Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners
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Economic review of: October 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.

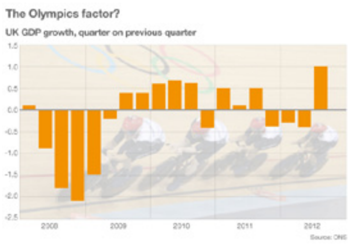
It is not intended that individual investment decisions should be taken based on this information; my colleagues and I are always ready to discuss your individual requirements. I hope you will find this review to be of interest.

Paul Smith

It is official - the end of recession

Growth seen in Q3

The Office for National Statistics (ONS) announced late in October that the UK economy grew by 1.0% in Q3 2012, thus ending the nine month recession. This is above the estimates of most economists who predicted a growth figure of 0.6% to be announced.



One of the major factors in this turn-around was the London Olympics, which according to the ONS added 0.2% to the gross domestic product (GDP) figure from July to September.

Whilst this is very good news, the economy remains below the level of output seen before 2008, at the start of the financial crisis.

They also commented that the economy contracted by 6.4% between the start of 2008 and mid 2009, but has since recovered nearly half of that amount.

This quarter's figures were also boosted, in comparison with the previous quarter, where we had additional public holidays to celebrate the Queen's Diamond Jubilee and exceptionally bad weather, which dampened growth in this period.

George Osborne, the Chancellor, commenting on these results on October 25th said: *"There is still a long way to go, but these figures show we are on the right track.*

"Yesterday's weak data from the eurozone were a reminder that we still face many economic challenges at home and abroad."

Given that these figures from the ONS are their initial estimate, it should be borne in mind that they can be revised higher, as happened in the last two quarters, or possibly lower in the ensuing weeks.

However, David Kern, chief economist of the British Chambers of Commerce added: *"The 1.0% GDP figure for the third quarter is affected by distortions in the second quarter due to the Jubilee and Olympic ticket sales. Compared to a year earlier, the figures show that the economy is stagnant."*

The Bank of England keeps its powder dry

The latest missive from the policy-setting committee of the Bank of England has left interest rates on hold, yet again, at 0.5% and states that they will keep their quantitative easing (QE) programme unchanged at its current level of £375.7bn.

All eyes on the GDP figures

With the nine members unanimously agreeing not to immediately increase the QE amount, they did say that some of them believe that future stimulus may be required in the near future, citing their belief that the economy was on a *"weaker path"* and that manufacturing output will probably remain flat for the remainder of 2012.

All eyes then were on the latest Q3 Gross Domestic Product (GDP) figures, released by the Office for National Statistics in late October, which showed an end to recession with output growth of 1%. This positive figure will influence the Bank's decision making process in regard to the need for future QE.

QE is a contentious instrument with some economists believing that with the Bank of England now having effectively purchased £375.7bn of the Government IOUs in the form of gilts, only £2bn of the latest Gilt issues (since August 1st) have been purchased on the open market, with The Bank purchasing £32bn of the £34.3bn issued.

This means that through its QE activities the Bank has purchased 31% of the total gilt market of £1.164 trillion. Supposedly, much of this will eventually be sold back into the market when the economy turns. If not then those gilts will have to be held to maturity, when they will probably be rolled over or scrapped.

One of the negative effects of these purchases is the subsequent drop in yields on gilts, which have adversely reduced the annuity rates offered by many insurance companies, as they typically invest large sums in the gilt market to fund these payments in the long-term

At the same time the UK's political influences are actively encouraging a continuation of QE with all three major parties in favour of the policy, for various reasons.

Markets: (Data compiled by The Outsourced Marketing Department)

Hurricane Sandy, that hit the east coast of the USA during the last few days of October, closed the New York Stock Exchange for two consecutive days, resulting in negative sentiment globally in the equity markets. Opening again on October 31st, the Dow Jones faded to 13,096.46 to end the month down 2.54%, probably reflecting on the estimated $50bn of damage caused by the storm across the region. The Nasdaq followed suit, drifting off 4.46% on the month to close on 2,977.23.

