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Investment Services

# Reeves Market Outlook

## October 2021

# 1. UK staycations and return to offices boost retail footfall in August.

Visits to UK shops rose in August to the highest level since the first Covid-19 lockdown. According to industry data, it was boosted by staycations due to foreign travel restrictions and by workers returning to offices. The total number of people visiting stores rose 10 percentage points from July after three months of relatively unchanged data and reached the highest level since the start of the pandemic. However, the number of people visiting stores in August was still down 18% compared to August 2019, highlighting long-term challenges for physical stores.

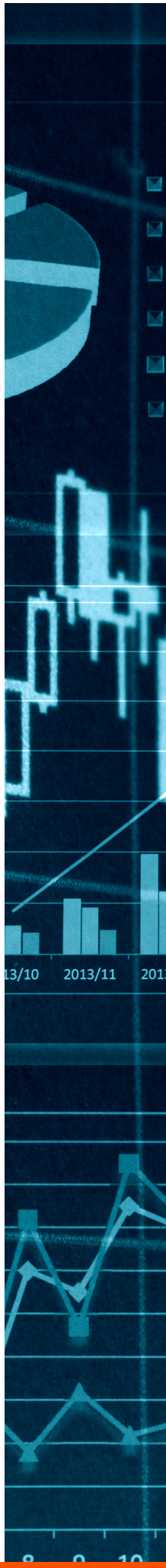
## Relevance/Impact

Shopping centres accounted for half of the increase in high street store visits, however, they were still down one-third relative to August 2019. Non-essential stores had all fully reopened since 12th April, however, the total number visiting stores has still remained low relative to the same period last year. This has mainly been due to the shift in online sales, increase in Covid-19 infections and adverse weather conditions in July. Approximately 28% of all retail sales were online in July.

If this increased demand of high street visits returns to its pre-covid levels, it will put further serious strain on supply chains across the nation. Current problems are already disrupting stock availability, which is exacerbated by Brexit and Covid-19. This would ultimately lead to volatile inflationary statistics due to a supply and demand mismatch. Investors, therefore, need to keep a close eye on inflation announcements and expectations for the UK over the coming months.

**Source:**

https://www.ft.com/content/15d4a2d0-eaa5-4cf8-bd04-fcb7a34c04b7



# 2. The UK economic recovery slowed in July

Figures show the UK economic recovery lost pace in July, with consumers spending less and construction being hit by a shortage of raw materials.

## Relevance/Impact

Output rose just 0.1% in July, significantly shy of the 0.6% forecast a poll of economists had predicted. The recovery is now losing its initial momentum, with July representing the weakest expansion since January and with various risks now threatening future expansion hopes.

In fact, without the large uptick seen in the mining & quarrying sector, July would likely have seen a contraction, underlining the weakness of other sectors and the differing recoveries seen across various parts of the economy. While the slowing of the recovery may worry some, there is still an expectation that the Bank of England will continue with an interest rate rise in the first half of 2022.

**Source:**

https://www.ft.com/content/0a2ed9e3-545b-4b38-81b6-1d0d4bedbdd0
https://www.bbc.co.uk/news/business-58502593

# 3. US Treasury Risks Running Out of Cash in October

US Secretary of the Treasury Janet Yellen has warned that the US government will run out of cash in October unless its borrowing limit is increased. This is worrying some senior members of the Biden administration as a possible debt default may occur which would damage the US credit rating.

## Relevance/Impact

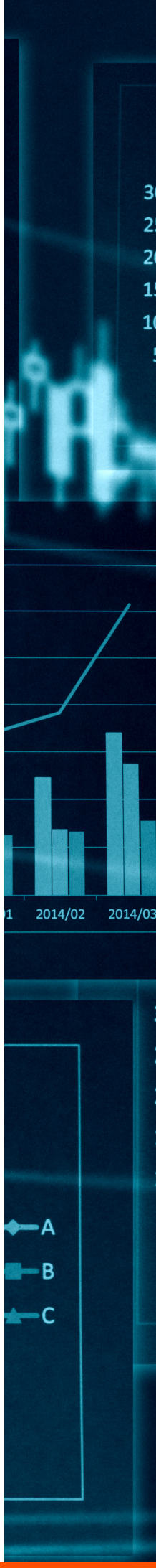
The US debt is currently around US$28 trillion, with a saturated market and with huge amounts of quantitative easing measures already in the system compounding the issues One of the biggest concerns the Biden administration must face is that the Republicans currently hold the majority in the Senate and have previously stated that they won't be voting to increase the debt ceiling.

However, a US debt default remains unlikely; even if the Republicans hold their ground and refuse to vote for a debt ceiling increase, the Democrats should be able to force it through using different political instruments, such as a simple majority in Congress. They may opt not to follow this route, instead they are more likely to seek compromises with the Republican party which is likely to result in Biden's newly proposed policies taking some of the hit, though his Infrastructure Bill has already passed in the Senate and will probably pass in the lower house.

If the worst was to happen and the US was to default on its debt, the resulting fallout would have widespread ramifications, not just in the US markets, but also globally. US bond yields would increase as prices and demand drop, which may in turn increase prices of UK gilts and EU bonds as investors flock there. We would also probably see an increase in the value of commodities such as gold, which some investors may use as a safe haven from a reduction in the dollar's value.

