ECONOMICREVIEW

of December 2014

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

Provident Solutions

Wealth Creation & Wealth Management
Financial Lifestyle Planners

www.providentsolutions.co.uk

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

'Black Friday' sales lift retailers

The near-manic scramble for discounted goods on 'Black Friday' that took place in some stores around the country at the end of November, helped to boost retail sales to their highest annual rate of growth for more than 10 years.

According to data compiled by the Office for National Statistics (ONS), November saw a rise of 6.4% in retail sales, the highest increase seen since 2004. On a monthly basis they increased by 1.6% and all sectors saw an improved sales performance for the first time since 2013.

Best retail sales in years

As seen on many televised news reports, electrical goods were in great demand, with sales volumes increasing by a massive 32% from 2013 levels and department stores reporting a 15% increase in sales. Both of these figures are the highest increase seen since records began in 1988.

Not just high street sales improved, as on-line sales also reported a 12.9% increase since last year.

Direct comparison of this data was skewed, however, as last year 'Black Friday' took place in the month of December.

Overall, average retail prices were 2% lower in 2014 than seen in 2013; this is the biggest fall since 2002. The continuing fall in the price of petrol and diesel was a factor here, by reducing freight and delivery costs for many retail outlets.

Retailers specialising in food also reported a 2% fall in prices, again the biggest fall since 2002.

Some economists believe that this surge in demand may just have been consumers bringing forward their purchasing decisions ahead of Christmas and that the December figures may well reflect this.

However, the Chief Economist of the British Chambers of Commerce, David Kern, was quoted as saying: *"The decline in store prices reflects fierce competition in the retail sector and provides further evidence that inflation will fall below 1% in the coming months."*

CPI at 1% marks a 12-year low for inflation

The Consumer Prices Index (CPI), which measures the UK inflation rate, dipped from 1.3% to just 1% in November. This represents a 12-year low for domestic inflation. At the same time the wider measure; the Retail Prices Index (RPI) also fell to a 5-year low of 2%, which is down from its previous level of 2.3%.

These figures, released by the Office for National Statistics (ONS) in December, came as a welcome Christmas present for people trying to fill the family's stockings.

As both food and fuel costs constitute a large element of the CPI data calculations, the major factors in this fall in CPI, was the dramatic drop in wholesale oil prices, which have declined by over 45% since June. This price drop has in turn resulted in high street petrol pumps seeing a drop in retail prices for petrol of 5.9% in November alone.

Food prices also fell, as a result of the continuingly fierce supermarket price war. They showed a decline of 1.7%, whilst culture and recreational prices also saw a decline of 0.3%.

Having seen inflation rise in the early part of the year, reaching a high of 1.9% in June, this reversal of fortunes is an endorsement of the Bank of England's (BoE) comments last month that, by their calculations, the CPI rate may well fall below 1% in the early months of 2015. Should this scenario come about, the Governor of the BoE would be required to write a letter of explanation to the Chancellor of the Exchequer, George Osborne.

As good as this news is to hard-pressed consumers; steadily declining inflation is not always welcomed by economists and investors. The spectre of deflation (continually falling prices) can easily deter those same consumers from buying, hoping for lower prices in the future, and thus stalling the nascent economic recovery.

Lower oil price drives fall

Markets: (Data compiled by The Outsourced Marketing Department)

Geo-political and economic turrmoil upset the equity markets in December with the continuing eurozone crisis - affected especially by the failure of Greece to elect a President – the collapse in oil prices, and the massive devaluation of the Russian Rouble all taking their toll.

Given the above, the FTSE100 fluctuated wildly, having lost over 8% at one time in December, only to recover to 6,566.09 at the close of the year for a fall of 2.33% during the month. This volatility through 2014 helped create 110 million trades by mid-December; the highest number seen since the 2008 economic crisis, with a total value of £825.3 billion.

The FTSE 250 fared better, gaining 1.47% to 16,085.44, while the junior AIM market fell by 3.26% to 702.0.

The European markets suffered as well, as the Eurostoxx50 lost 3.2%, to close out the year at 3,146.43.

Elsewhere, however, the American Dow Jones Index saw a record year, surpassing the intraday 18,000 mark for the first time in December, but finishing the month flat on 17,823.07, up 7.52% for 2014. The heavily technology-based Nasdaq index slipped by 1.16% during December, to 4,736.05.

