

## Economic review of:

November 2011

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*

**The Chancellor's Autumn Statement:**  
The Chancellor George Osborne's Autumn Statement realised the nightmare scenario that most economists and pundits alike had predicted.

With the Office for Budget Responsibility (OBR) now being the sole arbiter of official statistics, the Coalition was unable to finesse the terrible figures that represent the true state of our economy.

He offered a whole tranche of gloomy forecasts, including once again reduced GDP figures for the next five years. This year's GDP was downgraded to only 0.9% and 2012's likewise down to only 0.7%.

What this means is of course the Coalition's borrowings will have to raise £127bn in 2011 - 2012, with an overall increase of £111bn over the next four years.

This increased borrowing requirement will bring the national debt to an eye-watering 78% of GDP, an increase from the peak of 70.3% previously predicted.

Other painful predictions included the likelihood of an additional 710,000 public sector job losses; confirmation that the pensionable age will rise from 66 to 67 by 2026 (bad news for anyone under the age of 52 today) and the long suffering public sector workers, who are already suffering an enforced pay freeze, seeing any likely future pay increase limited to 1% over the ensuing two years. This act alone will save the Government £1.8bn.

Whilst state benefits for the unemployed will still rise by the RPI of 5.2% from 2012, those in employment but receiving tax credits will see those frozen. It is estimated that this freeze would push 100,000 children into official 'poverty'.

The Chancellor's solid and unbending commitment to reducing the strategic deficit (Plan A), ensures that we are due to endure governmental spending cuts through to at least 2017, if not beyond.

A nightmare scenario indeed with very little light at the end of the seemingly ever-lengthening tunnel.

On the plus side, because of his commitment to austerity and debt reduction, the UK still enjoys its AAA credit rating, allowing the Government to raise new 10 year debt at about 2.2%, so its £180bn, raised so far this fiscal year, compares extremely well with (say) Italy's short term borrowing costs of over 7%.

Other crumbs of comfort come from the Government's efforts

to drive the supply side of the economy by encouraging £31bn of private sector investment into getting Britain moving again through infrastructure projects given the go-ahead, particularly on road, rail, housing and internet expansion. Although only £5bn of government cash will be made available and none of this will be 'new' money, rather sums garnered from savings elsewhere.

A final sop to the motorist is the relief that the planned 3p rise in fuel tax has been postponed, but only until August next year, so fill up your tanks now.

### Markets:

The Eurozone debt crisis has again hung over the markets this month, and ensured a continuation of very volatile market conditions.



*Volatile markets continue*

With the FTSE100 trading in an 8% range during the month between a low of 5,127 and a high of 5,567 it finished the month on 5,505, making a last day recovery, thanks to the positive slant the markets took to the Chancellor's Autumn Statement and the statement from the US Fed, Bank of England, ECB, and the central banks of Canada, Switzerland and Japan, to reduce their dollar swap lines from 100 basis points (bp) to 50 bp, thus adding liquidity into the global markets. However, despite this good news, the index still finished the month down 0.7%.

Liquidity was relatively good at an average of 930,000 transactions a day.

Long-term trends in the FTSE100 declined slightly to sit 14.9% below the trend, compared to the 14.27% decline reported last month.

Across the pond the Dow Jones closed the month 0.76% up at 12,045 and its sister Nasdaq down 2.39% at 2,620. Elsewhere, the Eurostoxx50 showed a 2.3% decline at 2,330, whilst the Japanese Nikkei225 was 6.6% lower at 8,434.

Equity and debt markets will continue to be volatile until a successful solution to the outstanding Eurozone debt crisis can gain political, monetary, and fiscal consensus.

On the commodity front Oil was relatively stable with Brent Crude finishing the month on \$110.82. This represents a marginal 0.8% increase on the month.

Gold has remained becalmed, with market movements being

limited to a range of \$1,680 to \$1,790, closing the month on \$1,742 up \$33 in November, but still 10% off its all time high.

The foreign exchange markets were closely following the European debt issues as well, with sterling ending the month at \$1.56720 against the US Dollar and €1.16602 against the Euro. The Euro itself ended the month at €1.34416 against the Greenback, despite quite downbeat rhetoric from both the US Federal Reserve Chairman and the President of the USA.

