ECONOMICREVIEW
of August 2014

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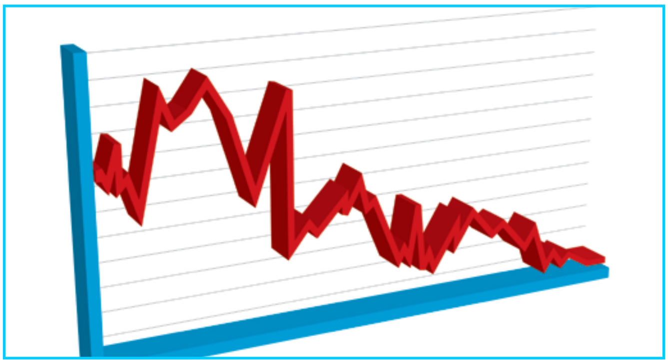
Our monthly economic review is intended to provide background to recent developments in investment markets as well as to give an indication of how some key issues could impact in the future.

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

Paul Smith

UK inflation dips to 1.6%

More encouraging news came from the Office for National Statistics (ONS) in mid August, as they announced that the Consumer Prices Index (CPI) had dropped to 1.6% in July from the 1.9% recorded in the previous month. This continues the trend of below 2% inflation throughout 2014, much to the pleasure of the Bank of England (BoE).



Good news on inflation front

The ONS cited a fall in the price of clothing, probably as a result of retailers extending their sales period to attract consumers, and both non-alcoholic and alcoholic drinks, particularly spirits and New World wines. There was also a reported drop in the prices of financial services, with some major banks dropping their overdraft rates. Food sales also saw a price fall overall. Food is now 0.4% cheaper than in the same month last year including syrups, jam, sugar, chocolate and confectionery. Finally, petrol and diesel fuel also saw a decline in price. Currently the average price of a litre of petrol is £1.31, against a price of £1.35 seen at the same time last year.

Whilst good news for the economy, it is not such good news for savers, as they will now need to find a home for their non-ISA savings paying at least 2% (or 2.67% for higher-rate tax payers) to counter the effects of both tax and inflation on their savings.

Meanwhile, the wider Retail Prices Index (RPI) remained static at 2.5%. This is a more closely followed statistic, as many other prices are measured against it, including train fares. The Government has stated that the train operating companies can increase next year's prices by the RPI rate calculated in July of each year, plus an average of 1%, with flexibility within that for some fares to rise a further 2%. Therefore, some commuters could see their tickets rise by up to 5.5%; well above the current inflation rate.

Service sector soars

The latest Markit/CIPS services purchasing managers' index (PMI) reports strong growth in the UK services sector, which currently represents 70% of the UK economy and which has driven the recent improvement in sentiment.

Their July index was recorded at 59.1, up from the 57.7 recorded in June. Given that any score above 50 represents expansion, this is very good news for the economy as a whole.

Further encouraging news also came from the construction sector where, driven by an increase in home building to its highest level for 11 years, their index was recorded at 62.4.

At these levels, it is encouraging for the July-September quarter, where its is expected that the country's Gross Domestic Product (GDP) will match the 0.8% growth achieved in both the first and the second quarter of 2014, should this positive trend continue.

Commenting on these findings, Chris Williamson, Markit's Chief Economist, said: *"The July PMI showed the sector expanding at the fastest pace since November, as demand for services continued to increase at a rate rarely seen in the survey's 18-year history."*

Services in demand

Markets: (Data compiled by The Outsourced Marketing Department)

Given the continuing geopolitical and military unrest in the Ukraine, Gaza, Syria and Iraq, the equity markets remained remarkably sanguine in August, with most indices managing modest gains.

Here in the UK the FTSE100, benefiting from confirmation of economic progress, saw a gain of 1.33% on the month to close August at 6,819.8 and the wider FTSE250 moving up 2.52% to 15,885.72. The junior AIM market followed suit closing at 778.97 to record a gain of 1.35%.

Across the pond the Dow Jones index continued to power ahead, closing the month out at 17,098.45, a rise in the month of 3.23%, with the Nasdaq likewise gaining 4.82% to finish at 4,580.27. Confounding many market analysts, the broader S&P500 index closed at 2,003.37; above the important 2,000 level for the first time ever.

