Monthly

Economic Review

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Economic review of: October 2013

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

GDP growth highest for three years

As many economic pundits predicted, the UK's Gross Domestic Product (GDP) for the third quarter of 2013 rose by 0.8%. This is an increase from the 0.7% recorded for Q2 and the British economy's best performance since 2010.

On the road to recovery

One of the main factors contributing to this improvement was the rise of 2.5% for the construction sector, building further on the improvement seen in the previous quarter.

House building continues to prosper from the boost given by the coalition Government's Help to Buy initiative and the mortgage guarantees it now offers.

The service sector, representing 75% of total economic output, continued to prosper, growing by 0.7%, which itself is 0.4% above the level reached in its pre-crisis zenith, achieved in Q1 of 2008.

Both manufacturing and production grew, with manufacturing recording a rise of 0.9% and production 0.5%; however, production still remains 12.8% below its 2008 level.

Commenting on these encouraging figures, the Chancellor of the Exchequer, George Osborne, said: *"This shows that Britain's hard work is paying off and the country is on the path to prosperity.*

"Lots of risks remain, so we have to stick with the economic plan that has got us this far.

"What's encouraging about these figures is that it's not just services that are growing. Construction is growing and production is growing."

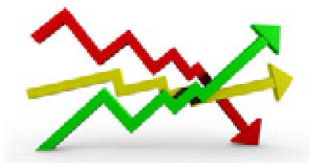
The Office for National Statistics (ONS), who compile these statistics, have now reported three straight quarters of economic expansion and, hopefully, herald a solid recovery.

As good as these figures are we are still below the levels of output achieved in 2008. Mr John Langworth, the Director-General of the British Chambers of Commerce was quoted as saying: *"This is the highest quarterly increase we've seen in three years, so the economy is clearly moving in the right direction.*

"But we are still behind a number of advanced economies, such as the US and Germany, that have managed to recover the output lost during the economic downturn.

Much more needs to be done to transform our economy from being good to being great."

USA back from the brink



US default avoided

Late on October 16th, the global markets breathed a collective sigh of relief, as America, at literally the eleventh hour, pulled back from the edge of their 'fiscal cliff' and Congress finally agreed the deal to raise the federal debt ceiling of $16.7 trillion (£10.5 trillion) and allow the government to open shop again.

It was still a close run thing, with the Democrat-led Senate voting 81 to 18 for and the Republican-led House of Representatives voting 285 to 144 for.

This vote allowed the US Treasury to extend its borrowing until February 7th 2014 and directly fund the Government until January 15th 2014.

The bill confirming this was signed by President Obama early on October 17th, just hours before possible financial meltdown. He followed this by stating we've got to *"earn back the trust of the American people"*. He went on to add: *"We've got to get out of the habit of governing by crisis.*

"My hope and expectation is everybody has learned there's no reason why we can't work on the issues at hand, why we can't disagree between the parties without still being agreeable and make sure that we're not inflicting harm on American people…"

Given that the US dollar is by far the most widely held reserve currency across the world and trillions of dollars of US Treasuries are held by investors and foreign governments, the thought of a default on these would have sent massive shock waves across the global financial markets and would have threatened sending the world into recession again.

The game of political brinkmanship, which effectively closed the country's civil service for 16 days, has had a serious impact on the US economy, with economists estimating that the partial government shutdown that ensued has given the American economy a $24bn negative hit to its GDP.

Markets: (Data compiled by The Outsourced Marketing Department)

Sanity prevails in Congress

As reported last month, the political brinkmanship in Washington over the national budget ran up to the wire, with Congress only agreeing to raise the borrowing limit just before midnight ahead of the deadline date of October 17th.

The result in the global market place was a communal sigh of relief. The FTSE100 had dipped as low as 6,337.9 during the month, but recovered strongly after the announcement to close October at 6,731.4, to record a 6.2% gain from its low point and an overall 4.1% gain for the month. The wider FTSE250 followed suit, ending the month at 15,480.0, an improvement of 3.8% from September's close. Meanwhile, the junior AIM market closed up 1.46% at 808.39.