Dramatic developments and declarations from the world's central banks late on the last day of November meant a lot of the market movements occurred on the last trading day.

### Are Eurobonds the answer?

With Greece, Ireland, and Portugal currently receiving the largesse of the ECB and the IMF to ensure that they do not default on their sovereign debt, the problems are compounding with both Spain and Italy being forced to accept unsustainably high interest rates to service their current refinancing requirements.



*A lender of last resort*

The problem is just not going to go away, as potential investors are fighting shy of re-funding the wayward countries. In the early days of the Eurozone, investors were lulled into a false sense of security, as they imagined that all Eurozone sovereign debt was as sound as German Bunds. Not so now, so where does that leave them?

Can Eurobonds - sovereign debt underwritten by all 17 members of the Eurozone - be the answer? By definition, Eurobonds thus denominated would appeal to many of the struggling countries as they would benefit from the security offered by the perceived strength of countries such as Germany.

The hope would be these Eurobonds would only be issued with strict caveats attached, to ensure that all countries maintained fiscal and budgetary discipline and that the debt was repaid in a timely and orderly way. This may be a smoke and mirrors approach to once again tempt investors back into the market assuming that the strength of the German economy would save the day.

There is a clarion call from global markets and investors for such a solution; however, this proposal is being ferociously opposed by Germany who, quite rightly, believe that their taxpayers will be bailing out the profligate states to the south and in effect giving them a get-out-of-jail card for their previous lax fiscal and budgetary controls.

So what other solutions are there available to the Eurozone?

Well, the obvious first one is the dismantling of the Euro and for the member states to revert to their legacy currencies. However, such a scenario would bring about the destruction of many of Europe's banks, as they would only receive massively devalued currencies in exchange for their existing Euro loans held on the books. It would also see the evaporation of the European dream.

A second solution would be for massive continued austerity programmes across all of the Eurozone. With current

economic activity at very low ebb, this solution would only bring about a double-dip into European-wide recession. The riots in Greece stand testimony to how such austerity measures would be accepted by the general population across the Eurozone.

Thirdly and finally, fiscal union could be demanded across the zone. What this would mean in reality is that Germany would be calling the political shots and disenfranchising the governments of the failing sovereign economies. Whilst this fiscal union was the holy grail of the economic union, it simply would not be acceptable by many countries, as they would be ceding their national sovereignty away.

What this equates to is the fact that the governments of the Eurozone are therefore stuck between a rock and a very hard place. Meanwhile, the risk-averse global investors are continuing to desert the debt of Eurozone governments and in turn their banks.

We have a danger of a spiralling cycle of higher and higher borrowing costs for the member nations, leading to more austere spending cuts and slower economic growth. This could be a very difficult scenario to reverse, as many of the banks also struggle to refinance their debts.

The coming few weeks will see this heated debate continue apace as the global investor eyes the Eurozone with an ever more sceptical view.

### Jobs:

Once again the unemployment figures have brought very bad news, particularly for the 16-24 year olds.

Probably this was to be expected with the on-going Eurozone debt crisis throwing up the threat of recession across the region and creating possible contagion here in the UK.



*Youth bear the brunt again*

The bare figures show another increase of 129,000 unemployed in the three months to September, to 2.62 million, with those unemployed and claiming Jobseeker's Allowance rising by 5,300 to 1.5 million.

Worst of all, however, is the fact that unemployment within the 16-24 year olds has risen once again to 1.02 million and unemployment for women is now at its highest level for 23 years. This last fact probably reflecting the number of part-time positions lost.

Overall these figures represent a national unemployment rate of 8.3% and these overwhelmingly dismal statistics reflect the stagnant UK economy, as reported in our leading article.

With current work opportunities representing their lowest figure since 1988, the case for expecting improvement to the unemployment figures in the short-term looks very thin, though the Government has just announced six-month cash incentives for companies to take on 18-24-year-olds.

As reported last month, the regional variation remains constant with the North East bearing the brunt of it by recording the highest unemployment rate of 11.6% whilst the South East enjoys the lowest rate of 6.3%.

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