INVESTMENT BULLETIN

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Brighter prospects ahead?

Chancellor of the Exchequer George Osborne delivered a relatively optimistic assessment of the UK economy in his 2013 Autumn Statement. The UK economy is growing more quickly than that of any other major advanced nation, including the US and Germany, but remains particularly vulnerable to future shocks from the eurozone.

The UK economy appears to be recovering more rapidly than expected – the Office for Budget Responsibility (OBR) more than doubled its forecast for economic growth this year from 0.6% to 1.4%, and also raised 2014's prediction from 1.8% to 2.4%. Meanwhile, the rate of UK unemployment is forecast to fall from 7.6% this year to 7% in 2015, and is expected to reach 5.6% by 2018. This is particularly significant because 7% is the threshold at which the Bank of England will consider tightening monetary policy.

The government intends to introduce a cap on total welfare spending, but this will not include the basic UK state pension or the "most cyclical of benefits for jobseekers". The state pension will increase by £2.95 per week from April 2014, and individuals of pensionable age will be allowed to make additional voluntary National Insurance contributions to help boost their state pension. However, a rise in the state pensionable age will be imposed earlier than expected – the government plans to increase the state pensionable age to 68 in the mid2030s and to 69 towards the end of the following decade. The increase in pensionable age is intended to keep track with increased life expectancy.

New debate on house price

House prices have re-emerged as a hot topic for debate. Some market participants are expressing concern over signs of escalating prices amid worries government backed schemes to boost activity in the housing market could help to create a house price 'bubble'. The Royal Institution of Chartered Surveyors has urged the Bank of England (BoE) to take away the "froth" from increases in house prices by capping rises at 5% per year. The limit would be imposed by restricting the amount individuals could borrow – whether in relation to the value of the property or to their income – in order to avoid the risk of a house price bubble created through debt.

Spending Cuts

The UK government is likely to remain in deficit until at least 20172018, according to the Office for Budget Responsibility (OBR) . However, according to Chancellor of the Exchequer George Osborne, the government ultimately intends to achieve a budget surplus. A budget surplus occurs when a government's income outstrips its expenditure, and the government – or more specifically, the Conservative party – aims to accomplish this through spending cuts rather than tax increases. Looking ahead, although the UK economy appears to be showing welcome signs of recovery, the government's Sometimes controversial austerity measures appear likely to remain in place for some time.

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Fed revisits end to QE

US monetary policy – and the much discussed possibility stimulus measures might be brought to an end – remained at the forefront of many investors' minds during November. Sure enough, amid mounting confidence the US economic recovery is gathering pace, US Federal Reserve policymakers confirmed the outlook warranted "trimming back" the central bank's stimulative policy over "the coming months". Although share prices initially wobbled in response, US markets did reach new highs in November – for example, the Dow Jones Industrial Average index rose 3.5% over the month to breach 16,000 points for the first time ever.

Meanwhile, in the UK, the Bank of England believes the country's economic recovery has "finally taken hold", according to its latest Quarterly Inflation Report. The rate of unemployment from July to September eased slightly from 7.8% to 7.6% although, on balance, the central bank's policymakers do not expect unemployment to have reached the key level of 7% by the end of 2014. The annualised rate of inflation staged a sharp drop during October, falling from 2.7% to 2.2%. Over November as a whole, the FTSE 100 index declined 1.2%.

On the continent, the European Central Bank reduced its main interest rate from 0.5% to a new record low of 0.25%, citing a backdrop of subdued inflation and continuing economic weakness in the region. The eurozone's economy expanded at a quarterly rate of just 0.1% during the third quarter of 2013, compared with growth of 0.3% during the second quarter, while growth in Germany decelerated from 0.7% in the second quarter to only 0.3% in the third quarter. The year on year rate of inflation in the euro area slid to 0.7% during October, raising fears over the prospect of deflation in some of the weaker member states. November saw Germany's Dax index rise 4.1% over the month while France's CAC 40 index fell 0.1%. The pace of Japan's economic growth lost some momentum during the third quarter although the Bank of Japan still believes the country's economy remains on course for a "moderate" recovery. Share prices in Japan were driven upward by encouraging comments from the central bank, as policymakers reiterated they had no plans to scale back its asset buying programme, which is intended to boost Japan's economic growth, and the benchmark Nikkei 225 index surged 9.3% over the month.