# ECONOMICREVIEW
## of December 2015

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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

## The USA finally raises interest rates after nine years

In a widely anticipated move, Janet Yellen, the Chair of the US Federal Reserve, announced on Wednesday 16th December that they were raising interest rates by 25 basis points (0.25%). Therefore, the rate of inter-bank lending in the US will now move in a range of between 0.25% and 0.5%. This is the first rise in US interest rates seen since 2006. Following the Great Recession of 2008, interest rates there have been at near zero.

***Where next for global interest rates?***

One of the major factors in this unanimous decision by the Fed's board to raise rates was the continuing strength seen in the US economy and jobs market, together with the consistently low rate of inflation. In response to this data, the Fed also raised its projection of domestic economic growth from 2.3% to 2.4%, stating that any such interest rate rise will not damage growth.

In a statement, the Fed said: *"The Committee judges that there has been considerable improvements in labor market conditions this year, and it is reasonably confident that inflation will rise, over the medium term, to its 2% objective."*

Equity markets in the US and UK reacted positively, with both the Dow Jones and FTSE100 seeing immediate gains.

However, the wider implications of this historic upward trend in interest rates in the US will have profound impact on global markets, as the higher borrowing costs implied in such a move will have a negative effect on many developing economies, such as Brazil, Argentina and Far Eastern countries, who are already seeing slow growth, as the Chinese economy continues to slow.

All eyes will now be on the European Central Bank (ECB), who last month moved in the opposite direction, reducing their interest rates to negative territory and the UK's Bank of England (BoE) who have maintained interest rates at a historical low of 0.5% for over six years.

## Q3 2015 GDP growth confirmed at 0.5%

The UK recorded its 11th consecutive quarter of growth in Q3 (July-September) 2015, according to the second estimate from the Office for National Statistics (ONS).

Although slightly lower than the 0.7% recorded in Q2, Q3 saw the Gross Domestic Product (GDP) rise by 0.5% which confirmed the ONS's previous estimate.

GDP per head (GDPPH) in volume terms, rose by 0.3% between Q2 and Q3 and GDPPH between 2013 and 2014 increased by 2.2%. Again in volume terms, GDP was seen to increase by 6.4% between Q1 2008, at the start of the recession and Q3 2015.

One of the major reasons cited for this 2015 quarterly slowdown was the UK's widening trade gap which showed a deficit of £14.2bn in Q3, as exports increased by 0.9%, but imports increased by 5.5%. This compares with the much lower £7.7bn trade gap recorded in Q2.

Therefore, overall, this trade gap was responsible for reducing the GDP figures by 1.5% over the period. Other factors included the construction sector contracting by 2.2%.

On the plus side, the all-important service sector, which accounts for approximately 75% of the economy, saw growth of 0.7% and industrial production (including manufacturing) also recorded a rise of 0.2%, whilst business investment was estimated to have increased by 2.2%.

Mr. Lee Hopley, the Chief Economist of the manufacturers' organisation EEF, was reported as commenting on this latest data: *"No surprises in the second estimate as the economy was ticking over, including a chunky contribution from business investment, which has had an unbroken run of expansion for a year.*

*"Pulling sharply in the opposite direction is the contribution from net trade, with modest export growth being swamped by a massive bounce in imports."*


***Slight slowdown seen in Q3 GDP***

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

The global equity markets had a bumpy ride in December. In London the FTSE100 started well for two days, then, because of the heavy weighting of commodity and mining shares in the index, encountered a fall of 546.8 points (8.52%) over the next 8 trading days, before recovering in the second half of the month to close at 6,242.30, for a final loss of 1.79% on the month. As a result of this the FTSE saw a fall over 2015 of 4.93%.

The wider FTSE250 fared better, thanks to its diversification, finishing December at 17,429.8 for a marginal gain of 0.05%, with the junior AIM market following suit with a 0.2% rise to 738.8.

Following the much anticipated rise in interest rates announced by the US Federal Reserve, the Dow Jones Index lost a little ground falling 1.66% to 17,425.03 and the NASDAQ losing a similar 1.98% to 5,007.41.

The European markets also lost investor appeal with the Eurostoxx50 ending the month down 221 points, or 6.35%, at 3,267.52. Whilst in Japan, despite the continued fiscal stimulus from the Bank of Japan, the Nikkei 225 lost 3.61%, as it fell 713 points, after the past two months of gains, to close the year at 19,033.71.

On the foreign exchange markets, the mighty greenback benefited further from the US interest rate rise, gaining 2.65% against Sterling to $1.47 and 3.19% against the Euro to $0.91. Sterling itself lost ground against the Euro slipping 4.93% to €1.35.


***A volatile FTSE seen in December***

All eyes remained on the price of oil, with the world's largest producer, Saudi Arabia, confirming it will keep its wells pumping, further increasing global oversupply. As a result, the Brent Crude benchmark price fell to $37.28 a barrel for a monthly fall of 16.4% and marking a fall for the year of 34.9%.

Gold managed to hold its ground in the month, closing at $1,072.31 a troy ounce, a marginal gain of 0.61%, but still down 10.57% since the beginning of the year.

## Treasury to launch secondary annuity market

Demand for annuities has fallen sharply now that people have greater flexibility over their retirement funds. In response to this, the Government has confirmed its plans to extend reforms in the pensions market to encompass the selling of annuities.

In December it was announced that Britain's finance ministry will be launching a secondary market for annuities. From 6th April 2017, these changes will enable over five million people who currently have an annuity to sell their contracts for an upfront cash sum, or place it into drawdown to use the proceeds gradually, if they wish.

Harriet Baldwin, Economic Secretary to the Treasury confirmed that tax restrictions for people looking to sell their annuity will be removed; from April '17 people will be charged at their marginal rate, as opposed to the current 55% tax charge, or 70% in some cases.

Minister for Pensions, Baroness Altmann commented: *"Keeping an annuity will still be the right decision for the majority of people. But some were forced to buy annuities in the past that may not be suitable for them – and I am delighted that this reform will allow more people greater choice and the opportunity of a more flexible income stream."*

The Treasury delayed plans for the secondary annuity market from the original launch date of April 2016, to allow sufficient time to develop protection for consumers. The Government has confirmed that advice will be mandatory for those people who select to sell their annuity.

In recognition of the complexity surrounding these proposed changes, Pension Wise, the Government's pension guidance service, will be expanded to provide free and impartial guidance to people who are considering selling their annuities. A consumer protection framework will also be introduced by the Financial Conduct Authority.

## Retail sales rise in November

In an encouraging sign of continuing economic growth, the quantity bought in the retail industry in the UK was estimated to have risen in November by 1.7%, compared with the previous month, and up 5% from the same month in 2014, according to the Office for National Statistics (ONS). This is, therefore, the 31st consecutive month of increase seen year-on-year.

In more detail, the ONS estimated online sales to have risen by as much as 12.7% in November, compared with the same month in 2014 and by 4.9% compared with October 2015.

Interestingly, average store prices, including those at petrol stations, saw falls of 3.3% from the previous year, which is the 17th consecutive month of year-on-year falls.

Commenting on this data, Chris Willamson, Chief Economist of research organisation 'Markit', said: *"Retailers may see some pay-back after the Black Friday promotions led shoppers to pull-forward spending that would otherwise have taken place in December, but the underlying sales trend looks set to remain strong as we head into 2016."*

He went on, however, to add that it was not just a matter of discounting that drove this increase in sales: *"Households are benefiting from improved job security, low inflation and falling energy prices, the latter helping free-up more income to boost retail sales."*

***Encouraging surge in retail sales data***