Building Contractors					
Balfour Beatty	1,520	▼ -4.4%	-14.2%	-19.1%	
Carillion	1,230	▼ -3.8%	-17.3%	-16.1%	
Morgan Sindall	242	▼ -1.2%	2.2%	-11.4%	
Kier Group	491	▼ -6.3%	-8.7%	-0.5%	
Lend Lease Corp*	2,542	▼ -1.3%	-7.0%	-7.5%	
Average		▼ -3.0%	-10.7%	-11.7%	
Building material suppliers					
Wolseley	4,970	▼ -5.0%	-4.0%	-1.1%	
SIG	550	▼ -7.2%	-20.3%	-33.8%	
Marshalls	181	▼ -2.8%	0.1%	-14.7%	
Kingspan	857	▲ 2.6%	0.0%	-1.9%	
Average		▼ -4.1%	-4.7%	-4.3%	
Housebuilders					
Persimmon	1,400	▼ -6.4%	-8.6%	29.2%	
Taylor Wimpey	1,160	▼ -7.9%	-2.8%	43.7%	
Barratt	908	▼ -4.5%	3.6%	26.3%	
Bovis Homes	592	▼ -2.0%	-5.2%	31.9%	
Bellway	838	▼ -3.8%	-4.2%	32.1%	
Berkeley	1,600	▼ -0.2%	0.3%	48.5%	
Average		▼ -4.1%	-2.8%	36.7%	

**Sector averages are weighted according to current market capitalisations