Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners

Economic review of: July 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

A mixed forecast predicted for the UK economy

The road to recovery?

The Ernst & Young Item Club, which is one of the most respected independent economic forecasting groups that uses the same economic model as the UK's Office for Budget Responsibility (OBR) and The Treasury, has good news in its latest quarterly forecast for the UK economy.

They believe - although the latest GDP figures (released on July 25th) for Q2 paint a far gloomier picture and some forecasters are much less positive - that it will enjoy an *"Indian summer"* following its dire performance in the first half of the year.

Whilst they predict the rate of inflation to continue to decline to 1.7% by year-end and see growth for the whole of 2012 remaining flat, they go on to forecast growth in 2013 to reach 1.6% and by the end of 2014 to see a rate of 2.6%.

In addition, real disposable incomes should rise by 0.4% in 2012 and in 2013 by 1.5%.

The chief economic adviser to the Item Club, Peter Spencer, was quoted as saying: *"Spiralling inflation has cut real wages by 7.5% over the last four years, but the squeeze is almost over.*

"Inflation is now coming back to heel, helped by the Chancellor's decision to postpone the increase in fuel duty, falling energy and commodity prices, plus tax changes dropping out of the calculation."

It is widely believed that any growth in the UK economy will be export-led, as most households appear determined to pay down personal debt, rather than to consume goods.

Having said this, UK unemployment will remain high, possibly reaching 8.6% by the end of 2012 and increasing to 8.7% in 2013.

On the positive side, the report believes that business spending will increase by 3.4% in 2012, although it is unlikely to reach the levels achieved pre-recession till at least 2015.

Mr Spencer went on to conclude: *"However, a resolution of uncertainty about the euro could transform the outlook, pushing company spending up much faster than forecast."*

UK inflation continues to fall

Continuing on the good news front, the Office for National Statistics (ONS) has reported the Consumer Prices Index (CPI) and the Retail Prices Index (RPI) inflation rates fell in June to 2.4% and 2.8% respectively.

Nearer to target rate

This represents the slowest rate of increase in UK prices since the latter half of 2009 and the third month in a row that the rate of increase in CPI has fallen.

Reasons behind this decrease were a drop in clothing and footwear costs - with a reduction of 4.2% seen in these sectors - probably due to retailers bringing forward their summer sale promotions.

Whilst a drop in prices here was anticipated, due to aggressive price reductions by those retailers, a fall of this scale was not forecast.

We also saw a reduction in alcohol and transport costs, which were down by 0.5% and food prices, particularly meat, down by 0.1%. The ONS cited the lack of domestic barbecues, due to the inclement 'summer' weather we have experienced as one reason for this decline.

Fuel costs were an important element of this overall reduction, with petrol seeing a fall of 4.3 pence per litre, to an average price of £1.33 a litre and diesel falling 4.7 pence to an average of £1.39 a litre.

Echoing this good news, Neil Saunders, retail analyst at Columino stated: *"However, if inflation continues to drop back at this pace, wage settlements will outstrip inflationary growth by the fourth quarter, meaning we will see a return to growth in real disposable income."*

With regard to the reduction in fuel costs, he went on to say: *"This has benefited most households although, in our view, it will take time for this to drive tangible changes in behaviour in terms of shopping and spending habits."*

Representing a welcome continuing decline in inflationary pressure and a move nearer to the Bank of England's CPI target rate of 2%, these latest figures will reassure the Bank that its Quantitative Easing (QE) programme (totalling £375bn so far) has not stoked the inflationary fires in the UK economy as some members of the bank's Monetary Policy Committee and other economic pundits feared may have happened.

Is the state going to guarantee your pension pot?

It may be guaranteed!

In an unexpected, but gratefully received, message from the pensions minister, Steve Webb, the Government announced an intended ground-breaking policy to protect future pensioners' investment funds from falling equity prices.

His message was that pensioners, and those saving for their future pension, need certainty that they will have a guaranteed income when they come to retire.

He was quoted as saying: *"People really don't want to work for a year and get a pension statement showing their savings have gone down, not up."*

Ministers are concerned that unless such guarantees are made, then workers will be discouraged from saving for their retirement.

Currently millions of workers, who have diligently saved into their pension funds, have seen the value of their pension-pots diminishing in the last few months and years, due to the fall in equity markets, because of the global economic situation. Added to this are the actions of the Bank of England, who have continued to print money through their quantitative easing programme - in the hope of reviving the lagging UK economy - but reducing UK Gilt yields as a consequence and exacerbating the fragile investment climate.

Any such guarantee would probably take the form of a policy, to be provided by insurance companies, that would guarantee the workers that their pension fund at maturity would at least equal the total amount of their contributions, plus their employers' contribution and the amount of tax relief that would have been gained during the lifetime of the pension plan.

