



MARKET & ECONOMIC REVIEW

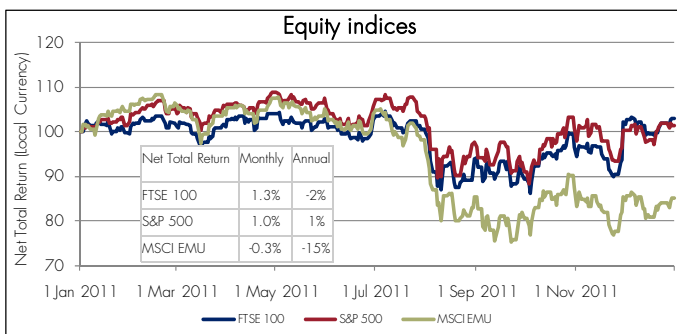
Overview

Most European leaders announced an accord for tighter long-term fiscal integration that will see penalties for countries that break the Euro's debt and deficit rules. Britain vetoed any revision to the Lisbon treaty after David Cameron failed to secure concessions for the City of London and will be outside of any agreement. A few European governments will need to get parliamentary approval before signing up to the agreement that is due to be finalised by March. Markets remained largely unmoved after the summit.

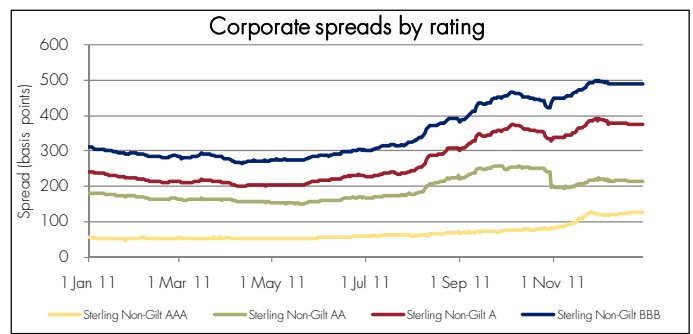
There was larger than expected demand from European banks for the three year loans that were on offer from the European Central Bank. The loan programme will provide around €490bn to banks in an attempt to ease liquidity pressures ahead of the first quarter of 2012, when a large volume of bank and sovereign debt is due for refinancing. The Bank of England announced contingency plans to provide access to a similar scheme for British banks, should the liquidity problems extend to the UK.

In the UK, CPI inflation fell slightly from 5% to 4.8%, as a result of slowing rises in food, clothing, household goods and transport costs. The expected slowdown in inflation next year led to the MPC voting unanimously to keep interest rates at 0.5% and maintain the same level of quantitative easing.

Equity markets end the month close to starting levels



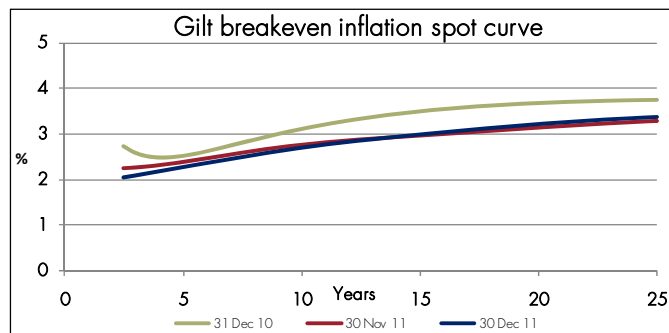
Credit spreads were broadly unchanged over the month



LATEST ECONOMIC NUMBERS

Current Base Rate	0.5%
CPI increase November (%/y)	4.8%
Halifax house prices Nov (%m/m)	-0.9%
IPD TR property index Nov (%m/m)	0.5%
UK total trade balance October	-£1.6bn
VIX (volatility) index	23.4
\$/£ exchange rate	1.55
Numbers as at the end of month unless stated	

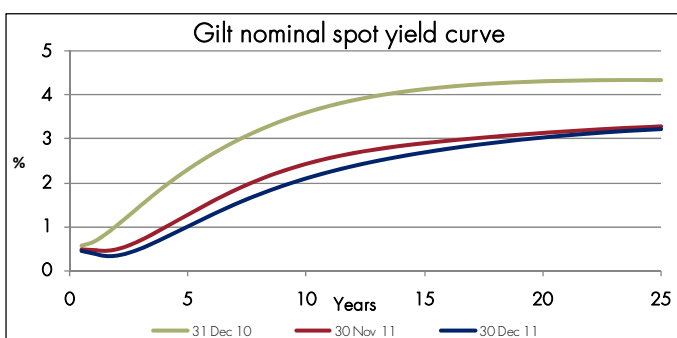
Breakeven inflation is largely unchanged this month



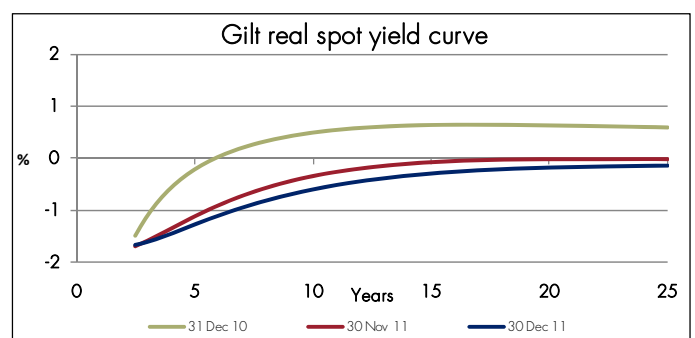
CALENDAR OF EVENTS AND DATA RELEASES

Quarterly Economic Survey	10th Jan
UK Trade	11th Jan
MPC interest rate announcement	12th Jan
RPI / CPI	17th Jan
Producer Price Index	24th Jan
Minutes of MPC meeting	25th Jan