Across the pond the Dow Jones eventually recorded a gain of 2.75%, finishing at 15,545.75, with the Nasdaq faring slightly better with a 3.93% improvement to 3,919.71.

Benefiting from benign political activity, Europe saw a stronger equity performance with the Eurostoxx50 powering to 3,067.95 for a monthly gain of 6.04%.

Again in Japan there was little political or fiscal stimulus, so the Nikkei 225 finished the month virtually flat at 14,327.94, a modest dip of 0.88% in the month.

In the currency markets sterling benefited from the uncertainty around the US dollar, gaining initially in the month; however, with the US political settlement, the dollar recovered to $1.60, so sterling finished off 1.48% at the close. Likewise, against the Euro sterling fell by 1.42% to finish at €1.18, meaning the Euro/US dollar rate was little changed on the month, at $1.35.

The political uncertainty triggered a reactionary rise in the oil price, as the benchmark Brent Crude rose to $108.84, an increase of 1.8%, but the gold bullion price was stable, closing out October at $1,321.37 an ounce, down less than 1%.

Government borrowing falls in September

The UK's net public debt stands at £1.21 trillion, or 75.9% of the Gross Domestic Product (GDP) of the nation.

Spending reduction on track

As high as that is, the Chancellor of the Exchequer, George Osborne, was pleased to see Government borrowing (excluding past bank bail-outs) dip to £11.1bn in September. This is lower than the £12.1bn reported in September 2012. Much of this improvement was because of higher tax receipts.

Between April and September 2013, the Government's cash receipts were £265.3bn, an increase from the £237bn recorded a year earlier.

The coalition Government has stated that it wishes to reduce the deficit to less than £120bn in the 2013/14 tax year, excluding any cash transfers from the Bank of England, as a result of its quantitative easing programme, or the Royal Mail flotation and its attendant pension funds.

Having said this, they appear to be on track, as the first six months of this tax year saw them report a deficit of £56.7bn, which is a reduction of 9% from the same period last year.

The medium-term aspiration of the Government is to eliminate the budget deficit entirely by 2020.

Speaking at a recent Thomson Reuters symposium, George Osborne was quoted as saying, that whilst the country's economic problems were not yet over: *"An improving economic situation in the UK does not automatically lead to a windfall for the public finances… we are going to go on as a Government having to take very difficult decisions to control public spending and make sure we are on top of the deficit."*

The continuing recent tranche of positive economic data, across retail sales, housing, unemployment and trade, has reinforced the opinion that the Government is on track to meet its aspirations for reduced borrowing this current tax year; however, the jury is still out.

Retail sales increase by 0.6%

Good news came from the high street, further reinforcing the pick-up in the UK economy. The Office for National Statistics (ONS) reported in October that retail sales in the UK grew by 0.6% in September. On a quarterly basis spending improved by 1.5% from the previous period (April-June) and annually, they saw sales volumes increase by 2.2% against September 2012's figures.

Given the volatility of retail sales and their importance to the 'feel-good' factor in the country, we should consider this data over the medium term and look at the underlying trend reported.

July, with the fine weather we experienced, saw overall sales increase, particularly for barbecue goods and food, but August saw a decline.

This latest period, of the third quarter of 2013 (July-September), shows the largest increase in sales since the first quarter of 2008, just prior to the recession that followed that period. Clearly this September's consumer performance greatly influenced these results.

Some retail sectors boosted these findings further with, on an annual basis, non-food stores showing a 3.6% improvement and non-store retailing a 19.1% boost. Meanwhile, petrol stations (including supermarket forecourts) and food stores saw a fall of 2.4% and 0.6% respectively.

With annual wage growth still considerably below the current rate of inflation (CPI of 2.7%) these figures are somewhat surprising, as it indicates that consumers are rediscovering their appetite for spending at last.

The average weekly spend in September, across the country, was a non-seasonally adjusted £6.8bn.

However, until we can see a consistent improvement in wage growth across the board, consumer spending is likely to remain subdued in the short and medium term.

Annual store price inflation, which is measured by the implied price deflator, slowed in September to 0.9%. This was an improvement on the 1.6% reported in August.

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