Monthly

Economic Review

Provident Solutions
Wealth Creation & Wealth Management
Financial Lifestyle Planners

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Economic review of: December 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

A fiscally neutral Autumn Statement

Country told "Live within its means"

The Chancellor of the Exchequer, George Osborne, delivered a fiscally neutral Autumn Statement in December.

Government borrowing has been reduced to £111bn in 2013 and he forecast that it will drop progressively to only £23bn by the tax year 2017-18.

Net Government debt has been reduced to 6.8% of GDP in 2013 and could fall to zero by the 2018-19 tax year, meeting their ambition to return the economy to a surplus.

The Chancellor confirmed that the UK was *"growing faster than any other developed economy"*, with the Office for Budget Responsibility forecasting GDP growth of 1.4% in 2013, 2.4% in 2014 and then 2.7% in 2018.

Overall welfare spending will be capped and Job Centre Plus will compel those on Jobseeker's Allowance aged between 18-21 years to train in basic English and maths.

University places will be increased by 30,000 in 2014 and the student numbers cap will be abolished the following year. £150 million will be made available for updating and building school kitchens, while all primary school children in Reception, Year 1, and Year 2, will receive free school meals.

The Chancellor extended Business Rate relief for small firms out to 2015 and limited any future increases to 2%.

Employers' National Insurance contributions will be abolished for those employees under the age of 21, from April 2015.

Married couples and those in a civil partnership, where neither is a higher rate tax payer, will be able to transfer £1,000 of income to their partner to reduce their joint income tax by approximately £200.

Green Levies will be rolled-back, contributing to a reduction of £50 in the average consumer's energy bill.

The planned fuel duty escalator rise for 2014 will be cancelled and the paper-based road excise duty 'tax disc' will be replaced with an electronic version, although the tax will still be payable.

The state pension will not be affected by any cap on the overall welfare system, as the existing 'triple-lock' will guarantee year-on-year rises. Next April's rise for those on the maximum basic pension will be £2.95 per person per week.

Those currently younger than 40 will have to wait longer to take their state pension, with the retirement age being raised to 68 in the 2030's and to 69 in the 2040's.

£9bn is hoped to be raised by closing down aggressive tax-avoidance schemes over the next 5 years and Capital Gains Tax will now be payable on the sale of UK residential property belonging to non-resident owners, as from April 2015.

The bank levy will be increased to 0.156%, raising £2.7bn for the Treasury in 2014.

Inflation dips to four-year low

Good news on inflation

Further encouraging news on the economy was announced in mid December.

UK inflation measured by the Consumer Prices Index (CPI) fell to 2.1% in November, down from the previously reported 2.2%. This is a four-year low and brings the core inflation rate (excluding food and energy) to below 2%.

The Office for National Statistics (ONS), who compile the data, cites lower food, transport, and utility prices as the major factor in this decline. However, they warned that recently announced increases in energy prices have not yet filtered through the system and therefore they will impact the next set of inflation figures, relating to December, adversely.

At the same time the wider Retail Prices Index (RPI) growth was unchanged at 2.6%.

These lower figures will be welcomed by most consumers, as inflation has been a problem for them with annual weekly wage increases only averaging 0.9% recently and therefore creating a squeeze on family budgets.

Meanwhile the Governor of the Bank of England (BoE), Mark Carney, was also pleased, as he has avowed to meet the inflation target of 2%, set by the Government, even though the figure has been above this level since November 2009.

Good progress has been made though, given that the CPI figure was above 5% just two years ago.

The historically low interest rates of 0.5% are a cornerstone of the BoE's policy and Dr Carney has stated that he will not increase these until the UK's unemployment rate dips below 7%; it is currently at 7.4% for the previous August-October quarter. If, however, inflation continues to remain subdued, he will be able to maintain these low interest rates beyond that time, helping businesses and consumers alike.

Property prices are not helping him here though, with the ONS reporting a 5.5% increase in UK house values since October 2012.

Markets: **(Data compiled by The Outsourced Marketing Department)**

Global equities find favour

The US Fed's announcement in mid-December, that it is to finally 'taper' its quantitative easing programme by $10 billion a month, paradoxically had a very bullish effect on the global equity risk markets.

With all eyes on the Dow Jones Index; it rose 3.05% to 16,576.66, an all-time high. To put this in perspective the index has now risen by 26% in the year. Meanwhile, the Nasdaq soared in 2013, gaining a massive 40% over the year and closing up 2.87% in the month at 4,176.59.

