Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners

Economic review of: January 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

2011 sees UK GDP grow by 0.9% during very difficult times

GDP in positive territory

The Office for National Statistics (ONS) figures for 2011 have shown the economy (GDP) growing by 0.9%. This annual growth rate is pretty much in line with official estimates.

Unfortunately, the last quarter of 2011 saw minus 0.2% growth, which threatens the UK slipping into a technical recession if Quarter 1 2012 reflects another negative period for GDP. All the indications are, however, that any such double-dip, if it were to occur, is likely to be only shallow and short-lived.

As most pundits and economists had forecast a slightly smaller reduction of GDP to -0.1%, these figures were considered disappointing.

This is the first fall in GDP since Quarter 4 of 2010. At that time the very severe weather was blamed for the decline.

This time around the contraction was attributed to a 0.9% fall in manufacturing, a 4.1% decline in electricity and gas production – due to the very mild weather experienced in the period – and a 0.5% reduction in general construction activity. The public sector strikes in November also compounded these economic factors.

Such a double-dip recession would signal a sharp drop in economic activity here in the UK, which is likely to be repeated across the wider Eurozone in early 2012. Having said that, the ONS may yet revise these figures down or even up by 0.2%. The positive uplift scenario could well be the case if the quantitative easing undertaken by the Bank of England really kicks in to the economy as a whole.

After these figures were released, The Chancellor of the Exchequer, George Osborne, was quoted as saying: “They are not entirely unexpected because of what’s happening in the world and what’s happening in the Eurozone crisis.”

National Savings and Investments (NS&I) sees its target exceeded

Savings on the rise

NS&I has reported an inflow of savings funds of over £4 billion in the third quarter of 2011, which will see it exceeding its target for the year. This quarterly increase has seen the annual inflow grow to £14.8 billion.

The net financing requirement for the quarter of £0.2 billion raised the annual financing cost to £4.8 billion, which was greater than the £4.5 billion target for 2011-12.

As a result of this NS&I announced that it would decrease the rate on Direct Saver accounts to try to reduce the level of deposits into this vehicle.

The CEO of NS&I, Jane Platt, was quoted as saying: “However, we have to take action to try and moderate the level of deposits into this account over the coming months.”

Mortgage Lending increases in 2011

A lifeline for first-time buyers

2011 saw gross mortgage lending increase as market activity picked up in the latter part of the year.

December saw lending increasing by 12% over the same period last year, so said the Council of Mortgage Lenders (CML). This marks the fifth month in a row where year-on-year activity has seen an increase.

In quarterly terms, lending amounted to approximately £37.3 billion in Q4, slightly down on the approximately £39.2 billion in the previous quarter. However, this £37.3 billion was itself 11% higher than Q4 of 2010, which saw total lending of £33.6 billion.

Whilst the CML itself forecast demand at £138 billion (3% up on 2010 figure of £136 billion), in fact during 2011 as a whole it saw a total of £140 billion being lent.

The Chief Economist of the CML, Bob Pannell, said: “The closing months of 2011 saw stronger mortgage lending activity and housing transactions, despite the fact that short term economic prospects are challenging.”

He went on to add: “There is a glimmer of light ahead for households in that real incomes could stabilise and perhaps even start rising by the end of the year. But, continuing Eurozone problems mean that mortgage funding prospects are uncertain, so overall UK mortgage market conditions for the year ahead remain difficult to call.”

To add more cheer to this scenario, the global bank HSBC has confirmed it is to commit a minimum of £15 billion to the UK mortgage market in 2012. This sum will include a dedicated £3 billion for first-time buyers. It is estimated that this commitment will raise HSBC’s UK mortgage market share to approximately 11%. Its estimates are that this additional funding availability will assist about 150,000 existing homeowners and over 27,000 first-time buyers into the market.

Markets: (Data compiled by The Outsourced Marketing Department)

Showing a positive trend

The equity markets perked up across the globe. The FTSE100 traded in a 3.2% range during the month between a low of 5,612.3 and a high of 5,795.2. It finished the month on 5,681.6, up 109.3 points from its December close.