The currency markets were dominated by the across-the-board strengthening of the US Dollar. It rose to $1.56 against Sterling and to $1.21 against the Euro. UK Sterling held its own against the Euro, showing a gain of 2.5% to €1.29.

The deeply troubled Russian Rouble fell to 80Rub to the US$ at one stage in December, compared to its zenith of 28Rub seen in the first quarter of the year. It stabilised by the close to 55Rub, as some of Russia's $400 billion of foreign currency reserves were put to play to stem this fall.

The price of oil continued in free-fall with the benchmark Brent Crude price retreating to $57.33 a barrel. Oil fell by 48.5% during 2014.

Given the economic shock waves seen in December, gold, the usual safe haven in times of unrest, had a relatively quite month, closing 2014 at $1,199.00 a troy ounce, to show a gain of 2.89% for the month (but a loss of 1.74% for the year).

Volatile global markets in December

Variations in UK spending habits

In its latest Quarterly Review (for Q3), the Bank of England (BoE) has concluded that households with high levels of personal debt continued to support UK consumption and the Gross Domestic Product (GDP) during periods of economic growth. Indeed, prior to the "Great Recession" following 2007, UK households had shown faster than average spending growth.

However, as a result of the recession that followed in 2008/9, they then made larger-than-average cuts in spending relative to their income. This reduction in consumption has been calculated by the BoE to have resulted in a reduction by this group of aggregate personal consumption of 2%.

The Bank's analysis has not been able to identify if this reduction in personal consumption was a result of their indebtedness, or as a result of their increased concerns about future debt repayment and the increased tightening of credit conditions generally.

In a separate study, the Office for National Statistics (ONS) has in December released household expenditure figures from 2001 to 2013. They stated that in 2013 UK households, on average, spent £517.30 per week, up from the £501.00 spent in 2012. The £517.30 figure when inflation is taken into account represents a reduction from the £539.80 spent on average back in 2006.

The 2013 figures show that the largest area of expenditure for most households was on housing (excluding mortgages but including net rentals) and domestic power. This equated to £74.40 per week on average, which itself was the highest level seen since current records began. The previous largest area of expenditure was seen as transport, reflecting the dramatic increase in power and energy costs over the period covered in the report.

There are, of course, regional variations. In the South East of England the average spend per week was £585.40 over the years 2011 to 2013, whilst in the North East of England the figure was only £424.60 per week.

Interestingly, but not surprisingly, the lowest earning 10% of UK households spent only an average of £189.80 per week, whereas the highest earning 10% spent an average of £1,119.50 per week.

Trade deficit falls to seven-month low

The UK's trade deficit, which is the difference between the value of goods and services that the country imports and exports, dropped to a seven-month low in October, according to the latest figures from the Office for National Statistics (ONS).

The net figure was a deficit of £2bn, which is a reduction from the £2.8bn recorded in September.

Taken separately, the deficit in the goods trade fell from £10.5bn in September to £9.6bn in October; however, this figure was just above the £9.5bn that many economists had predicted. Total exports rose in October by £0.1bn to £24.3bn, whilst imports fell by £0.7bn.

Trade to and from the 28-member European Union also improved, thanks to a small increase in the value of exports to this region, showing an increase in value of £0.1bn, due in part to the increase in sales of fuel of £0.3bn, offset by a fall in the value of imports from the EU. This helped to dissipate the fear that slow economic growth in the eurozone would harm our trade deficit further, as currently 57% of UK trade is conducted with these countries.

Some of the factors behind these figures were the increase in the seasonal export of silver to the Indian sub-continent and a drop in the value of oil imports into the UK.

Whilst welcoming this good news, the ONS did go on to state that despite the narrowing of the trade deficit, the lack of a sustained increase in both the volume and value of exports generally, is raising concerns about the hoped-for strength in the UK's economy as a whole.

Encouragingly, some market watchers have suggested that, should this trend continue, then the country's trade balance may soon make a positive contribution to the UK's Gross Domestic Product as early as Q4 this year.

Q3 saw the UK economy grow by 0.7%, despite the weaker trade performance.

Trade gap continues to narrow