Monthly

Economic Review

Economic review of: February 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

Is the housing market on the move again?

A rise in asking prices

The property website **rightmove** has reported that the average asking price for houses across England and Wales has risen at the highest rate for a decade this month.

Reporting a 4.1% rise, after a 0.8% fall in January, this represents the greatest rise in asking prices since 2002. Translated to annual prices, this would see a 1.4% increase which would show the average house price across England and Wales rising to £233,252. (Rightmove does not use the same basis of calculation as some other index compilers. The Nationwide House Price Index, for example, showed an average price of £162,712 for February. So, when checking trends, it is always important to compare like with like.)

Having said that, there appear to be several ‘micro-markets’ across the regions, with large variances in asking prices being recorded. These ‘micro-markets’ reflect the areas where there is high buyer demand but low housing stock. Of course, London is amongst these areas and asking prices here are approaching all-time highs, rising by 4.3% in the last twelve months.

In these prime locations, whilst vendors have increased their asking prices, they have still managed to sell, creating a virtual circle of optimism.

An added element of this rise is that mortgage approvals have reached a two-year high. First-time buyers in particular are taking advantage of the current two-year exemption from stamp duty, which ends on 24 March. This element has compounded the effect, as more buyers are entering the market place with lower deposits required from them.

The British Bankers’ Association, representing most of the major mortgage lenders, say that 38,092 mortgage applications in January were approved, which represents a two-year high and a 34% increase in lending from January 2011.

Unfortunately, the North/South housing market divide remains. Whilst the south of the UK has seen these increases in asking prices, the anomaly is that those same asking prices in the West Midlands, East Midlands, North East, North West, and Wales have been falling.

A sobering thought here is that, again in the last decade, the average value of houses in the UK has increased by £1.8 trillion, or £68,500 per owner-occupier, but with most of that increase being achieved between 2001 and 2007, whilst declining by 5% since then.

The Eurozone bailout of Greece buys time

11th hour reprieve from default

At last the Eurozone (and the global markets) can breathe a sigh of relief after the Greek Government finally approved the swingeing austerity and fiscal demands of the Troika at the eleventh hour.

This Troika of the EU, the ECB, and the IMF, demanded that Greece find another €3.3bn of austerity budget cuts and a 22% cut in the national minimum wage. This will see the minimum monthly wage drop to €580 and even lower for the workforce aged under 25 years.

The Greek MPs will also be voting on additional pension cuts for their public sector workers, including doctors, teachers and health, transport and defence workers.

Crucially, in addition to this, the Greek Government had to successfully negotiate with the private holders of their national debt bonds a 53% haircut (or loss), equating to €107bn of Greek debt being removed. Most of this was achieved through debt swaps. This means that those holders of this debt have agreed to exchange their existing loans for new bonds, paying a substantially lower rate of interest.

Many of these private owners of the debt are major Eurozone banks across the region, including Commerzbank in Germany and BNP Paribas and Crédit Agricole in France, who have seen their investments decline by approximately 75%. Of course, the largest holder of this debt is in fact the Greek banks themselves, severely damaging their balance sheets.

The end result of this was that the Eurozone countries have agreed to offer €130bn of funds, to allow the Greek Government to meet its immediate debt refinancing needs - due shortly, on March 20th - and eventually bring its sovereign debt down to 120.5% of GDP by 2020 without having to resort to additional loans.

This ‘rescue package’, whilst welcome in principle, has deeply divided the nation with continuing civil unrest and riots across the country.

Oil price continues to rise

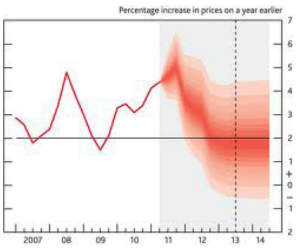
The crude oil price soaring to record highs in Sterling and Euro terms of £79 and €93.60 a barrel, respectively, poses a serious threat to the UK and Eurozone’s already faltering economies. The EU has forecast that the Eurozone economies will decline by 0.3% in 2012, with the Greek economy shrinking by 4.4%.

These increases reflect not only the weakness of the UK pound and Euro against the greenback but, most importantly, the political tensions that are building up in the Middle East, especially Iran's posturing around cutting off oil supplies to Europe and threatening to close the Straits of Hormuz, being a retaliatory gesture to sanctions being imposed on them because of their nuclear ambitions.

