Monthly

Economic Review

Provident Solutions

Wealth Creation & Wealth Management
Financial Lifestyle Planners

Economic review of: August 2012

Our monthly economic review is intended to provide background to recent developments in investment markets as well as to give an indication of how some key issues could impact in the future.

It is not intended that individual investment decisions should be taken based on this information; my colleagues and I are always ready to discuss your individual requirements. I hope you will find this review to be of interest.

Paul Smith

Good news on the housing front

More funds made available

Last month (July) saw mortgage lending increase by 8% from the previous month to £12.7bn, the highest level seen this year and up 2% from the same month last year, according to the Council of Mortgage Lenders (CML).

Whilst encouraging, the CML warns that these figures represent a *"see-saw"* graph pattern and that they believe the property market is still *"broadly flat"*.

Also, these figures mask the fact that lenders are continuing to ration the funds available to borrowers through increasing the level of deposit required – in some cases to as much as 20% - and by so doing halving the level of house sales since the heady days of 2008. This means that many first-time buyers are having to accumulate the best part of a year's take-home pay before being able to qualify for mortgage funding.

One market participant commented: *"Until lenders start lending consistently at higher loan to values, the mortgage - and subsequently property - markets are destined to cruise.*

"For the property market to regain any kind of traction, we need to see lenders target borrowers with smaller deposits, or less equity, far more aggressively, but the will to do so simply isn't there."

Encouragingly, the Bank of England's (BoE) new Funding for Lending scheme may well add impetus to the market place by offering banks and building societies below market rate loans on the condition that these additional funds are then made available to borrowers. By offering these funds to non-financial businesses in what the BoE calls "the real economy" mortgage lending should increase accordingly.

Meanwhile, The Halifax has commented that mortgage repayments are now more affordable than at any time in the last 15 years. They go on to say that these repayment costs represent just over 25% of the borrower's take-home pay. This is the lowest percentage of disposable income since 1997. They also cite the current record-low base rate of 0.5% as a contributory factor to this, ensuring that house prices will remain steady for the remainder of 2012.

At the other end of the spectrum, baby-boomers and pensioners have seen major price gains on their properties. This lucky group of people have, therefore, seen very considerable success in their property investments.

Increase in retail sales boosts UK's economic sentiment

Consumers start to spend

An unexpected increase in retail sales for July has seen sentiment in the UK economy boosted and gives hope that the current recession may not be as deep as previously reported. Figures just released by the Office for National Statistics (ONS) report that retail sales increased by 0.3% in July and were 2.8% up against the same period last year. At the same time they revised upwards the June figures from a previously reported 0.1% to 0.8%.

These revised figures have led analysts to believe that the ONS's figures of shrinkage of 0.7% in the April-June Gross Domestic Product (GDP) figures may prove to have been over pessimistic.

Vicky Redwood, of Capital Economics commented: *"The latest UK retail figures are pretty good - as much for the upward revision to past months as for July's figures.*

The fall in sales in Q2 overall was revised from 0.7% to 0.3%, adding to other evidence suggesting that the initial estimate of GDP will be revised up in next week's second estimate.

"What is more, sales should maintain this recent positive momentum in the near term as the boost from the Olympics comes through."

Factors underlining this overall increase in retail sales include an increase of 2.6% in fuel sales, driven by a pump-price war by the big supermarket chains and food sales rising by 0.4%.

However, the ONS went on to say that retailers also reported little impact on sales from the London Olympics.

Amit Kara, of UBS said: *"The data shows there's been a widespread pick-up in volume growth across most of the sectors...and of course this is all coming before the boost we're likely to get from the Olympics."*

"As such it is consistent with the view that Q3 will be a lot better for overall economic growth in the UK."

Meanwhile, George Buckley, of Deutsche Bank commented: *"I think it supports what the Bank of England's been saying that as real incomes start to improve because of lower inflation* *and possibly eventually higher wages, you might start to see the retail sector show some signs of improvement."*

A shallower recession than previously reported

More good news from the Office for National Statistics (ONS)!

Revised figures encouraging

The gloomy forecast of the ONS for UK economic growth between April and June was overly pessimistic it appears. Their revised figures show Gross Domestic Product (GDP) actually contracted by only 0.5% in the period rather than the 0.7% previously reported.

