Monthly

Economic Review

Provident Solutions

Wealth Creation & Wealth Management
Financial Lifestyle Planners

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Economic review of: December 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

Funding for Lending starts to work

Unlocking funds is working

The Funding for Lending (FLS) scheme - introduced earlier this year by the Bank of England to offer cheaper funded money amounting to approximately £60bn to banks and building societies to enable them to lend-on to individuals and smaller businesses – is showing signs of starting to work.

Although in early December they reported that only £4.4bn of funds had been drawn on by only six lenders. Whilst emphasising that they did not expect to see the full picture until into the New Year, the Bank of England stated that early signs of take-up were good.

In their quarterly bulletin they said: *"FLS should lead to more and cheaper credit flowing into the real economy than otherwise.*

"Early signs have been encouraging: market funding costs for UK banks have fallen sharply and many loan rates have fallen.

"But given the usual lags from credit being offered to loans being made, the FLS is unlikely to materially affect lending volumes until 2013."

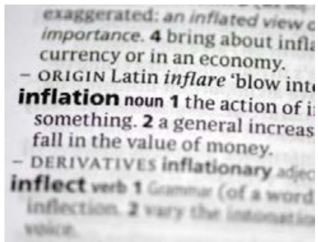
One negative aspect of this initiative is that savers rates have also declined, as the banks and building societies involved are under less pressure to raise funds from the wider market place.

Being just one of many initiatives introduced to try to boost the economy; FLS joins quantitative easing as another arrow in its reflationary quiver. Here they have injected £375bn of 'new' money into the banking system and they have held interest rates at an historical low of 0.5% for nearly four years.

Echoing the Bank's comments, Mike Cherry, of the Federation of Small Businesses (FSB) was quoted as saying: *"The cost of borrowing is beginning to slightly fall, so there is some sign that FLS is having an impact.*

"There has been an increase in the number (of loans) that have been approved straight away."

Inflation remains static



Mixed messages from the data

Reporting the official inflation figures for November, the Office for National Statistics (ONS) stated in late December that the Consumer Prices Index (CPI) measure remained static at 2.7%.

Whilst good news that there had been no increase in November, the previous month (October) saw the index jump to 2.7% from its three-month low of 2.2%. The CPI figure has remained stubbornly above the Bank of England's target rate of 2% for the past three years, resulting in the Governor, Sir Mervyn King, having to write a regular letter to The Treasury to explain the reasons. The Bank hopes to now achieve its target rate in the autumn of 2014.

Many pundits believe that the CPI measure will increase slightly moving into 2013, as anticipated increases in gas and electricity prices work through and supermarket food prices rise as a result of drought in the United States and Russia and low monsoon rains in India adversely affecting the global price of grain.

Whilst November price rises were recorded in fruit, cereals, bread, and energy, these were offset by a fall in air fares, car fuel, carpets and beer.

Meanwhile, the wider Retail Prices Index (RPI), which incorporates mortgage and housing costs, showed a decline from the previous month's 3.2% to 3%.

Given the still fragile state of the UK's economy, there is some speculation that the new incoming Governor of the Bank of England, Mark Carney, may well ignore this current inflation target and concentrate more on other economic measures, such as the nominal gross domestic product (NGDP), which tracks the total economic output of the country.

Such a move would risk allowing inflation to rise, to boost consumer spending and deflating the value of individuals' and corporate borrowings.

As a result of these moves all eyes are then on the Bank to see if they restart the printing presses and increase their Quantitative Easing programme in early 2013.

Markets: (Data compiled by The Outsourced Marketing Department)

The political impasse was taken to the wire over the anticipated American 'Fiscal Cliff' with no resolution offered at the close of the markets in December. Therefore, most global markets remained muted awaiting news from across the pond.

Attention on the 'Fiscal Cliff'

The Dow Jones finished the year on 13,104.14, up a marginal 0.6% on the month, and 1.2% on the year. The Nasdaq closed on 3,019.51 to record a monthly rise of 0.31% but an impressive gain of 15.9% for the year.