**Source:**

https://www.ft.com/content/4433d8ef-7d18-4c07-ba08-7f05fcbdb0b8



# 4. Rishi Sunak to set out New Fiscal Rules to Rein in UK Borrowing

UK chancellor Rishi Sunak is intending to use next month's Budget to lay out rules to reduce Government borrowing. This comes at a time that the Treasury fears that a rise in interest rates could damage the heavily indebted public finances.

## Relevance/Impact

The implementation of these new rules will commit him to stop borrowing to fund day-to-day spending within the next three years. The current government spending plans follow these new rules, however, they allow little extra room for giveaways, such as furlough or universal credit. According to those privy to Sunak's thinking, they also feel that the fiscal rules will also require underlying debt, which currently stands at more than 100% of GDP, to start falling by 2024-25. Boris Johnson's backing of this plan has helped to restore the recently weakening relationship between PM and Chancellor.

With the tightening of fiscal policy as the Chancellor attempts to reduce the country's debt, it is expected that we will see a reduction in retail spending in the short-term, particularly as some families will have significantly less income, with the end of the furlough scheme and a reduction in universal credit. However, there may be an increase in consumer spending in the approach to Christmas, although this will probably be hit by continuing supply issues. The Government may also attempt to reduce its debt by buying back gilts.

**Source:**

https://www.ft.com/content/eb23375d-7219-4b22-a8a7-3060cd848163

# 5. Evergrande bondholders left in the dark as crucial deadline passes

Chinese property developer Evergrande faces the prospect of defaulting on US$84m of offshore coupon bond payments. Investors in the offshore bonds have said that they are yet to receive the interest payment due on the midnight of the 23rd September. This adds further uncertainty to a liquidity crisis for the world's most indebted property developer and has the potential to raise volatility within global markets.

## Relevance/Impact

The fears that the biggest property developer in China - which is a similar size to the Lehman Brothers - could default on its debts has shaken the global stock and commodity markets ahead of the payment deadline. Although Evergrande has not formally spoken, missing its bond payments alone can signal to the markets the current difficulties they face. However, according to a Hong-Kong based investment group, whether it is paid or not does not change the surrounding uncertainty. The only thing that could change their current investor sentiment is some form of intervention and significant liquidity to restructure the business.

The possible Evergrande default could have a significant drag on the property sector in China which could have a ripple effect on the global economy as the default would involve losses for banks and bondholders globally, forcing these institutions to liquidate holdings in other asset classes to cover the potential losses from Evergrande. The majority of liquid asset classes, including cryptocurrencies, faced a sell-off after the news which is expected to decrease investor sentiment over the coming weeks and months. The current situation highlights the importance of a diversified portfolio and of remaining defensive in times of economic uncertainty to dampen portfolio volatility and advantage of any equity sell-offs.

The rest of the year is expected to remain bumpy in the financial markets, with volatility expected to increase further.

**Source:**

https://www.ft.com/content/e7c0f31d-4dff-4992-88e6-a70402b7b4bc

# 6. Two UK Power Companies Collapse as Ministers Brace for More Casualties

Energy companies Avro and Green have collapsed following the current huge spike in natural gas costs, resulting in more than 835,000 customers being reallocated by Ofgem to more secure providers.

## Relevance/Impact

A combination of diminishing reserves, low wind levels and increased demand for natural gas in China has resulted in soaring gas prices for Europe. This has hit the UK particularly hard after a fire at a substation cut off power imported from France. Speculation suggests that Russian gas companies have been reducing their reserves in the underground European storage tanks prior to winter to drive up prices with the backing from Moscow, which is stressing that the Nordstream 2 gas pipeline, which bypasses supply via Ukraine, can alleviate the spiking prices. As many companies in the UK are intermediaries and do not hold physical reserves, they are in danger of folding, resulting in a migration of customers to more stable longstanding companies.

Though gas prices have already spiked, we are currently seeing a decrease in the demand for steel. This has arisen in-part due to the threat that Chinese construction company Evergrande may default on its US$300bn debts, which has sent shockwaves through construction industries. Furthermore, many European and British steel manufacturers are reducing steel production due to the rising cost of gas, which accounts for 20% of overall manufacturing costs. With delays in steel production, we will see further disruptions in the already hit supply chains, which are also burdened by increased shipping costs. Following this we may also see a strong rally in the price of steel in the new year when construction becomes favourable again, bolstered by a strong housing market.

**Source:**

Financial Times (22nd July 2021) Bets on electric vehicles light up lithium miners and battery makers
https://www.ft.com/content/837dca08-d6fa-4336-bc31-add202b1e372

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The value of your investment and any income from it could fall or rise, and you may not get ack the full amount you invest.

Past performance is not a reliable indicator of future results. We always recommend you talk to a qualified financial adviser before making any investment decisions.

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Pension, Investments & Retirement Advice

Reeves Independent Limited: 30 High Street, Gosforth, Newcastle Upon Tyne, NE3 1LX
Tel: 0800 989 0029
Email: info@reevesifa.com