Oil touches $124 this month

UK inflation follows its downward trend

The Office for National Statistics (ONS) has reported a sharp reduction in both Consumer Prices Index (CPI) and Retail Prices Index (RPI) inflation for the fourth month running.



Sharp reduction in inflation reported

With the inflationary pressure of the previous year's VAT rise (from 17.5% to 20%) dropping out of the equation, both measures of inflation in the UK dropped substantially in January, with the CPI rise reduced to 3.6% (from 4.2%) and the RPI rise to 3.9% (from 4.8%).

This brings the CPI measure down to a 14-month low, albeit still above the Bank of England's benchmark target of 2%. This means that the Governor, Mervyn King, had to write a letter to the Chancellor, George Osborne, to explain why this figure remains at least 1% above that target rate.

In doing so, he stated that in the MPC's opinion the inflation rate would continue to decline and explained that they are continuing to boost the money supply by injecting another £50bn into the economy via the bank's quantitative easing programme.

On publication of these figures David Cameron, the Prime Minister, was quoted as saying:

"Inflation is coming down and that is good news, as the cost of living is the most important issue facing families up and down the country."

Other factors cited for this reduction in inflation were; a smaller increase in basic commodity and oil prices from last year, small falls in the cost of clothing, footwear, household goods, furniture, and transport.

The analysts' consensus is that inflation will continue to fall to below the 2% target before the end of 2012, thanks to anticipated lower commodity and agricultural prices.

Markets: (Data compiled by The Outsourced Marketing Department)

For the second month running, all the markets tracked here saw bullish sentiment taking over. The investors' "risk-on" mentality appears to have taken hold, with the FTSE100 trading in a 2.6% range through February, with a closing-price low of 5,790 and a high of 5,945.3, but finishing the month 190 points higher at 5,871 for a 3.3% rise from January's close. Similar gains were seen in the FTSE250, rising 6.3% to 11,449, and the AIM market adding 8.58% at 825.73.

Markets show strong rebound

Global sentiment, buoyed by positive developments from Europe in the Greek debt scenario and positive economic data coming out of the USA, saw other equity markets follow suit, with the Dow Jones adding 2.3% through the month, finishing at 12,952, although having closed earlier in the month above the psychological barrier of 13,000.

Meanwhile, the European markets continued this positive trend with the Euro Stoxx50 closing at 2,512 to record a 3.95% gain in the month.

Elsewhere, Japan recorded another good month for investors, with the Nikkei adding 10.46% to close the month on 9,723.2.

Political sabre rattling in the Middle East continues, with Iran threatening both military action to close the Straits of Hormuz and also halt oil shipments to Europe seeing the Brent crude price react accordingly, rising 9.52% in the month to $121.55.

In February, gold traded in a narrow range but retained its allure for investors, rising marginally to $1,781, up 2.67%.

On the foreign exchanges, the Euro saw gyrations against the US$ with the political see-saw around the Greek debt bailout affecting daily sentiment. However, it closed the month at $1.33, only 1.43% up on the month. Elsewhere, sterling was steady against the greenback, ending February on $1.59 and at 1.19 against the Euro.

EU Bonds move to centre stage

The European Central Bank's (ECB) further largesse of injecting liquidity into the European banking and financial sector has resulted in a boost to the EU bond market, allowing the EU to raise €3bn in 20-year bonds at a yield of 3.4%, which represents a premium of only 90 basis points over similar German bonds. This tranche of borrowing follows an issue by them of €3bn of 30-year bonds in January.

Strong demand for EU bonds

Having already borrowed €489.4bn through the December issue of the Long Term Refinancing Operation (LTRO) initiated by the ECB, Eurozone banks and financial institutions are expected to take up another €500bn - much of which will be invested again into EU bonds - after this further injection of liquidity from the LTRO timed for the end of February.

The positive sentiment in the EU bond market could be upset, though, should the banks not take up this expected amount of funds from the ECB.

The market needs to be watched carefully with Italy, Germany, France, and Spain all expected to raise funding from the sovereign bond market in the next few days.

A cautionary note was issued by the rating agency, Standard & Poor's, however, who put the European Financial Stability Facility (EFSF) on negative outlook for its present A+ rating.

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