Hurricane Sandy closes the NYSE

Across the pond, here in the UK the FTSE100 closed at 5,782.7, up marginally over the month by 0.71% (this is 11.42% below its long-term trend) with the FTSE250 faring better by rising 1.71% to close on 11,934.95, and the junior AIM market drifting by 1.14% to finish October on 697.73.

European stocks were resilient, with the Eurostoxx50 finishing on 2,503.64 to record a gain of 2.01%, reflecting improved sentiment over the continuing sovereign debt issues of Greece and Spain.

The Nikkei index in Japan saw little movement, closing flat at 8,928.29.

On the foreign exchanges, sterling remained unchanged at $1.61 against the greenback and at €1.248 against the Euro, again unchanged on the month. Meanwhile the Euro improved slightly against the US$, finishing the month at $1.29.

Gold slipped by 3.5% during October to close at $1,709.60 an ounce, whilst Brent Crude oil saw out the month on $108.70, down 3.28%.

UK disposable income rises

Further encouraging signs were seen in the latest figures released by the Office for National Statistics (ONS) that showed average real household income* rise by £69 to £4,510 in the April – June Quarter of 2012. This represents an increase of 1.6% from the previous quarter and is the highest figure since the fourth quarter of 2010.

More money in their pockets

Given that real household incomes were at their lowest level for five years at the end of 2011, this boost will, hopefully, contribute to the anticipated bounce in the UK economy during Q4 2012 and into 2013 through an increase in consumer spending.

With the latest inflation figures (CPI at 2.2%) reducing as well, this should ease the burden on household income, even though their actual expenditure has held relatively unchanged during the same period, falling by £7 (0.2%) over the period.

One of the negative effects of lower inflation figures, however, is that those on benefits will be receiving increases of less than half they did last year, as any annual increase in benefit is linked to the CPI figure reported for September.

Household savings have also increased to £18.2bn, an increase from the previously reported £16bn. This reflects the emphasis many households have placed upon reducing their debt burden.

There were, of course, major regional variations in these figures. Annual real household income reported saw the richest area - London - recording a figure of £20,238 with inner London west heading the pack at £33,323 and the poorest region - the North East – reporting a figure of £13,329, with the city of Nottingham reporting the lowest figure of only £10,702. Across the whole of the UK the annual average was £15,709.

**Real household income is defined as wages and salaries (both employed and self-employed), pension receipts, state benefits, interest on savings, and dividend income.*

Families start to spend again

After months of belt tightening and keeping their purse strings taut, UK consumers have lifted their heads above the trenches.

Two surveys, looking at disposable incomes and consumer spending respectively, have recently been released by Deloitte and Markit.

Consumers start to spend

Whilst Deloitte's Consumer Tracker saw worries about disposable income dip by 10% in the last year (from 43% of respondents to 33%), Markit said October saw the *"least marked"* deterioration in household finances for two years; and that consumer confidence was at its best since Q3 in 2011 and that should lead *"to a likely upturn in consumer activity."*

Markit reported that although household budgets remained under stress, given that we have seen lower inflation figures published in October, together with a marked improvement in the employment figures, their economists believe that should result in increased consumer spending across the next twelve months. This should further add to the anticipated 0.7% growth seen in spending in Q3 2012.

They added: *"Household finances were supported by a near stabilisation of employment income in October, alongside a reduced squeeze on cash availability."*

Although 29% of their respondents said that their household budgets had deteriorated and only 7% said they had improved, this still signalled: *"a much weaker squeeze on households' financial well-being than had been the case for around the past two years."*

At the same time the chief economist of Deloitte was quoted as saying: *"The Consumer Tracker points to a reduction in the stress on the household, with consumers more positive about their income and employment and working hard to balance the books by reducing their levels of debt."*

Given that consumer spending is responsible for about 60% of economic output in the UK - which has been depressed since 2010, because of unemployment, pay rates below the rate of inflation, and a £1.5 trillion household debt burden – any increase seen here is very good news and should continue to impact positively on the forthcoming GDP figures due in 2013.

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