ECONOMICREVIEW
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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

BoE says negative inflation possible

Mark Carney, the Governor of the Bank of England (BoE), in its latest Inflation report, has stated that inflation, as gauged by the Consumer Prices Index (CPI), could well turn negative by this spring.

This being the case, it will clearly be dramatically below its target level of 2%. Should the CPI rate be either 1% above or below this target, it requires the Governor to write a letter of explanation to the Chancellor of the Exchequer, George Osborne.

Interest rates may fall further

Currently CPI sits at 0.3%, the lowest recorded rate ever, but Mr Carney further warns that inflation could actually turn negative in the spring, mainly as result of the recent collapse in the price of oil, which has fallen by over 45% over the past twelve months.

If such a decline in inflation continued, in the medium-term, the BoE would consider even cutting interest rates further from their current historically low level of 0.5%.

Commenting on their findings, Mr Carney was quoted as saying: *"The UK is not experiencing deflation"* and that the *"most important single reason for below-target inflation over the past year is the unexpected sharp drop in energy prices."*

Here he defines *"deflation"* as *"generalised and persistent declines in prices."*

He went on to add: *"On the assumption that energy and food prices stabilise, CPI inflation should pick up notably once earlier declines start to drop out of the annual comparison, towards the end of the year."*

To reinforce this projection the BoE says that their current future-looking inflation projection is for a rise in the CPI back to the target rate of 2% by the middle of 2017. Should this hypothesis prove correct, they would not need to take any evasive action.

In their report the BoE believes UK economic growth in 2015 of 2.9%, with their prediction for 2016 being growth of 2.6%. Importantly, they further project wage-growth of 3.5% this year.

Manufacturing & Services output increases

According to the latest Markit/CIPS Purchasing Managers' Index (PMI), the UK's manufacturing sector staged a modest expansion in January and at the same time reported a slight recovery in exports.

The index rose from 52.7 to 53, where any number above 50 indicates growth in the sector. Manufacturing rose by 0.2% a quarter, which was a marginal improvement on the 0.1% growth seen in Q4 2014.

One of the major factors here was the dramatic fall in the price of oil, down 45% over the last twelve months and prices falling for manufacturers' raw materials at the fastest rate since Q2 2009. This resulted in many manufacturers being able to reduce their factory gate prices. This is only the second time this has happened in the past five years.

However, the Senior Economist of Markit, Rob Dobson, said that such a modest improvement would *"provide little meaningful boost"* to the economy as a whole in Q1 2015. He went on to add though that the domestic market would remain *"the main growth driver"* even though they saw *"signs of improvement"* in new export orders that came in at a five-month high. A caveat was added, however, in that they believe *"it looks as if lacklustre demand from the eurozone in particular remained a headwind for British manufacturers."*

At the same time, Markit's PMI for the Services sector also increased strongly in January, from 55.8 to 57.2, further reflecting an encouraging and impressive rate of job creation within this sector of around 70,000 per month.

Reflecting on these findings Mr Dobson opined that the Bank of England would delay any increase in interest rates to *"late 2015 at the earliest."*

Orders up for UK manufacturers

Markets: (Data compiled by The Outsourced Marketing Department)

The FTSE100 finally reached a new zenith on February 24th, as it surpassed the previous closing high of 6,930 - last reached way back in December 1999 – to reach 6,949.63.

Closing fractionally down though on this high, at 6,946.66, up 2.9% at month end, it was buoyed by more positive news coming out of Greece, relieving the fear they would be forced to exit the Euro currency bloc, and an improving UK economic outlook, including low inflation, rising average wages and reduced unemployment levels. The wider FTSE250 also gained 5.9% to 17,273.82 and the junior AIM was up 3.5% to 714.5.

The Eurostoxx50 saw continuing support, closing at 3,599.0 for a 7.67% rise.

Across the pond, both the Dow Jones Index and the S&P500 touched new all-time highs in February, closing at 18,132.7, up 5.6% on the month and 2,104.5 up 5.5% respectively, whilst the Nasdaq closed February up 7% at 4,963.53.

