# ***ECONOMIC*REVIEW**

## of August 2016

Kingston House, Meadow Hill, Great Glen, Leicester LE8 9FX

Telephone: 0116 2592371 - Fax: 0871 750 2621

Email: enquiries@providentsolutions.co.uk

Website: www.providentsolutions.co.uk

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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 EDGES HIGHER

UK inflation, as measured by the Consumer Prices Index (CPI), edged higher in July rising from its previous level of 0.5% to 0.6%, according to the latest data from the Office for National Statistics (ONS).


***Rises seen in both CPI and RPI***

Whilst remaining at historically low levels, this rise of just 0.1% was sufficient to record the highest inflation figure seen since November 2014.

The major factors behind these statistics were the increase in the price of motor fuels, alcoholic beverages and accommodation services. Food prices, although lower, did not fall by as much as in previous months.

Counterbalancing these increases were falls in the cost of social housing rents, together with some falling prices for certain toys and games.

The wider measure of inflation the Retail Prices Index (RPI), which includes housing costs, whilst no longer deemed to be a National statistic, also rose to 1.9% from its previous recorded level of 1.6% in June. RPI is important, however, as many service costs, such as regulated train fares in England, Scotland, and Wales, are matched against this benchmark and could rise accordingly by a similar amount.

In future, the de facto devaluation of Sterling will impact further on prices as the cost of imported goods will increase accordingly.

The Head of Prices at the ONS, Mike Prestwood, commenting on this was reported to have said: *"There is no obvious impact on today's consumer prices figures following the EU referendum result, though the Producer Prices Index (PPI) suggests the fall in the exchange rate is beginning to push up import prices faced by manufacturers."*

## "MARKED SERVICE SECTOR DOWNTURN"

The latest Markit/CIPS UK Services Purchasing Managers Index (PMI) covering the 'Services' sector, reveals that – both output and new business – fell for the first time in three-and-a-half-years, and at the fastest rates since Q1 2009. Employment in the sector was unchanged from June, halting the period of continued job creation which commenced in 2013.

The Business Activity Index came in at 47.4 in July, down from the 52.3 recorded in June. Any figure below 50 indicates contraction and therefore a fall in output for the sector. At 4.9 points, the decline was the largest seen since the survey began in 1996.

Among some of the mitigating factors quoted were uncertainty surrounding Brexit, increased cost pressures, particularly in salaries, fuel and food costs and the consequences of Sterling's devaluation.

Markit's Chief Economist, Chris Williamson, said: *"The marked service sector downturn follows news from sister PMI surveys showing construction activity suffering its steepest decline since mid-2009 and manufacturing output contracting at the fastest rate since late-2012. At these levels, the PMI data are collectively signalling a 0.4% quarterly rate of decline of GDP.*

*"It's too early to say if the surveys will remain in such weak territory in coming months, leaving substantial uncertainty over the extent of any potential downturn. However, the unprecedented month-on-month drop in the all-sector index has undoubtedly increased the chances of the UK sliding into at least a mild recession."*

The importance of this particular PMI is the fact that the output of the UK's 'Services' sector currently represents about 75% of current Gross Domestic Product and is therefore an important pulse point for the overall economy.

***Largest decline in output since 2009***

## MARKETS:
(Data compiled by The Outsourced Marketing Department)

Equity markets worldwide recovered some of their momentum following the Brexit vote, reinforcing July's improvement with the FTSE100 ending August at 6,718.51 to record a 0.85% gain, although it had touched an intra-month high of 6,941, which was just 2.29% short of its all-time high of 7,103 seen in April 2015. The wider and sometimes more closely followed FTSE250 saw a more impressive rise of 2.6%, to close at 17,732.77 and the junior AIM market finished at 791.32, for an impressive 4.69% jump.

Across the pond the Dow Jones trod water somewhat, spoiling the party by losing a nominal 0.17% to close the month at 18,400.88. Meanwhile, the technology-based Nasdaq managed just short of a 1% rise to 5,213.22.

On the continent the Eurostoxx50 also improved by 1.08% to see the month out at 3,023.13. Likewise in Japan, who are still struggling with deflation, the Nikkei225 also improved by 1.92% closing August at 16,887.40.

The foreign exchanges saw a quiet month following the Brexit sell-off of Sterling in June, however, the pound managed to stand its ground against both the US Dollar and the Euro. It closed out the month unchanged at $1.32 and €1.18 respectively. The 'Greenback' also remained stable against the Euro, finishing at $1.11.

***Equilibrium returns to the markets***

The price of Brent Crude rose an impressive 10.92% to $47.04 a barrel, still 10.2% up on the year-to-date.

Gold lost a little of its recent sparkle, dipping 2.98% to $1,308.84, but it still recorded a very healthy year-to-date gain of 22.06%.

## RECORD NUMBER OF PEOPLE NOW IN WORK

Between April and June 2016, with 31.75 million people working, 23.22 million of those in full-time employment and 8.53 in part-time, the employment rate (for those aged from 16 to 64 years) in the UK has hit 74.5%. This is the highest rate seen since comparable records began back in 1971.

Of the unemployed, there were 1.64 million people, which is a rate of 4.9% and 52,000 less than the previous quarter and 207,000 lower than a year earlier. Again the lowest figure seen since the March to May quarter of 2008.

On the wages front, average weekly earnings including bonuses rose by 2.4% and those excluding bonuses rose by 2.3% although these figures are not adjusted for price inflation. The average total pay employees earned was £501 per week in the April to June quarter.

ONS statistician David Freeman commented: *"The labour market continued on a strong trend in the second quarter of 2016, with a new record employment rate.*

*"However, little of today's data cover the period since the result of the EU referendum became known, with only claimant count and vacancies going beyond June-July for the former and to May-July for the latter."*

***Brexit fears discounted***

## BANK OF ENGLAND CUTS INTEREST RATES

In a determined and direct effort to boost the UK's economy, after the fall-out from the recent Brexit decision, the Bank of England (BoE), for the first time since 2009, unanimously decided to cut interest rates. The rate now sits at 0.25%, an all-time low.

The Governor of the BoE, Mark Carney, also intimated that, should the economy worsen, they could lower the interest rate further in the future.

Another adrenalin shot to the economy was announced by the Bank of £170 billion worth of monetary easing measures. These include a new Term Funding Scheme, wherein £100bn of funds will be made available to the commercial banks at rates close to the new 0.25% rate, provided these funds are utilised as loans to households and businesses and that they benefit from this rate reduction accordingly.

The BoE will also purchase £60bn of UK Government Gilts and £10bn of corporate bonds, thus pumping more liquidity into the market.

Mark Carney was quoted as saying at the time: *"The MPC is determined that the stimulus the economy needs does not get diluted as it passes through the financial system."*

He went on to add: *"We took these steps because the economic outlook has changed markedly, with the largest revision to our GDP forecast since the MPC was formed almost two decades ago.*

*"By acting early and comprehensively, the MPC can reduce uncertainty, bolster confidence, blunt the slowdown, and support the necessary adjustments in the UK economy."*

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