Steve Webb plans to meet with pension providers, insurance companies and investment companies to thrash out the details of such a scheme. Following these meetings, a consultation paper will be published later this year.

Motivated by the soon to be introduced automatic enrolment of workers into pension funds that will draw in another estimated 10 million people to pension schemes, the Government wants to reassure those workers and encourage them not to opt out of these schemes, safe in the knowledge that their funds will be protected.

The pensions minister went on to add: *"As part of the options we offer people, we want greater certainty and guarantees or insurance to be on that list. Auto-enrolment is our best chance of getting people into saving and if they are put off by fear of risk, volatility and uncertainty, it is very hard to get them back again."*

"Some form of guarantee has an important part to play in the success of auto-enrolment."

Reinforcing the need for such guarantees, the CEO of the National Association of Pension Funds, Joanne Segars, was reported as saying confidence in pensions *"had never been lower"*. *"Any fresh thinking that encourages savings is welcome. People are understandably wary that their savings will be eaten away, so there may be appetite for pensions that carry a guarantee."*

The consultative paper will have to address the cost of such guarantees and how they will be funded. Will it be a charge deducted directly from the savings, or by the insurers taking a dedicated percentage of the pension-pot? The industry working party will be discussing these options in detail with their meetings with the minister in the weeks and months to come.

Good news on the trade front

Trade boost in May

A welcome fillip from The Office for National Statistics (ONS) as they reported May saw the seasonally adjusted UK export trade rise by 6.6%, greatly outstripping imports that rose by only 1%.

As a result, the trade deficit - which measures the difference between UK imports and exports - dropped to £2.7bn against a deficit of £4.1bn reported in April.

The trade surplus recorded for the service industries remained unchanged at £5.6bn, whilst goods recorded a deficit of £8.4bn against a figure of £9.7bn reported in April.

One of the factors in these better figures was ahead of the Queen's Jubilee long weekend, with an attendant increase in the demand for food and drink, which showed an increase of 2.2% from the April figures. Transport equipment manufacturing also saw a rise of 8.8%.

Because of the delayed bank holiday in May (to accommodate the longer Queens Jubilee weekend), that month had an extra working day, which resulted in manufacturing output increasing unexpectedly by 1.2%.

The counter to this good news was that pharmaceutical preparations and products saw a fall of 13.2% and food, drink and tobacco were down year-on-year by 3.9%.

Howard Archer, an economist at IHS Global Insight said of these figures: *"A double dose of good news on the UK economy with industrial production unexpectedly rising in May and the trade deficit narrowing more than expected."*

"However, the news is not quite as good as first appears, and there will be payback in June on the industrial production front."

At the same time the chief economist of The British Chambers of Commerce (BCC), David Kern, was quoted as saying: *"Unusually, UK exports to non-EU countries were higher than exports to the EU."*

He went on to add that UK exporters have *"huge untapped potential."* And that: *"This shows that exporters are adjusting to global reality, as growth in the eurozone will continue to stagnate, and the main opportunities for our exporters will remain outside Europe."*

Markets: (Data compiled by The Outsourced Marketing Department)

All eyes on the central banks

Equity and risk investors were buoyed by the positive rhetoric coming out of Brussels with regard to the eurozone, but the markets remained volatile with daily movements ranging from minus 2.09% to plus 1.36% in the FTSE100. However, the index managed to finish the month up 1.15% at 5,635.3, with the wider FTSE250 ending at 11,136.69, to show a gain of 1.87% for the month and a strong 10.23% gain since the beginning of the year.

Other markets remained cautious ahead of any proposed central bank action in the USA and Europe, following joint talks held in the last week of July. The possibility is of further Fed' quantitative easing (QE) and the European Central Bank (ECB) resuming its purchase of sovereign bonds after President Mario Draghi's statement that the ECB will do "*whatever it takes to preserve the euro and believe me, it will be big enough*".

With most of these factors already priced into the markets the Dow Jones ended the month just ahead 1% at 13,008.68 and the Nasdaq up 0.15% at 2,939.52

Elsewhere, the Eurostoxx50 benefited from the positive European sentiment gaining 2.88% in the month to end on 2,329.96.

Bucking the trend, the Japanese Nikkei lost 3.46% in the month finishing on 8,695.06.

On the currency markets sterling remained flat against the greenback at $1.57, but gained 2.42% against the euro finishing at €1.27. This represents a 6.7% appreciation since the beginning of the year. The euro rate against the US$ dipped to $1.23.

Gold had a quiet month ending at $1,616.57 an ounce (up 1.49%) and Oil (Brent Crude) up this month at $104.92, which is a 7.28% increase - reversing last month's drop - reflecting supply issues and continuing political unrest in the Middle East.