These new figures give credence to a number of industry commentators who questioned the earlier forecast, as they had seen little sign of such a dramatic drop in business activity.

Joe Grice, of the ONS, stated that:*"The production sector was not quite as bad (as we had thought); similarly the construction sector."*

Both of these sectors accounted for a downward reduction of 0.1% from the original overall 0.7% estimate, with output in the construction sector alone falling by 3.9% in the period, against a previous estimate of a 5.2% drop.

He also said that these revisions downward did not change the overall picture of the UK economy, which has been *"broadly flat"* for the last 48 months.

Commenting further on the gravity defying labour market, with unemployment falling, Mr Grice went on to say one of the reasons for this was perhaps a move to more part-time working, which also affected the "productive capacity" of the economy.

Pundits also agreed with this sentiment, with Vicky Redwood, of Capital Economics saying: *"The revision is very small in the big picture and means that output is still more than 4% below its pre-recession peak."*

Continuing on the positive vein, several statisticians believe that the UK's GDP will rebound in the current quarter (Q3), particularly because of the impact of the London Olympics, and a general rise in consumer spending (see our article on retail sales).

Markets: (Data compiled by The Outsourced Marketing Department)

Mixed sentiment this month

Ben Bernanke's clear hints at additional quantitative easing from the US Fed, announced late on August 31st were being closely analysed by the global equity markets. The FTSE100 ended the month on 5,711.5 up 1.35%, after a somewhat lacklustre monthly session. Likewise, the European exchanges enjoyed calmer waters with the PIGS sovereign borrowing costs somewhat reduced. The Eurostoxx50 closed August on 2,440.71, up an impressive 4.75%.

Meanwhile, across the pond the Dow Jones finished at 13,090.84 and the Nasdaq on 3,066.96 with the Japanese Nikkei index ending the month on 8,839.91.

On the foreign exchanges the Euro recovered somewhat, with the reported increase in eurozone inflation, tempering the ECB's resolve to reduce interest rates further. Against Sterling the Euro closed on €1.26 and at $1.26 against the US Dollar. Sterling closed the month on $1.59 against the greenback.

Once again, gold rose slightly in the month finishing up $73.75 at $1,690.32 an ounce.

For the second month running oil climbed higher, with Brent Crude finishing up $7.73, at $112.65. This represents a gain of 7.37% in August, following July's 7.28% increase.

UK staffing levels remain high despite recession

Firms hold on to skilled staff

The Chartered Institute of Personnel and Development's (CIPD) recently published *Labour Market Outlook* which canvasses over 1,000 employers via YouGov has reported that the current jobs outlook remains very positive, as many employers are deliberately retaining staff levels to avoid losing expensively trained and highly skilled workers, this is despite reduced levels of demand in the economy.

The balance of those employers canvassed who said they will increase their staff levels, against those saying they will reduce their staff levels in Q3 2012, has remained positive at +5 (against +6 during the previous quarter). This optimism was higher with private sector SME's at +46 than with larger private firms at +17, however, not surprisingly, the overall public sector score continued to be negative at -36.

Furthermore, the number of firms planning to make redundancies in Q3 dropped from 32% to 29%.

The fragility of the labour market is reflected in the reporting that many firms (31%) have been maintaining their staffing levels above the economically required levels, in order to retain highly skilled staff. Having said this, almost two thirds of these firms (62%) also reported that they will have to start reducing their staffing levels from current levels if the economy in general does not pick up in the coming twelve months.

Commenting on their findings, the Labour Market Adviser at the CIPD, Gerwyn Davies, was quoted as saying: *"Recent falls in unemployment suggest that the labour market is on a soft footing, but a closer examination reveals that many employers are holding on to more staff than is required by the current level of demand in order to retain their skills. This is a make or break moment for employers - unless growth picks up many will find that they cannot hold on to some workers any longer. The tenacity with which employers are hanging on to skilled labour is a reflection of the high value they place on it and the damage they fear will be done to their businesses if they are forced to start making more redundancies.*

"The spare capacity implied by the research suggests that many firms are ready to increase their output quickly if demand grows. But, there is only so long they can hold out for growth. The labour market is approaching a game-changing phase - one that could shape Britain's capacity to compete for a generation. Private sector firms should be using any spare capacity they have to train, to innovate, or to focus staff in areas such as business development to help drive the medium-term prospects of their firm and the UK economy."

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