Here in the UK the FTSE100 ended 2012 on 5,897.8 to show a monthly gain of 0.53% and a 5.8% improvement for the year. The wider FTSE250 closed out at 12,375.0, a 2.83% rise since November and recording a splendid 22.4% gain for the year. The junior AIM market finished the year on 707.21 improving a modest 2.91% for the month which mirrored its annual gain of 2.0%.

Elsewhere, the Eurostoxx50 closed out a turbulent 2012 at 2,635.93, a 2.36% gain for the month and a 13.7% improvement for the year. The Nikkei finished at 10,395.18, up a healthy 10.05% for the month and very respectable 22.9% for the year.

On the currency markets, sterling finished 2012 at $1.63 against the greenback and €1.23 against the Euro to record respective annual gains of 4.4% and 3.3%. The Euro also had an annual gain of 2.3% against the US Dollar ending the month at $1.32.

The Brent Crude benchmark for oil saw the black gold finish 2012 at a symbolically symmetrical $111.11, a monthly gain of 1.46% and a modest rise of 3.4% for the year. Gold recorded yet another year of gains, this year rising by 9.4% to close out the year at $1,675.90.

UK property records an annual increase in price

In encouraging news, UK property prices saw a 0.2% increase in November, raising the annual price increase to 1.5%, leaving the average house now costing £231,000, slightly off their recent peak value of £234,000, which was recorded in July and August.

Encouraging signs of activity

These figures, released by the Office for National Statistics (ONS) in December, fly in the face of recent surveys from Nationwide and Halifax, who are amongst the UK's largest lenders, who both reported slight price falls over the last year.

Not surprisingly, the ONS report also confirmed that the largest and fastest increases were recorded in London, but this did not skew the data, as if both London and the South East prices were taken out of the equation, the national price was still higher than a year ago.

Confirming these findings, the ONS said: *"House prices continue to remain relatively stable across most of the UK, although prices in London are increasing and prices in Northern Ireland are falling.*

"The year-on-year increase reflected growth of 1.8% in England and 2.8% in Wales, which were offset by a decline of 2.2% in Scotland and 11.7% in Northern Ireland."

Whilst this is welcome news, especially for home-owners, the modest annual increase shown does not represent a general revival in house prices and the market remains subdued in activity.

As reported in another article here (Funding for Lending), the Government's Funding for Lending Scheme (FLS) is starting to gain momentum and, hopefully, will start to prime the first-time buyer market, which in turn may increase market activity in the housing pipeline in the medium to long-term across the country.

Highest number of employed since records began

In an upbeat report from the Office for National Statistics (ONS) in late December, it was stated that unemployment fell by 82,000 to 2.51 million in the period between August and October bringing the national rate down to 7.8%, a 0.2% drop from the previous quarter, which is the largest quarterly fall since 2001.

Good news on jobs front

Employment also rose by 40,000 to show 29.6 million in work. This is the highest number of people in employment since records began.

The private sector recorded an increase of 65,000 workers to 23.8 million. However, the public sector continued its decline, losing 24,000 workers to 5.7 million.

The minister for work and pensions, Mark Hoban, commenting on these figures was quoted as saying: *"We see more people looking for work and actually finding work, so I think there's a really strong labour market there.*

"I think there's more flexibility in the labour market, although this month we've seen a big increase in full-time jobs and no movement at all in the number of part-time jobs."

On the down side total pay was only up 1.8% compared to the same period last year and therefore still below the rate of inflation. This lack of wage growth is likely to dampen consumer demand.

Meanwhile, the Office for Budget Responsibility, who are responsible for the veracity of economic forecasts on behalf of the economy, cut their forecast of the future peak of unemployment to 8.2%, which is considerably higher than the 7.8% reported by the ONS.

On behalf of the opposition, Liam Byrne, the shadow work and pensions minister stated: *"Pay packets are under intense pressure as the pace of jobs growth slows down - wages are now growing at only half the rate of prices.*

"Families are under real pressure right now and what today's figures show is that the Department for Work and Pensions' big back-to-work programmes are frankly delivering nothing."

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