Monthly

Economic Review

Provident Solutions

Wealth Creation & Wealth Management
Financial Lifestyle Planners

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Economic review of: August 2013

Our monthly economic review is intended to provide background to recent developments in investment markets as well as to give an indication of how some key issues could impact in the future.

It is not intended that individual investment decisions should be taken based on this information; my colleagues and I are always ready to discuss your individual requirements. I hope you will find this review to be of interest.

Paul Smith

UK's Q2 GDP revised upwards

In a widely anticipated move, the Office for National Statistics (ONS) revised their calculation of the UK's second quarter gross domestic product (GDP) upwards to 0.7% from the previously reported 0.6%.

Expected uplift in GDP

The economy had been moribund since the 2008-09 recession, so this good news was welcomed and the ONS added that in the three months to end June this year GDP grew by 1.5% compared with the same time last year. This reflects the increased confidence in the fact that the economy is gaining traction.

Commenting on this data the ONS cited an increase in activity across most business sectors, including construction, services, industry and agriculture, so a broadly based improvement has been recorded.

This is important, as most economists believe that the UK needs to move away from a historically debt fuelled consumer-led recovery towards a more balanced economy driven by investment, industry and exports.

Signs of this trend were an increase in business investment of 0.9%, with government spending increasing likewise by 0.9%.

British exports grew by 3.6% from Q1, helped by the eurozone economies bottoming-out and the weakening pound. At the same time imports only grew by 2.5%, so the balance of payments was also slightly improved.

On the services side, the ONS reported that the sector saw activity grow by 2.8% in June against the same time last year, with hotels, restaurants and financial services leading the way.

Whilst this all came as welcome good news, the ONS did go on to caution that the UK's output still remains more than 3% below its peak, attained in early 2008, just before the long recession. Many economic forecasters and pundits believe that to achieve a true recovery, the GDP figures have to reach these levels again.

Importantly though, the latest stream of positive economic data for the UK has boosted the feel-good factor across all the business sectors and bodes well for the remaining two quarters of 2013.

Manufacturing sector revives

The employers group, the Confederation of British Industry (CBI), has reported that UK factories have seen a revival in their August new orders, reaching their highest level for two years and giving a major boost to the economy's recovery prospects.

Order books are healthy

Surveying 413 manufacturers across the country, the CBI's measure showed total orders increasing from -12 to zero in July, where their previous forecast was only -8. Their forecast for the next three months increased from +15 to +25 and export orders also showed a strong gain to -7 against the previous measure of -20.

Given that a decline in UK manufacturing output contributed greatly to the country's recent economic malaise, with a contraction of 1.7% in 2012, mainly as a result of a decline in our biggest export market - the eurozone – this good news of a resurgent manufacturing sector was warmly welcomed.

So far in 2013 the sector has seen growth of 0.4% in the three months to June and the forecasts are for improving sentiment and performance moving forward.

Germany also saw a revitalised manufacturing sector with Markit's 'flash' estimate of output there at its highest level since January.

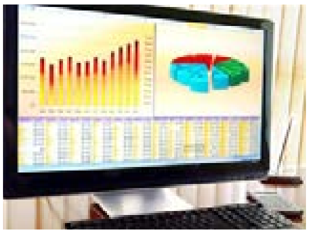
At the same time, adding credence to these figures, the Manufacturing Advisory Service canvassed nearly 700 UK companies and reported that half of them expected to increase their investment in their businesses in the coming months.

Crucial to the continued success of this sector is the maintenance of low interest rates, which with the Governor of the Bank of England giving the market 'forward guidance' that base rate should remain at 0.5% until UK unemployment drops to 7% has confirmed. Given this assurance, businesses are far more likely to invest in new plant and expanding their export sales efforts.

Markets: (Data compiled by The Outsourced Marketing Department)

Geopolitical tensions, especially in Syria, heavily influenced the risk markets, with sentiment turning negative in global equities.

The FTSE100 finished the month on 6,417.6 - having touched an intra-month low of 6,390.8 - to record a final loss of 3.07% in August. The FTSE250 followed suit, losing 1.67% and ending on 14,625.2. The junior AIM market fared better, gaining 4.69% to close on 752.61.



All eyes on Syria

Elsewhere, the Dow Jones dipped 4.45% finishing the session at 14,810.31, with the Nasdaq also losing 1.01% at 3,589.87.

Back in Europe, the Eurostoxx50 ended August on 2,721.37 to record a loss of 1.69%, whilst in Japan the Nikkei 225 faded by 2.04%, closing at 13,388.86.