Meanwhile, the Japanese Nikkei225 Index continued its bull run, gaining 6.4% to 18,797.94.

The foreign exchange markets saw increased volatility, as given the fiscal and political unrest within the eurozone, especially concerning the still possible Greek exit from the currency agreement, it is no surprise that Sterling has appreciated against the Euro currency to a new seven-year high.

As at the close of the month, Sterling was sitting at €1.38, up 2.8%, which is its strongest rate since January 2008. At the same time Sterling also appreciated against the mighty US Dollar to $1.54, up 1.99%. The Euro also struggled against the US Dollar, dipping to $1.12. One of the factors surrounding the Euro's decline was the announcement by the European Central Bank (ECB) of its €1.1 trillion quantitative easing programme.

Gold was one of the commodities to lose ground in the month, dipping by 4.6% to $1,214.0 an ounce, while black gold – oil - saw a recovery in price of 17.2% to finish February at $62.12 a barrel, as measured by the Brent Crude benchmark.

Equities storm ahead across the board

House prices continued rising in 2014

Despite tighter mortgage availability, as a result of the Mortgage Market Review (MMR), which has forced lenders to be more analytical regarding medium and longer-term affordability of mortgages for borrowers; the average house price across the UK rose by just under 10% in 2014.

Average prices were recorded as being 0.7% higher in December from the previous month and the annual price increase was reported as 9.8% by the Office for National Statistics (ONS). This equated to an average house price in the UK of £272,000. However, this is still below the all-time high of £274,000 recorded in August 2014.

December also saw record highs for average house prices in Wales, the East, the West Midlands, the South West, and the South East.

First-time buyers join the party

Every region saw higher prices in 2014, but as always, there were wide regional variations, as Wales and the North West of England recorded gains of 4%, whilst London saw price increases of 13.3% to £502,000. As impressive as these figures are, the December figures here were still below the peak reached in August 2014. Having said that, London prices are now more than 30% above the previous property price peak recorded before the Great Recession in 2008 and still substantially above any other region in the UK.

On the macro front, England recorded price gains of 10.2%, to reach £285,000, Wales saw a 4% rise to £173,000, Scotland 5.5% to £193,000 and even Northern Ireland reporting a 4.9% increase to £142,000.

Despite these rising prices nationally, 2014 saw the most first-time buyers enter the property market for seven years. These buyers have had to find an additional 9.5% for a property in December 2014 than they would have paid a year ago. The average price paid across the UK by those first-time buyers was reported by the ONS as being £208,000.

UK Unemployment continues to fall

Commenting on the latest unemployment figures released in February by the Office for National Statistics (ONS), Mr. Iain Duncan Smith, the Work and Pensions Secretary said: *"The jobs-led recovery is changing people's lives for the better on a daily basis."*

The positive report from the ONS stated that unemployment in the UK has continued to fall and wage growth has successfully outpaced inflation by its highest rate for nearly five years. Average earnings (including bonuses) rose by 2.1% in the last quarter, whilst inflation, as measured by the Consumer Prices Index (CPI), fell to its lowest level ever recorded of 0.3%.

The official figures are that unemployment now stands at 5.7% and the number of people unemployed has fallen by 96,000 to 1.86 million in the three months to December 2014.

People claiming the Jobseeker's Allowance fell by 38,000 in January, to 823,000, recording its 27th straight monthly fall.

Regionally the picture was mixed, with the North East recording the highest level of unemployment at 8%, or 103,000 people out of work, although this was down 15,000 from the previous quarter. The South West had the lowest rate of unemployment at 4.5%, where unemployment also fell by 7,000 to 122,000. Not surprisingly, given its population, London had the highest number of people out of work at 295,000, or 6.4%, which showed an increase of 7,000 from the last statistics published.

As a direct result of these bullish employment figures, the continuing decline in the CPI inflation figures and the fact that two members of the Bank of England's influential Monetary Policy Committee stated that any future interest rate rise was *"finely balanced"*, the foreign exchange markets reacted positively to Sterling; pushing it to a seven-year high against the Euro at €1.38 and also improving against the US Dollar to $1.54.