The Bank of England to the rescue

Urgent funds made available

August will see the launch of a new initiative by the Bank of England to make more and cheaper loans available to small and medium sized enterprises (SMEs) and individuals.

For a period of 18 months, funds will be made available to banks and building societies via the new 'Funding for Lending' programme.

These lending institutions will be able to borrow the equivalent of 5% of their existing lending, but should this increase they will be able to ramp up their access to these cheap funds.

They will be allowed to borrow these funds for a four-year period for a fee of 0.25%, substantially less than their current wholesale borrowing costs. However, should these institutions not be seen to be lending more, the Bank of England retains the option to levy on them a higher rate of up to 1.5%.

The Bank of England has agreed to publish the amounts lent via this scheme on a quarterly basis.

The joint statement from The Treasury and the Bank of England stated: *"For every pound of additional real economy lending an institution advances, an additional pound of access to the scheme will be permitted for that institution."*

In reality, what this means is that whilst the initial government contribution will be approximately £80bn, there will be no cap on the amount of funds made available, provided that more lending is made available to their clients.

This initiative comes after the eurozone debt crisis has severely dented business confidence and led to a drastic reduction in lending levels, and an accompanying increase in borrowing costs.

As an example, it is estimated that the borrowing costs of new mortgages, here in the UK, has increased by 0.5% over the past 12 months.

In this context it is important that any such additional mortgage lending be aimed at the future homeowners who most need it.

Mark Harris, the CEO of SPF Private Clients commented: *"It is vital that any lending is available in the loan-to-value band that need it."*

He went on to add: *"If funding will only be cheaper and easier for those with, say, a 50% deposit or similar level of equity, for example, there will be little improvement on the current situation."*

Endorsed by the Chancellor of the Exchequer, George Osborne, he believes that 'Funding for Lending' will help households and businesses *"at a challenging time."*

Given the previously mentioned increase in the cost of borrowing, due to the eurozone crisis, he went on to say, in a letter to the Bank of England's governor, Sir Mervyn King, that the initiative *"will support the flow of credit to where it is needed, complementing the MPC's asset purchase programme in easing monetary policy conditions."*

This programme was initially offered a cautious welcome from the British Chambers of Commerce (BCC), mentioning, however, that they would like to gauge how the programme will work in practice.

The BCC policy director, Adam Marshall added: *"We will be watching closely to see if this has any positive impact for new and growing businesses, which have largely been frozen out of the market for finance in the recent years"..."As roll out Funding for Lending, they should be even more radical and plan for the creation of a bona fide business bank in the medium to long term."*

Jobs

The Office for National Statistics (ONS) released data this month that showed the UK unemployment level falling to 2.58 million (a reduction of 61,000 people) in the three months to May 2012. This represents a rate of 8.1% against a figure of 8.3% reported in the previous quarter.

Good news of the work front

Details reveal that the number of people now in employment rose by 181,000 to 29.35 million and, encouragingly, unemployment among 16-24 year olds fell to 1.02 million, a reduction of 10,000.

Self-employed people (both full and part time) rose by 32,000, which was an increase of 0.8% on the quarter and represented an increase of 166,000 to 4.16 million, or 4.2%, compared to the same period a year ago.

On the negative side, the number of people who have been unemployed for more than two years increased by 18,000 to a total of 441,000. This is a 15 year high. Also those claiming Jobseekers Allowance increased by 6,100 to a total of 1.6 million.

Regionally, the picture was mixed, with about 50% showing negative figures. An example of this is Wales, which saw unemployment increase from 8.8% to 9%, and Yorkshire and Humber, which saw unemployment rise from 9.3% to 9.7%. Whilst Scotland saw their rate fall by 0.2% to 8% and the North East's unemployment rate fell from 11.2% to 10.9%, the latter remains the region with the highest unemployment rate in the UK. The South West was the best region, reporting an unemployment rate of just 5.9%.

Commenting on these figures, Chris Grayling, the Employment Minister, said that unemployment was: *"still much too high."*

He went on to say: *"But, I'm at least encouraged, in what are difficult times economically, that we are seeing improvements across the board."*

Adding further encouraging prospects, the forthcoming London 2012 Olympics should further boost the short-term employment picture.

A spokesman for Commerzbank, Peter Dixon, stated that it was: *"entirely possible that there will be a temporary boost due to the Olympics, possible that there will be more to come, but if this is Olympic-related temporary hiring, it is likely to be unwound again later in the year."*

Issued by: **Provident Solutions Ltd**
Kingston House, Meadow Hill, Great Glen, Leicester LE8 9FX
Telephone: 0116 2592371 - Fax: 0871 750 2621
Email: enquiries@providentsolutions.co.uk - Website: www.providentsolutions.co.uk