Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners

Economic review of: May 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

UK housebuilder reports best start for 5 years

Best results for 5 years

With the construction industry's negative data being held responsible for helping to push the UK's Q1 GDP figures negative and thus precipitating the double-dip recession, it is encouraging to hear that Barratt Developments, the UK's largest housebuilder, has reported a positive spring selling season with its strongest sales for over 5 years.

Barratt reports that buyers reserved an average of 248 properties a week. This represents an increase of 25% on the previous year. With an increased sales drive across all its sites, this result represents the strongest demand for new-build houses since the heady days of the property boom of 2006-7. One of the major factors in this positive data was the improvement in mortgage availability in recent months.

The developer believes that it will be able to complete an additional 600 house sales this year to reach a total of 12,600, against sales of 11,000 in the previous year. It also hopes to reduce its cancellation rate to 15.4% against last year's 16.1%.

Mr. Mark Clare, CEO of Barratt, was quoted as saying: *"Each year the gap between supply and demand gets bigger and bigger, I think there's always going to be strong level of underlying demand, despite the economic headwinds."*

At the same time, commentators have raised concerns over the effectiveness of the Government's FirstBuy shared-equity scheme and its more recent NewBuy initiative. This latter scheme sees the Government and the builders guarantee mortgages for buyers of 'new build'. However, lenders to this scheme, which include Nationwideand Lloyds, have been criticised for being restrictive in their credit ratings of borrowers and pricing those loans too high.

A housing analyst at stockbrokers Peel Hunt, Robin Hardy, also flagged his worries on this score, saying: *"In the last few weeks there has been a sharp about-face (in the previous easing on lending terms) and pressure on homeowners is rising ...We see this as a threat to prices."*

British farmers see profits increase 25% in 2011

Bumper year for our farmers

According to the National Farmers Union (NFU), Britain's farmers saw a bumper 25% increase in profits for 2011. This had the effect of increasing overall profits by £1.75bn to a total of £8.84bn.

The rising international price of both grain and meat helped to achieve this increase in profit, with US wheat prices reaching a seven-month high during trading in Sydney in May. This represents a 17% rise, as many US farmers deal with very dry weather.

The NFU report said: *"With stocks depleted and demand from emerging markets rising all the time, supply and demand have been on a knife edge, with just small changes in supply prospects causing big swings in prices."*

It went on to say that: *"Together, farming and food make up a precious oasis of growth and potential at a time when the economy generally is struggling,"*

As a spin-off benefit of this increased productivity, employment in the agricultural sector also saw an increase, with the industry employing 303,000 in 2011; this is a 3% increase from the previous year. UK farmers also saw their exports grow by 11% in 2011, elevating food and drink to fourth place in the export sales pecking order.

Strong German growth helped eurozone avoid Q1 recession

Eurozone avoided recession

Thanks to a stronger than expected 0.5% growth rate of Gross Domestic Product (GDP) in the first quarter of 2012 for Germany, the eurozone as a whole managed to avoid recession. Destatis, the German statistics agency, attributed this increase to a combination of higher domestic consumption and an increase in exports.

Joerg Kraemer of Commerzbank stated: *"This is a very strong comeback. The decline in the fourth quarter was not the start of a recession but just an economic dip... Germany is faring better than the rest of the eurozone. But I do not believe that it will continue at this speed."*

Given that in Q4 2011 the eurozone saw GDP shrink by 0.3%, any negative figure in Q1 2012 would have resulted in them declaring a technical double-dip recession. The German economy saved the day, as France saw GDP flat-line at zero growth after recording only an adjusted 0.1% growth rate in Q4 2011. These figures were reported on the day François Hollande was inaugurated as President, succeeding Nicolas Sarkozy. Monsieur Hollande campaigned on boosting the French economy, renegotiating the eurozone's 'Fiskalpakt' and establishing growth in their economy again.

The Italian economy declined by 0.8%, which represented the third straight quarter of decline there. Meanwhile, Spain also recorded a decline, of 0.3%, and Greece a massive fall of 6.2%. This reflects the draconian austerity measures in the latter country that have resulted in on-going civil and political unrest and fresh elections on 17 June.

Markets: (Data compiled by The Outsourced Marketing Department)

Making sense of the data

The eurozone crisis continued as the dominant influence on Continental bourses, also nervous about the early-May election of a socialist French president, François Hollande. News of an interim government and fresh election in Greece on 17 June, with the prospect of a new administration hostile to the European bailout conditions, unsettled investors also edgy over Spain's economy and banks. After the month's nervous gyrations, the Eurostoxx 500 index ended 8.1% lower at 2118.94.

Performance of UK shares was also weak and erratic during May, due to worries about the double-dip recession and poor growth figures that reflected a decline in construction activity. The eurozone situation was also an influence, as sluggish consumer demand in this important market could hit UK exporters. The FTSE 100 index ended the month at 5306.95, a substantial 7.5% drop, and inevitably slid further below its long-term trend to -18.4%. The FTSE 250 closed on 10,545.96 (-7.6%) and the AIM market on 690.55 (-11.1%).