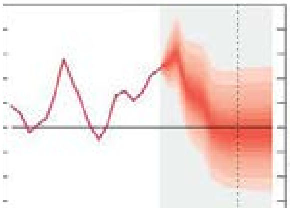
The foreign exchange markets saw some emerging markets currencies under pressure with the Indonesian Rupiah and Indian Rupee seeing heavy depreciations in the month. Sterling did slightly better, gaining a modest 2.3% against the greenback to end August at $1.56 and against the Euro rising 3.25% to €1.18. The Euro itself was unchanged against the dollar at $1.32.

On the commodity front, gold almost ventured back into bull market territory, recovering to $1,394.75 an ounce, which represents an 18.2% rise from its recent intra-day low (on June 28th this year) of $1,180 an ounce. Heightened tension in the Middle East, especially Syria, with the threat of military action by a western coalition, returned the precious metal temporarily to its 'safe-haven' status.

Strongly influenced by these same events, the price of oil spiked, with the Brent Crude benchmark closing August on $114.01 a barrel, a monthly rise of 6.64% and a three-month hike of 13.5%, on fears of diminished supply.

UK inflation down in July

The Office for National Statistics (ONS) announced that the Consumer Prices Index (CPI) fell in July to 2.8% from the previous recorded 2.9%. Whilst still above the Bank of England's (BoE) 2% target, the news was welcomed by consumers and the BoE escaped having to write to the Chancellor, George Osborne, explaining why it has risen 1% above this threshold.



Both CPI and RPI fall

Several factors caused this decline in the CPI, mainly long-haul air fares rose at a lower rate than last year, lower costs of cultural and leisure goods and discounts offered by clothing retailers in the summer sales - both clothing and footwear saw a reduction in prices of 3.2%.

Against this, fuel costs (petrol and diesel) both rose, by 0.7p and 0.4p per litre respectively, from June to July, whereas a year earlier they saw a decline.

At the same time, the wider Retail Prices Index (RPI), which includes housing costs, also fell to 3.1% from its previous level of 3.3%. This is a more important measure, as state pensions, some state benefits, the return on index-linked Government bonds, utility prices and train fares are all benchmarked against this index. As an example, regulated rail fares can be increased by the July RPI figure plus 1%, so this will impact a large swathe of commuters across the country from next January.

Commenting on this data, Phil Gooding of the ONS was quoted as saying: *"Essentially, both the CPI and RPI reports are very close to market expectations.*

"On the CPI, the figures do suggest that the downtrend in inflation is in place and we think that there is a reasonable chance that inflation will be at the 2% target in spring next year."

UK Inflation has been persistently above the 2% target since November 2009; annual CPI inflation peaked at 5.2% nearly two years ago.

Mark Carney, the Governor of the BoE, added a caveat to his recent 'forward guidance' on interest rates, stating that if inflation projections 18-24 months out rose above 2.5%, he would consider increasing the ultra-low BoE base rate of 0.5%.

Unemployment continues to fall slightly

Although only a modest fall, UK unemployment continued to shrink in the three months to June.

Figures released by the Office for National Statistics (ONS) in August showed a drop of 4,000 in the unemployed, with the total remaining at 2.51 million and their comments were that this leaves the unemployment rate *"broadly unchanged"* from the first quarter of the year.

However, the number of people claiming the Jobseekers Allowance saw a steeper decline of 29,000 to 1.4 million.

On the negative side, youth unemployment continued to increase by 15,000 to 973,000 and those unemployed for more than two years saw a rise of 10,000 to 474,000, its highest level in 16 years.

At 7.8%, the overall rate of unemployed remains well above the level of 7%, which Mark Carney, the new Governor of the Bank of England, has chosen as the benchmark at which he believes base rates - currently at 0.5% - may have to be raised. To achieve this level, another 750,000 jobs will need to be created and he believes that this will take at least three years.

With 69,000 more people in employment in Q2, this brings the employment level to its highest since records began at 29.78 million, an increase of 307,000 compared to the same time last year.

Given the recent controversy around the impact of immigration in the workplace, David Freeman, of the ONS said that 66% of this increase was as a result of UK nationals being employed, with 33% of the increase coming from non-UK nationals.

At the same time, the ONS said that over the last year wages grew by 1.1% and if bonuses were included, the figure rose to 2.1%. Whilst still below the current levels of inflation, these figures represent the highest annual growth in earnings since June 2011.

The Work and Pensions Secretary, Steve Webb, alluding to the fact that the general economy was picking up said: *"things were starting to look much more positive."*

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