Taking its lead from the prospects of a strengthening US economy, here in the UK the FTSE100 gained 1.48% to close at 6,749.1. That represents an annual gain of 14.43%, whilst the wider FTSE250 closed at 15,935.35 for a rise of 3.03% in the month and 28.77% for the year.

Elsewhere in Europe, the Euro Stoxx50 improved by just 0.54% in December to close out the year at 3,109.0 but recorded an annual gain of 17.95%.

The Japanese market, however, won the gold medal, seeing a massive improvement of 56.72% over the year to finish December at 16,291.31

With all the attention on the equity markets, the foreign exchange markets had a quiet month. Sterling continued to improve again against the US greenback, finishing the year at $1.66, up 1.84% in 2013. Against the Euro it closed December at €1.21, flat on the month, but down 1.63% from a year earlier. The Euro itself improved against the US Dollar, ending the year at $1.37.

Gold bullion had a bad year, losing 27.19%, and closed out 2013 at $1,220.22 an ounce.

Oil, having had a volatile year, dipping to as low as $99.95 during 2013, finished at $111.21 a barrel as measured by the Brent Crude benchmark, flat on the year.

"Warp speed" to be avoided in housing market

No bubble just yet

The Governor of the Bank of England (BoE), Mark Carney, has warned of a *"potential"* housing price bubble here in the UK.

In December, speaking at the Economic Club of New York, he was quoted as saying: *"There is a history in the housing market of moving from stall speed to warp speed… we want to avoid that."*

He intimated that the BoE would intervene and tighten the lending requirements to this sector if they believed such a risk was evolving.

They have already acted on this premise by removing house purchase loans from their Funding for Lending Scheme, which will inevitably have the effect of restraining the housing market to some extent.

The Government's independent budgetary watchdog The Office for Budget Responsibility has forecast that house prices will rise by 5.2% in 2014 and by 7.2% in 2015.

These fears were echoed by the Royal Institution of Chartered Surveyors (Rics), as their recent research has revealed more surveyors are expecting price rises than at any time in the last 14 years.

Simon Rubinsohn, the Chief Economist of Rics, said: *"It's no secret that the housing market is on the way up and prices are surging ahead in many parts of the country."*

He went on to add: *"The improvement in wholesale and retail funding markets may mean the impact on mortgages is relatively limited."*

However, at the same time the Council of Mortgage Lenders (CML) was less pessimistic of a bubble forming, as they believe an unbridled property boom was unlikely and furthermore, borrowing for house purchases would continue to increase throughout 2014.

Their Chief Economist, Bob Pannell was also optimistic, stating that: *"We think there are good grounds to be optimistic that the majority of households will cope with a slow but certain transition to more normal interest rates."*

As mentioned elsewhere, he was referring to the BoE's Governor confirming that he will not consider raising interest rates generally until the UK unemployment rate hits 7%, and maybe not even then.

When they do indeed raise interest rates, this will have the effect of making mortgages more expensive and putting a brake on house prices.

Jobs

The vacancies are out there

Good news on the jobs front this month, as the Job Vacancies Index rose to a level not seen since 1998.

This index compiled by Markit and sponsored by the Recruitment and Employment Confederation uses data supplied by 400 recruitment companies. It shows a sustained growth in UK job vacancies

Most encouraging was the demand seen for engineers, nursing and care staff and other medical positions.

One of the sponsors of the report, Bernard Brown, Partner and Head of Business Services at the consultants KPMG, said of these findings: *"Six months ago - after almost five years of pain – most employers were wondering just how real the signs of recovery were.*

"Business certainly seems to be more confident."

Paradoxically, given the current high unemployment rate, the availability of suitable candidates to fill this increasing number of vacancies fell. This is a trend that appears to be continuing.

On this point, Mr Brown, went on to add: *"It may be that people are still worried about job security but it is more likely that we are seeing a return of the traditional winter slowdown in recruitment as staff are more focused on Christmas than careers."*

Meanwhile, the Office for National Statistics (ONS) reported in mid-December that UK unemployment now stands at 7.4% representing 2.39 million people and that there were 562,000 job vacancies available. The Governor of the Bank of England has stated that he will not contemplate raising interest rates from their historically low level of 0.5%, until the country's unemployment figure drops below the 7% level.

Issued by: **Provident Solutions Ltd**
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