With all the markets we track here showing territory gained over the month, risk sentiment appears to be improving in the equity markets, despite the Eurozone debt worries. The FTSE100 boasted a gain of just short of 2% on the month and thus improved to sit 12.29% below its long-term trend, compared to the 13.9% deficit reported last month.

Liquidity also improved from the December session, seeing average trades per day nearly double to 941,038, further indicating a return of confidence in the market.

The wider FTSE250 market also picked up on this confidence gaining 6.6% from December's close and even the junior AIM market rising by 9.7% in the period.

Across the pond, the Dow Jones also closed the month in positive territory, rising 3.4% to close at 12,632.9, and its sister Nasdaq market closed at 2,813.8, a gain on the month of 8%.

The European equity markets appeared to shrug off their sovereign debt worries with the Eurostoxx50 ending January at 2,416.66, a gain of 4.3%; whilst in Japan the Nikkei225 was up 4.1% at 8,810.5.

With the political tensions escalating in the Arab world in general and Iran in particular, fears over a threatened blockade or closure of the Straits of Hormuz, reflected badly on the Oil price with Brent Crude closing the month at $110.98, a 3% increase from its December close of $107.38 reversing the similar fall in price that was recorded in the previous period.

Gold managed to break through its recent $1,600 resistance cap, closing the month at $1,734.74, adding 13% on the month to the 8% gain it achieved through 2011.

The safe-haven currency mentality remained through January, resulting in sterling ending the month at $1.577 against the US Dollar. Against the Euro, sterling gained another 1% at €1.203. The Euro itself ended the month at $1.311 against the Greenback, a very slight improvement on the $1.29 reported last month.

Inflation falls again - as predicted

A downward trend predicted

As widely predicted, the UK's Consumer Prices Index (CPI) fell in December, from 4.8% to 4.2%. Whilst only a modest reduction, this matches the largest drop since 2008, according to the Office for National Statistics (ONS).

This drop was mainly brought about by the aggressive discounting in the retail sector in the run-up to Christmas and also falling gas and petrol prices.

Whilst slightly above the predicted 4.7% rate, inflation as measured by the Retail Prices Index (RPI) was also reduced from 5.2% to 4.8% in December. This was the largest fall since June 2009.

Similar reasons were put forward for the reduction here, including lower gas and oil prices, and clothing. However, an increase in car insurance premiums and higher telephone charges were seen to limit the overall reduction.

Seeing this third successive month of reduction in inflation confirms the Bank of England's forecast made in its last inflation report in late 2011, which stated that the inflation rate would reduce sharply in 2012. The main reasons for this optimism were stated as the declining contributions from VAT receipts, lower energy prices and – thanks to the devaluing sterling rate – lower import prices.

Looking forward, the pundits predict that this trend will continue well into 2012, with the CPI inflation figure likely to fall below the target level of 2%. Given this possibility, it is thought likely that the Bank of England will embark on a further round of quantitative easing in the very near future as a countermeasure.

Green shoots showing in consumer confidence

The first green shoots?

A recent survey from GfK NOP has found that UK consumer confidence started to return slightly in January this year.

Their research revealed that their benchmark consumer confidence index – which measured people's expectations for their personal finances and the UK's economy - rose by 4 points to -29, as measured from December 2011 to January 2012. This represents the highest level since June last year.

This measure, which has been tracked since 1974, probably reflected the general euphoria around the festive season and the reduction in utility bills announced early in the New Year. Whilst modest at the 5% level, any reduction in such outgoings is bound to have a positive effect on sentiment.

The respondents' answers indicated that their opinion of the state of the economy had risen by 8 points to -33 over this reporting period and that taken as a group their personal financial position had improved over the previous 12 months and would continue to improve in 2012.

Still on the positive side, this year's hosting of the Olympics and the underlying reduction in inflation bode well for consumer spending through 2012.

The Managing Director of GfK NOP, Nick Moon, was quoted as saying: "Should February show another rise then we may be seeing signs that gloom is dispelling. Until then we should treat January's findings as good but certainly not great news."

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