

The international picture

The global financial market has again been under scrutiny recently, with several EU countries (Portugal, Ireland, Greece, and Spain) suffering from a lack of investor confidence in relation to the size of their government deficits and fragility of their financial markets. This has resulted in falling stock market indices across the globe as investors seek to find 'safe havens' for their funds. The EU and IMF, although publicly announcing they would take the necessary measures to support Greece in particular, have published little detail on what such plans would entail. This may have reassured some investors but has not had the wide ranging effect on confidence the market would have liked.

However, there are some signs of recovery. The IMF has recently revised its forecast of world output for 2010 upward by of ¼ percentage point to a growth rate of 4%. Policy decisions in the near future are going to be complex with governments having to account for the, "timing, pace, and sequencing of exit policies, both from [a] monetary and financial" aspect.

Investors are concerned that there is a lack of coherent exit policies, which could subsequently decimate confidence at the first sign of trouble.

The recommendations of the IMF are that near term exit policies need to focus on securing financial stability, ensuring that the recovery is maintained and eliminating the prospect of further negative growth feeding back into the financial and real economy. Governments need to resolve deficit issues and maintain the integrity of balance sheets whilst continuing efforts to restructure weak banks.

UK snapshot

The economic picture within the UK continues to be one of subdued growth and fragile trading conditions. The preliminary estimate for GDP showed a small increase in Q4 at 0.1% with the UK only just managing to emerge from recession. This compares with a decrease of 0.2% in Q3 and has potentially (subject to revisions) ended six quarters of negative growth. The increase in output over the period is attributable to increases in distribution, hotels and restaurants, government and other services. However, these figures are subject to revision and so far indications are that

a significant upward revision is unlikely. For example, the UK's trade deficit on goods and services was £3.3 billion in December, compared with £2.9 billion in November. A negative contribution from trade to GDP may hamper the possibility of a positive revision.

Conditions within the labour market continue to show signs of resilience with the unemployment rate (Oct-Dec 09) unchanged on the previous quarter (7.8%). The number of people unemployed over the period fell by over 3,000 with the total number of unemployed standing at 2.46 million.

The latest house price indicators have also reported monthly increases (Nationwide up 1.2%, Halifax up 0.6%). Halifax has now reported seven consecutive monthly increases compared to Nationwide's nine. Both series are now showing annual rates of growth.

Credit markets are unlikely to display signs of recovery in the near future, with credit constraints continuing to limit investment opportunities. Fiscal expectations are also unclear, given the lack of detail provided by the political parties regarding the timing and type of cuts proposed. This is likely to result in financial/investment decisions within the private sector being delayed until after the general election.

Inflation, interest rates and sterling

January's inflation figures may cause some degree of unease with policymakers. The CPI measure for inflation was reported as having risen 3.5% on the same period a year earlier; the RPI index tells a similar story, rising by 3.7%.

However, it must be noted that a significant contributor to the increase in inflation was the restoration of the standard rate of VAT at 17.5%. Although the latest Bank of England inflation report (10/02/09) occurred prior to the release of January's inflation figures, the effects of VAT and the probability of further rises were commented upon:

- December's sharp rise in inflations "reflects the impact of one-off adjustments to the level of prices." Inflation is likely to remain "significantly above" the 2% target in the near future before downward pressure is exerted from a "persistent margin of spare capacity".

Another contributor was that of transport costs, which are feeding through from the continued increases in the price of crude oil. ►

Volume of new orders obtained by contractors: December 2009

Source: ONS

	Public Housing	Private Housing	Infrastructure	Public - non residential	Industrial	Commercial	Total new work
2008-09	5%	-27%	42%	9%	-38%	-44%	-13%
QonQ	-19%	41%	-13%	-15%	24%	18%	0%
QonY	38%	20%	34%	6%	-22%	-23%	5%
MonM	60%	-25%	198%	-11%	-3%	-4%	21%
MonY	*168%	-10%	14%	10%	-22%	-22%	4%

*it should be noted that the new orders for public housing during Decemeber 08 and January 09 were very weak, contributing significantly to the MonY growth rate.

The MPC has voted to maintain the current rate of interest (0.5%), and to hold quantitative easing at its current level (£200 billion). The committee believes these levels will continue to provide a sufficient financial stimulus. The Bank of England assured the markets that it is continuing to monitor inflation closely given it is now above the 2% CPI target.

The exchange rate as of the 16 Feb 2009 stood at \$1.568 and €1.144. Since the first of October 2009 the pound has weakened against the dollar and is currently at its lowest level over the period. However, the pound has fared better against the euro. The continued weakness of the UK economy, our exposure to the financial services market, investor concerns regarding our deficit and political uncertainty all suggest that sterling will continue to remain weak in the near future.

The construction industry

Overall, the total volume of construction output in Q3 rose by 2% compared with the previous quarter. However, it should be noted that this figure includes repair and maintenance work as well as new construction projects.

When looking specifically at output with regards to new work, there was a contraction of 4% on the previous quarter and 13% on the same period a year earlier.

The sectorial breakdown of output reveals that quarterly growth is being fueled by the public sector. This is of concern given that there are likely to be cuts in the funding available for public projects after the next election.

The (provisional) new orders figures for Q4 indicate that that total new work was down very slightly down on the previous quarter (-0.1%). However, when comparing Q4 with the same period a year earlier only two sectors (industrial and commercial) have reported a reduction in orders

The Glenigan index for the construction industry also shows that 2009 ended on a weak footing, having suffered a challenging year, with the index reporting a 9% fall in underlying year on year projects. Unfortunately the initial data for 2010 currently shows little signs of improvement. January's CIPS construction PMI figure (48.6) indicates that activity is still contracting (anything below 50 indicates contraction) but did improve on the previous month (47.1).

Trading conditions in the construction sector are going to remain tough, 2010 has already presented its share of challenges in the form of January's extreme weather conditions. A continued lack of investor confidence, and tight credit conditions are likely to restrict construction growth throughout the summer, with some potential for improvement toward the end of 2010. However, public sector cuts look inevitable, and these may not occur until early 2011, potentially damaging any progress. ■

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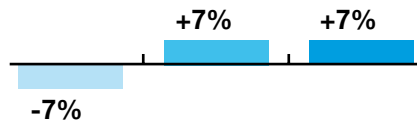
Aggregate forecasts

See below for a consensus of independent forecasts for construction output [annual percentage change]

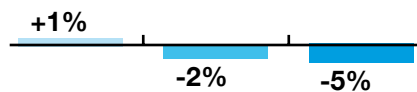
Source: ONS; Hewes & Associates

2010 2011 2012

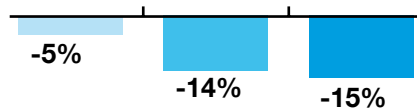
Private housing



Public housing



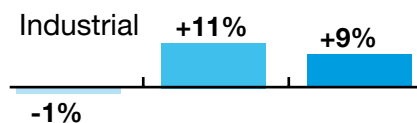
Public non-residential



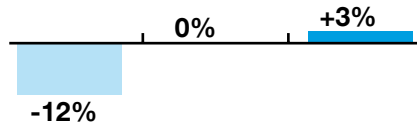
Infrastructure



Industrial



Commercial



Volume of construction output: 3rd quarter 2009

Source: ONS

	Public Housing	Private Housing	Infrastructure	Public - non residential	Industrial	Commercial	Total new work
2007-08	-7.8%	-19.3%	15%	16%	-19%	2%	-3%
QonQ	14.3%	-11.8%	-3%	7%	-4%	-11%	-4%
QonY	2.8%	-30.6%	7%	31%	-35%	-28%	-13%