

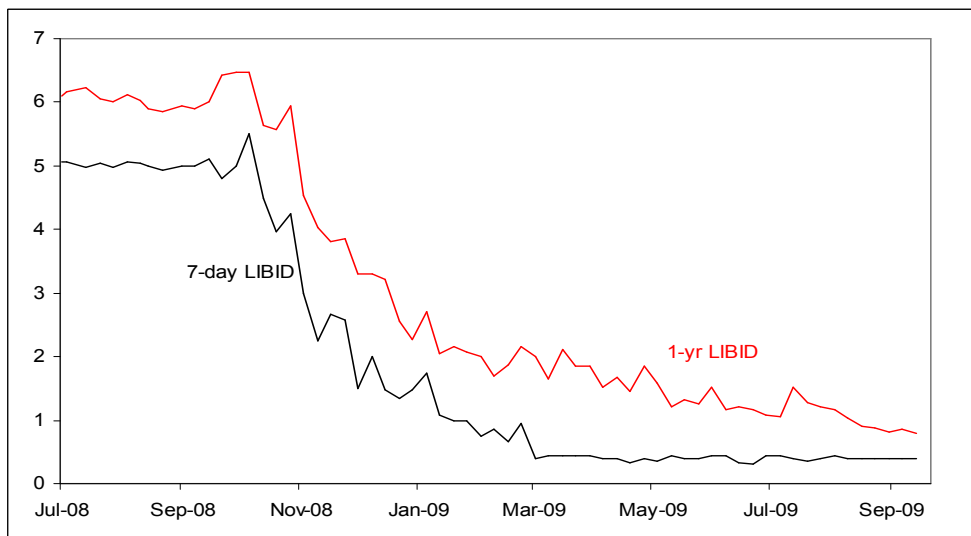
Market Overview – April to September 2009
(courtesy of Butlers)

Financial markets entered calmer waters at the outset of the 2009/10 financial year as the worst fears of global depression and bank meltdown subsided. Nevertheless, while economies showed tentative signs of stabilising, a return to a positive growth path was still considered to be a long way off. Indeed, the Gross Domestic Product data for the first half of 2009 registered their sharpest falls for over 20 years (minus 5.5% year-on-year at the low point).

It was not until the summer months that economic performances began to stage a welcome improvement. Fear of a collapse of another leading financial institution lessened markedly and this was reflected in the more 'normal' behaviour of money market rates. That said banking sectors in most countries were far from trouble free; asset write downs continued, minor US banks continued to fail and the troubles of a number of building societies made the headlines from time-to-time.

The UK economy continued to post a mixed performance and it was far from clear how far down the road to recovery it had travelled. The low point of the business cycle is believed to have been passed during the third quarter of the year but analysts and officials remained sceptical, first, about the speed of return to trend growth (considered to be around 2.5% pa) and, second, about the sustainability of any recovery.

Money Market Deposit Rates



Industrial production was one of the buoyant areas of the economy, although this had run out of steam by the autumn. Consumer spending, by contrast, remained mixed as attempts by the household sector to reduce its heavily indebted position deterred credit-fuelled spending. In addition, the continued deterioration in the employment situation and the weakness of earnings growth served as further deterrents to spending.

In aggregate, this provided an uncertain backdrop for policy makers. It was clear from the outcome of the meetings of the Monetary Policy Committee (MPC) during the period that policy makers remained concerned about the underlying health of the UK economy.

The bias of MPC decisions remained directed towards further policy ease. Clearly this could not take the form of interest rate cuts – bank rate at 0.5% is considered to be as close to zero as makes no odds. Consequently, relaxation took the form of an extension of the Quantitative Easing (QE) programme, the first tranche of £125bn sanctioned in March was followed by an additional £50bn boost in August.

The accommodative policy approach, coupled with dwindling fears of financial collapse, created an environment in which money market rates eased to yet lower levels. In addition to this the margin between London Interbank Offer Rate and London Interbank Bid Rate returned to a more normal position. This was a sign that banks were more comfortable about transacting business between each other but the availability of credit to a wider cross-section of the economy remained problematic.

Long-term interest rates returned to a declining trend at the outset of the financial year. The MPC's decision to embark upon a policy of QE of money supply, via the purchase of fixed rate securities (principally gilts) injected new life to the market. For, it countered the very negative concerns about the massive supply of bonds that would be necessary to finance the Government's rapidly deteriorating finances.

Via the QE 'mechanism' the Bank of England would become the largest buyer of gilts and reduce the net supply of stock to the market to a mere trickle. This, together with some further investor demand for safe-haven securities drove yields back towards the low points seen in the closing stages of 2008/09. Nevertheless, the easier trend drew to a close by the autumn as the positive influence of QE was eclipsed by uninspiring performances in major international bond markets, unattractive yields and the realisation that with economic recovery, the prop from QE would be withdrawn.