The eurozone also saw gains, despite reports that GDP has fallen again in Germany and France and with the whole zone teetering on a deflationary spiral. All eyes are therefore on the European Central Bank as to how they will address the crisis. However, the Eurostoxx50 index still managed to gain 1.82% in August, to close at 3,172.11.

Unfortunately, Japan spoilt the party as the Nikkei 225 lost 196 points (or 1.26%) closing out at 15,424.59

Foreign Exchange dealers followed the deliberations of Mark Carney, the Governor of the Bank of England carefully, trying to gauge the timing of any UK interest rate rise and deciding it will be later than previously expected, and therefore Sterling fell against the US Dollar by 1.19% to $1.66, but still managed to gain a little against the Euro to €1.27. The greenback itself also improved against the Euro, to finish August at $1.31

As last month, despite the global unrest, the price of oil remained subdued; with the benchmark Brent Crude price falling 3.36% lower to $102.46 a barrel.

Likewise gold, the usual safe-haven asset in times of unrest, remained pretty flat, gaining only a modest 0.55% to $1,292.9 a troy ounce.

Markets defy the unrest

First-time buyer numbers highest since 2007

Thanks in part to the Government's 'Help to Buy' initiative, mortgages offered to first-time buyers rose to 28,600 in June, with an accumulative value of £4.2 billion, an increase of 7% over the previous month and the highest number seen in any one month since 2007. This was also an increase of 19% over the same period last year by volume. By value, the figures were up 11% on May's figure and 27% up on June last year.

The Council of Mortgage Lenders (CML), which represents 95% of all residential mortgage lenders, reported that the typical loan size for these borrowers was £123,865 and that, given a typical gross annual income of approximately £37,000 in June; this represents an average of 3.47 times their income. The average age of these borrowers also fell from 30 to 29 years.

First step on the housing ladder

With interest rates remaining at their historic low of 0.5% the Bank of England (BoE) appears sanguine about the affordability of these mortgages moving forward, as it calculates that 19.3% of their gross income will be spent on servicing the capital and interest payments on such mortgages.

On the wider front, overall gross mortgage lending across the market in June grew by 6% from the May figures and by 20% on the year to £17.9 billion. There were 66,279 house purchase approvals in July, against 61,651 in the same month last year. This represents a 7.5% increase year-on-year and is the highest monthly figure since 2007.

Whilst the introduction of the Mortgage Market Review (MMR) had slowed the approval process initially, as there was a slight dip in lending volumes seen in April and May, it appears that the bottleneck in those approvals has now been cleared and the mortgage lending recovery is now in place.

Unemployment continues to fall

In the three months to end June, according to the latest figures from the Office for National Statistics (ONS), unemployment in the UK fell by 132,000 to 2.08 million.

This represents a rate of 6.4% in the quarter, which is the lowest level recorded since 2008 – a near six-year low.

Those people claiming the Jobseeker's Allowance also fell for the 21st consecutive month, dropping by 33,600 to 1.01 million.

More importantly, the number of young people, those aged between 16-24 years old, also dropped by 102,000 to 767,000. This is a decline of 200,000 from the same period last year and represents the biggest fall since records began in 1992.

Interestingly, 40% of the increase in employment overall came from people who were not born in the UK. Whilst the number of people employed and born in the UK, rose by 502,000. 326,000 people not born in the UK enhanced those figures.

Many of these 326,000 came from what are known as the A8 countries, those from the former Soviet bloc; states such as Hungary, Lithuania, and Poland, who represent the newer members of the EU since 2004.

Commenting on these latest encouraging figures Iain Duncan Smith, the Work and Pensions Secretary said: *"In the past, many people in our society were written off and trapped in unemployment and welfare dependency.*

"But through our welfare reforms, we are helping people to break that cycle and get back into work."

Good as this news is, average wage growth remains stunted. The ONS recorded that average wages, excluding bonuses, rose by only 0.6% in the year to June, registering the slowest increase since records began in 2001. Even worse, including bonuses, wages actually fell 0.2%. There is an argument here that employees are accepting nominal wage increases under the fear of losing their jobs and not wishing to 'rock the boat'.

It is important always to seek professional advice before making any decision regarding your finances. If you would like any assistance, please contact us.
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