APPENDIX 5
Economic and market review for April 2013 to June 2013 (Arlingclose)

Growth: The UK economy showed some improvement, although growth was subdued. GDP for the first quarter of 2013 was +0.3%, but the underlying numbers were disappointing as inventory growth contributed largely to the output figures. Revisions by the Office of National Statistics to GDP back-data showed the UK avoided a double-dip recession in 2012, but that the downturn in 2008-09 was deeper than previously estimated. Growth is now nearly 4% below its peak back in 2007.

Some positive signs for household spending emerged, mainly from a slower deterioration in real earnings growth (i.e. earnings less inflation) which implied a slower erosion of purchasing power. Household savings rates remained high, which is unsurprising given the uncertain economic outlook. The outlook for Q2 GDP growth is more positive following signs of a pickup in consumer spending and growing business confidence.

Inflation: Annual CPI was 2.7% in May. Inflation was expected to pick up again temporarily in the near term, peaking around 3% in June and remaining close to this level throughout the autumn. Further out, inflation should fall back towards the 2% target as external price pressures fade and a revival in productivity growth curbs domestic cost pressures. The oil price (Brent Crude) climbed above $100/barrel on the back of political unrest in Egypt and the unresolved crisis in Syria.

Monetary Policy: There was no change to UK monetary policy with official interest rates and asset purchases maintained at 0.5% and £375bn respectively. Minutes of the Bank of England's Monetary Policy Committee meetings during the quarter showed that whilst the MPC voted unanimously for no change in official interest rates, it remained split (6-3 in favour of no change) on whether further QE was required to stimulate the economy.

In his testimony to Congress on 22nd May the US Federal Reserve Chairman Ben Bernanke stated that, if the nascent recovery in the US economy became established, the Fed would reduce its $85bn monthly asset purchase programme (QE). The apparent movement by the Fed towards tapering its open-ended QE programme prompted extreme asset price volatility in bonds and equities, as investors sought to crystallise gains driven by excessive liquidity. As a consequence, government bond yields spiked. UK gilt yields jumped up 0.50% over the six weeks to the end of June.

The market negativity appeared to be overdone. Whilst the outlook for the global economy appeared to have improved over the first half of calendar 2013/14, significant economic risks remained, particularly in China and the Eurozone. The Chinese banking system is facing tighter liquidity conditions as officials seek to slow down rampant credit growth, and, despite the time gained by the ECB to allow individual members and the Eurozone as a whole to reform their economies, the Eurozone debt crisis has not gone away. The region remains in recession and up-coming political events, such as the German general election, could derail any progress towards a more balanced and stable regional economy. The US recovery appears to be in train, but political risks remain regarding the debt ceiling and the federal budget.