Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners

Economic review of: December 2011

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

IMF signals better year to come:

Late in the year, the International Monetary Fund (IMF) forecast positive growth in the global economy with GDP estimates at about 4% for 2012.

Global GDP growth of 4%

Whilst most pundits suggest that Europe may see a return to a shallow but short-lived recession, the United States is seen as remaining in positive territory and the emerging markets - especially China, India and Brazil - maintaining their growth profiles.

China is expected to see GDP growth in the 8%-9% range, with Chinese domestic consumption continuing to grow.

Whilst Brazil, in late December, was seen to rise above the UK in the economic league tables by becoming the sixth largest global economy.

Markets:

The Eurozone debt crisis hangs over the markets, with investors wary of equity risk and sovereign debt.

Looking for Safe Havens

The FTSE100 traded in a 4.8% range during the month between a low of 5,312.8 on the first trading day of the month and a high of 5,572.3. It finished the month on that high of 5,572.3.

With the warnings of a possible double-dip recession for the European region hanging over the markets, the equity risk appetite was muted and liquidity remained subdued at an average of 469,000 trades a day, also reflecting the usual wind-down of activity in the run up to Christmas.

Long-term trends in the FTSE100 improved to sit 13.9% below the trend, compared to the 14.9% decline reported last month, a useful 1% improvement in sentiment.

In positive territory, the American Dow Jones closed the month 1.43% up at 12,217 however, its sister Nasdaq was down 0.58% at 2,605. Elsewhere, the Eurostoxx50 showed a 0.6% decline at 2,316 whilst the Japanese Nikkei225 was 0.25% lower at 8,455.

With commodities linked closely to the global economic outlook, attention turned to the main players with Oil remaining relatively stable as Brent Crude finished the month on $110.82. This represents a marginal 3.2% decline on the month, better news for industry.

Gold again remained unloved, tracking continuously under the $1,600 level and ending the month (and year) at $1,531. Whilst this was a decline of 12% on the month, the precious metal still managed to finish the year up 8%.

On the foreign exchanges, sentiment followed the sovereign debt issues, with the credit rating agencies sending out negative comments about several sovereign countries, including Italy, Greece, Spain and France.

A flight to safe-haven currencies resulted in sterling ending the month at $1.557 against the US Dollar and €1.199 against the Euro (a 2.8% gain on the month). The Euro itself ended the month at $1.299 (a 4% decline in value) against the Greenback demonstrating the lack of positive action is damaging the exchange rate of the embattled Euro.

New Blood in the UK banking market:

The Co-Operative Group has been chosen as the preferred bidder for the 632 branches of The Lloyds Bank Group that they were obliged to sell by the European Commission to avoid charges of overt financial Governmental support.

More competition at last

With over £35 billion of deposits, representing nearly 4% of the UK current accounts, this will see a reversal of the process, whereby formerly mutual banks were taken public.

Provided that the existing customer base is happy to switch to the new owners, this is surely good news for the consumer, with increased competition being introduced into the high Street banking market at long last.

When combined with the existing customer base that the Co-Operative boasts, this will increase their profile to nearly 8% of the current account market.

The UK vetoes new Lisbon treaty:

The camp is divided as to whether David Cameron's refusal to sign up to the EU's proposed revisions to the Lisbon Treaty - to help resolve the latter's Eurozone countries' debt crisis - is good for the UK or not.

No to new treaty

With the debt crisis refusing to go away, possibly because of a lack of realisation by the Eurozone member states of the size and gravity of the issues at hand, David Cameron used his (our UK) veto.

In effect, he was protecting the UK's interests, especially those of the City of London in particular and the financial services industry in general, that is such a large contributor to our UK GDP.

In addition, he was vetoing any transfer of power from the Sovereign state to an anonymous EU regulator of financial services. The European Banking Authority is currently domiciled in London and he did not want to see this transferred to Europe.

More importantly, he also objected to the statement that all Euro-denominated transactions take place within the Eurozone. Given that currently the vast majority of global foreign exchange transactions (including those denominated in Euros) across multiple markets (FX, Equity, Fixed Income, and Derivatives) are conducted through London, this was also unacceptable.

Should the Eurozone countries try to club together to enact their wishes against the UK's interests, David Cameron suggested that these would also be blocked by our veto.

He was quoted saying: *"While there were always dangers of agreeing a treaty within a treaty, there are also risks with others going off and forming a separate treaty. So we will insist that the EU institutions (the court and the commission) work for all 27 nations of the EU. Indeed those institutions are established by the treaty and that treaty is still protected."*

The political poker game continues with sources in Brussels being reported as saying that the UK is playing a *"dangerous game"* because at present financial services regulations are decided upon within the EU by the qualified majority voting system, within which the UK does not have a veto. However, short-term it can create a *"blocking minority"*, but if an increasing number of EU member states join the Eurozone (but why would they want to?) then this option will be dramatically diluted.

On slightly less contentious issues, at the summit it was agreed that day-to-day management and control of both the European Stability Mechanism and the European Financial Stability Facility would be handed over to the European Central Bank (ECB).

Having said that, the ECB has found itself shackled, in its effective market interventions to protect the Euro and its Sovereign member states, by the legal restrictions put upon it by the very treaty that the summit was trying to amend.

UK Gilts gain from their safe-haven status:

Perversely, for a country with one of the largest budget deficits, the UK Gilt market has enjoyed a strong rally in December, resulting in 10-year Yields dipping to as low as 1.9%.

UK Gilt market enjoyed a strong rally in December

One of the lowest yields rates available in the sovereign debt markets.

This is mainly due to the fact that the UK, with its independent currency, and thus greater fiscal and monetary flexibility, is being viewed globally as a safe-haven for cash.

Given that the UK's Bank of England is almost certain to reintroduce a programme of quantative easing to the tune of a further £75 billion in the very near future, the prospect of yields falling even further is very much on the cards.

Overall returns on Gilts through the 2011 calendar year have exceeded 16%.

The other side of the coin is, however, that corporate bonds have seen a counter rise in their yield rates as investors' plump for safety.

Jobs:

In the three months to end-October, UK unemployment rose to 2.64m. This represents a rise of 128,000 people and amounts to 8.3% of the population.

Another set of bad figures

Youth unemployment (those between the ages of 16-24) also rose to 1.027m. This represents an increase of 22% to end-October from the previous quarter.

Whilst the percentage claimant count of the Jobseeker's Allowance did reduce somewhat, there was still an increase during November of 3,000 (to 1.6m people) in those out of work and claiming.

Overall, the number of people actually in employment in the economy fell by 63,000 over three months to 29.11m. The private sector managed to generate 5,000 jobs in this period.

With average wage rises showing a modest increase of 1.8% from the previous year and only 0.1% from the previous month, it is clear that wages are declining in real terms, with the CPI sitting at a slightly reduced rate of 4.8% from the previous month in November.

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