A modest fall in US unemployment to 8.1% was not sufficient to enable the Dow Jones index to build further on the four-year high of 13,279 attained on the first day of May on the back of higher manufacturing output. The euro crisis was a key influence here as well and risk aversion saw the index drift lower; it closed the month on 12,393.45 (-6.2%). The NASDAQ technology stocks index similarly lost ground, closing on 2,827.34, down 7.2%. Tokyo share performance was very weak, with one electronics major down 20% towards month-end, leaving the Nikkei index 10.3% lower at 8,542.73.

Eurozone issues also preoccupied traders on the foreign exchange markets, where the euro weakened further against the US dollar and sterling to close at $1.236 and €1.247, respectively. Sterling weakened versus the dollar, closing at $1.541.

After starting the month above $1,660 an ounce, the gold price drifted lower by mid-May and then traded within a narrow range, closing 6.4% down in dollar terms at $1,557.97. Prices also fell back in the oil market, where Brent Crude closed the month at $101.87 a barrel, down a shade under 15% - its biggest monthly percentage fall in over three years.

Data released mid-May showed that some UK consumer price pressures eased during April. Consumer Prices Index inflation was lower, at 3%, from 3.5% the previous month. Retail Prices Index inflation stood at 3.5%, from 3.6%.

Demand for gold soars in China

All that glitters in China

With the price of gold having risen by more than 20% at one stage this year, demand for the precious metal has soared in China; so says the World Gold Council (WGC). With the Chinese New Year falling in the first quarter of this year, we saw investment in gold - including jewellery - reach 255.2 tons.

The WGC cited rising internal inflation and the tightening of the property market as possible reasons for this gold rush in the country. Having said that, overall global demand actually fell 5% in the same period, to 1,097.6 tons, with the WGC saying that the rapidly rising price of the metal was the catalyst for this. Q1 2012 saw the price of gold hit $1,690.57 per ounce, a rise of 22% on the closing price at the end of Q1 2011.

In their quarterly report on the complex global gold market, the WGC clarified the phenomenon of demand falling while prices rose by explaining: *"Reduced demand for gold from jewellery, technology and official sectors more than offset growth in gold investment demand."* Thus, the gold price easing seen in May is not surprising.

In India, which historically is one of the largest global markets for gold, they saw demand slow. This was probably a result of an increase in the import duty on gold and a new excise duty on jewellery. These penal fiscal measures prompted Indian jewellers to rapidly go on strike, after which the Government immediately abandoned the proposals, reflecting gold's importance to the Indian economy.

Jobs

There has been better news on the jobs front, with unemployment falling by 45,000 to 2.63 million in the first quarter of 2012. This leaves the current unemployment rate in the UK at 8.2%, according to data released by the Office for National Statistics (ONS) in May.

Encouragingly, youth unemployment also dropped, by 17,000 to 1.02 million, and the number of people who were claiming Jobseeker's Allowance declined by 13,700 to 1.59 million. However, on the downside, the number of people who have been without work for over 12 months increased by 27,000 to 887,000; this number represents the worst result since 1996.

It should also be noted that the number of people in part-time employment also reached a record level. Figures released by the ONS state that 7.99 million were in part-time work in Q1 2012, which is an increase of 118,000 from Q4 2011. Of this number 1.42 million represented those that wanted but couldn't find full-time employment. This is the highest level since 1992.

Commenting on these figures, Chris Grayling, the Employment Minister, said *"These show a welcome step in the right direction. For a number of months now, employment has been growing and this is starting to feed through into improving unemployment figures."*

Inflation rate down to 3% in April

Best figures since 2009

The ONS announced in late May the lowest inflation figures since February 2010, when the rate was also 3%. The last time it was lower than that was December 2009. They cited lower clothing prices and a smaller increase in transport costs than last year as key reasons for the fall in April. Data showed the Consumers Prices Index (CPI) falling to 3% after the 3.5% recorded in March and the Retail Prices Index (RPI) dipping slightly to 3.5% from 3.6%.

Whilst welcome news for Sir Mervyn King, as he will not have to write yet another letter to the Government explaining why the CPI rate remains more than 1% adrift from the 2% target, he still warns that the rate will remain above target *"for the next year or so because of the storm in the eurozone"* continuing to threaten the UK's recovery.

Inflation had risen to 5.2% in September 2011, but has come down substantially since then. As well as the headline components, other factors responsible for the April improvement included the cost of clothing and of alcohol from off-licence outlets. On the contra-side, increases were recorded for house rental and hotel and restaurant costs, albeit tempered by lower energy costs. The Chancellor of the Exchequer, George Osborne, commenting on the figures, said: *"This is a welcome relief to families on tight budgets"…"The Bank of England expects the rate to fall in the next year or so."*

Meanwhile, Brendan Barber, the TUC General Secretary, also commented that the reduced inflation figures were: *"a relief to millions of people…with earnings growing by just 0.6% people are still getting poorer every month."…"We need falling inflation to be matched with far better pay rises to get people's incomes growing again."*

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