

Economic outlook for 2012



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I am very conscious of the fact that writing an economic outlook for the year ahead whilst the Euro crisis remains unresolved is not without its risks: by the time this article is published my thoughts may look horribly out of date. The market view on the most likely prognosis for the Euro crisis seems to evolve hourly, rather than week by week. Our base case assumes that a way is found through the current impasse and that peripheral debt markets stabilise over the next few months, preventing a disorderly break-up, although downside risks are significant and a Euro break-up would create a much more serious crisis than the collapse of Lehman Brothers in 2008.

The crisis has now gone on for long enough now to act as a significant dampener on economic activity and the outlook for the world economy has deteriorated since the summer. US economic news has actually improved somewhat in recent months, although this is the exception and the general pattern of data in Europe, the UK, China and even hitherto booming Brazil, points towards a marked slowdown in growth in the final months of 2011.

The UK economic situation is weak, although there are some glimmers of hope, particularly with regard to inflation. Inflation is a year-on-year calculation and as the January 2011 VAT hike and the upward pressure from higher commodity prices drop out of the annual comparison, the rate of inflation should fall quite sharply. This should take some of the pressure off household finances, although it will be offset by a further rise in unemployment, unless the economy grows much faster than we think likely. The Bank of England will keep interest rates at current levels, providing important support for the housing market, although we do not expect to see a significant pick up in the volumes of mortgages or housing transactions.

Looking overseas, while central banks and governments in the developed world have run out of conventional policy instruments, there is still scope for policy stimulus in the emerging block and this is set to become one of the key trends in the first half of 2012. Assuming oil prices stay at or around current levels, inflation rates should fall and allow those countries which had embarked on a policy tightening phase – via higher interest rates and curbs on lending – to give their economies a booster shot.

2011 has proved to be a watershed year for global economics and politics: we have seen significant political change in the Middle East and North Africa, governments around the world have had to tell their electorates uncomfortable truths about the balance of taxation and public spending and the half-baked Euro project finally faced reality. No doubt all of these issues will still remain agenda items for investors in 2012.

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