Nominal yields fell during the month



Real yields fell during the month

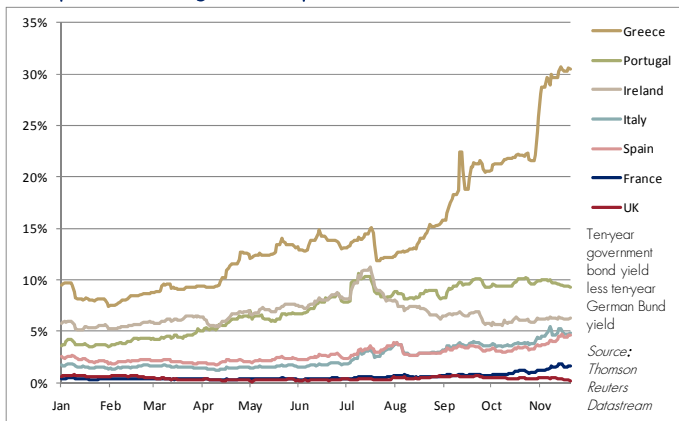




A look back at 2011 and forward to 2012

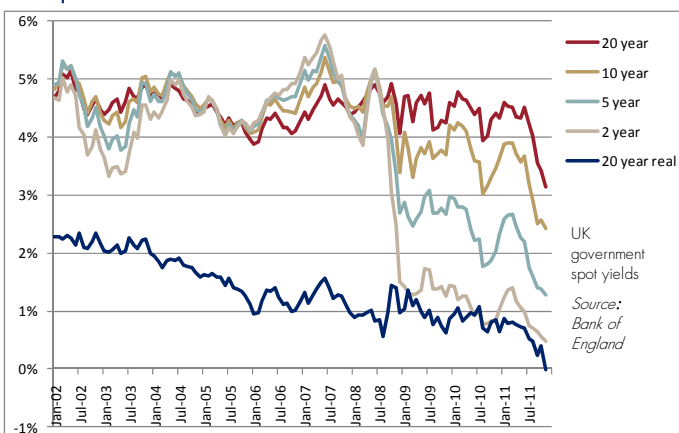
The Eurozone was very much under the spotlight for most of 2011 as a result of concerns over debt levels, growth prospects and the future of the single currency. Equity markets started 2011 in a relatively benign fashion despite civil unrest during the Arab spring and the natural disasters in Japan and New Zealand. By August however, markets had grown increasingly frustrated with the indecisiveness of policymakers on both sides of the Atlantic. In the US, Democrats and Republicans jostled for political gains and flirted dangerously with a technical default, whilst in Europe, numerous bailout and stimulus packages did little to provide the much needed shot in the arm. There is no doubt that the prospects for 2012 depend heavily on the ability of global leaders and central bankers to demonstrate to markets the ability to implement bold measures that provide short and long term stability.

European sovereign bond spreads



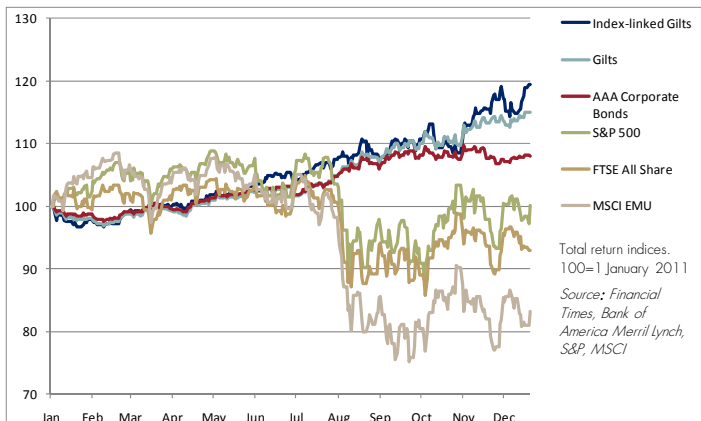
Yields on European government debt continued to diverge during 2011, however it wasn't just in the peripheral countries (such as Greece). Spreads on 'core' Eurozone countries like Italy, Spain and France reached record Euro-era highs, fuelled by growing concerns over sovereign risk and growth prospects.

UK spot interest rates



The increase in gilt yields during the end of 2010 and early part of 2011 was reversed with yields falling to record lows. By the end of the year, real yields for durations to 25 years were negative reflecting the belief that interest rates would remain low, the 'flight to quality' in gilts and the QE programme.

Total Return Indices



Markets were relatively benign throughout the first half of the year, however there were significant losses on risky assets in August and investors sought the safe havens of bonds and gold. By the end of the year, markets had recovered in the US, however significant losses in European equities reflected the uncertain outlook there.

Average UK forecasts

	2011	2012
GDP growth	0.9 %	0.6 %
CPI	4.6 %	2.1 %
RPI	5.2 %	2.7 %
Claimant unemployment	1.62 m	1.77 m
Current account	-£20.8 bn	-£18.4 bn
PSNB	£129.3 bn	£119.1 bn

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury

In the UK, growth in 2011 is likely to have been lower than many expected. A protracted recovery is now forecast by many economists, with many expecting growth to remain stagnant in 2012 as deleveraging continues and the government remains committed to austerity packages. Inflation over the last year is likely to have been higher than expected as a result of soaring energy prices. However, the Bank of England and other commentators expect inflation to fall in 2012, once this and last January's increase in VAT drop out of the inflation figures.

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