ECONOMICREVIEW
of July 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

Interest rates cleared for take-off?

The Governor of the Bank of England, Mark Carney, chose the unusual setting of Lincoln Cathedral to make his most clear-cut announcement to date concerning the likely timing of the UK's first rise in official interest rates since they were lowered to 0.5% in March 2009.

In his speech given on 16th July, he said that rates could rise as early as the turn of the year. Confirming remarks he has previously made, he underlined that rates will rise slowly from 0.5% eventually reaching around 2.5%. He said that the 'equilibrium' rate of interest, the rate required to keep the economy on track and inflation under control, will be perhaps half the historical average of 4.5%.

Unusual setting for Mark Carney's interest rate comments

Rises to be in gentle steps

The Governor has maintained when rates rise, they will do so in gentle increments, typically smaller than the half of a percentage point that was commonly used before the recession in 2008. He added that it would take time for any increase in interest rates to feed through into the economy, and that the peak impact is likely to be around 18-24 months after the Bank's Monetary Policy Committee makes its move.

Factors in the decision

There are many factors that will no doubt play a part in the nine-strong committee's decision. The general state of the economy, inflation, employment figures, the strength of sterling and, of course, external factors such as the continuing Greek debt crisis and the recent fall of the Chinese stock markets will all need to be taken into consideration. What is clear is that if market growth remains buoyant, we have less need of very low interest rates to underpin the economy.

Some economists have taken these announcements to mean that the UK will see interest rates rise to around 1.25% by the end of 2016, possibly reaching 2% by the end of 2017.

UK Trade Gap Narrows

Official figures released in July showed that Britain's trading position with the rest of the world has improved.

Data released by the Office for National Statistics reports that the UK's deficit on trade in goods and services was estimated to have been £0.4 billion in May 2015, compared with £1.8 billion in April 2015. This reflects a deficit of £8.0 billion on goods, partially offset by an estimated surplus of £7.6 billion on services. This deficit is the smallest since June 2013 and the narrowing is a result of imports decreasing by £1.4 billion to £43.4 billion as exports were unchanged at £43.0 billion.

Service providers to the world

Whilst the UK continues to spend heavily on imported goods, and export deals are proving harder to win as the value of the pound rose in recent months, these figures underline UK plc's continuing success in selling its services to the rest of the world. We're now recognised, the world over, as specialists in sectors such as financial services, advertising, public relations, design, and management consultancy.

Do trade deficits matter?

Some economists believe that trade deficits don't matter as much as they once did in today's globalised economy. They argue that it's better to be good at product and service design and innovation, and to outsource the manufacture and production of goods to other parts of the world. This has resulted in the rise of what the economist Anatole Kaletsky called the 'platform economy' – businesses such as Apple, Dell and Nokia that 'sell everywhere, but produce nowhere'. As manufacturing and production are arguably the most volatile and capital-intensive parts of the business process, outsourcing benefits the country's economy and makes it a more attractive proposition for investors. The USA for example has, many would add successfully, run a trade deficit for several years.

Britain's trading position has improved

Markets: (Data compiled by The Outsourced Marketing Department)

Global stock markets found a few reasons to be cheerful during July, even as efforts to sort the Greek debt crisis continued and a big correction to Chinese share prices followed a mid-June peak. The latter unsettled the emerging markets sector as a whole.

At home, FTSE100 member/owner Pearson agreed to sell the FT Group to Japan's Nikkei. Aided by other prospective deals and better UK growth data, the blue-chip index ended July 2.69% higher at 6,696.28. The FTSE250 mid-cap index closed just 0.83% up at 17,677.4, with the junior AIM drifting 0.6% lower to 751.16.

In New York, the Dow Jones index saw gyrations that left it a net 0.4% higher at 17,689.86. The Nasdaq, joined during the month by online payment operator PayPal, closed July 2.84% up at 5,128.28.

European bourses continued to watch the Greek situation, but prospects of a new bailout deal helped to more than reverse June's 4.1% fall and, at 3,600.69, the Eurostoxx50 ended July up 5.15%.

The Tokyo stock market, whose Nikkei index pushed past 20,000 in April during a five-month bull run, made gains during July despite the volatility in China, improving 1.73% to 20,585.24.

On foreign exchange markets, the long-suffering euro drifted lower again. By end-July it stood at $1.10 against the dollar, down 0.9%, and €1.42 against sterling, down 0.6%. Sterling lost about a cent versus the dollar, at $1.56.

The Chinese slowdown and other issues weakened commodities. Gold, down 6.43% at $1,095.73 an ounce, was not immune, some analysts questioning its safe-haven status as key interest rates long nailed to the floor looked set for gradual release. Oil prices slumped again, with Brent crude down 17.9% at $52.21 a barrel.

China corrects after 150% gains

Stock markets in China went into freefall during the last month or so, wiping around 30% off Chinese shares by early July. This news came as an unwelcome shock to many, but Chinese markets had hit a seven-year peak in June, as the Shanghai stock market recorded gains of more than 150% in 12 months, so a correction was perhaps due. The volatility of the Chinese market accentuated the impact. Emerging markets are for seasoned investors with nerve and well-diversified portfolios.

When it seemed clear that the bubble was set to burst, the Beijing government stepped in to try and control the situation. Working with the China Securities Finance Corporation, it placed curbs on new share issues, organised lines of liquidity and enlisted fund managers and brokers to take part in a massive share buying operation in an effort to bring stability to the markets. Then, in mid-July, the Shanghai market had its best two-day rise in seven years but remained volatile.

The Chinese authorities are anxious to keep markets buoyant for several reasons. A high percentage of domestic shareholders are private individuals with limited means, many of whom borrowed extensively

Chinese stockmarkets had a bumpy ride

when they saw prices rising sharply. If the stock market remains at a new low, there is a risk of widespread debt and even social unrest. This would have a knock-on effect for the economy which is already seeing a marked slowdown in growth. China's GDP growth rate halved from 14% in 2007 to 7.4% in 2014.

The shock waves are already being felt throughout South East Asia. In Australia, mining shares have suffered as China's demand for iron ore and coal will no doubt fall if the economy weakens. Mining stocks listed on the FTSE 100 have experienced the fallout too.

With China having been viewed as the powerhouse of global growth, the worries have spread around the world. When Chancellor George Osborne made his July 8th Budget speech, he highlighted the risks to the UK economy and included China in his list of potential threats.

Jobless figures disappoint but may be a blip

Figures from the Office for National Statistics covering March to May 2015 showed a slight reversal in what had been seen as the continuing upward trend in UK employment figures. The unemployment total rose for the first time in two years.

Unemployment total rose for the first time in two years

There were 30.98 million people in work, 67,000 fewer than for the three months to February 2015, equivalent to a 0.2% drop, the first quarterly fall since April 2013. The total number of unemployed stood at 1.85 million. At the end of June 2015, there were 804,200 people claiming unemployment benefits.

However, there were 265,000 more people in work compared with 12 months earlier, an increase of 0.9%, with 272,000 more people working full-time. Average pay including bonuses was also up by 3.2%. The UK still has the lowest jobless rate in the EU after Germany.

Experts are divided as to what has caused what many believe will only be a temporary blip. David Kern, Chief economist at the British Chambers of Commerce, said the employment data suggested that the economic recovery was not as strong as many had hoped. *"This setback is a reminder that our recovery is still fragile and that further measures are needed to nurture economic growth, in particular by encouraging businesses to invest and export,"* he said.

The increase in those claiming benefits has bucked the trend which has seen this figure gradually tapering away as employment increased. This could signal an end to the hiring spree that has lasted for several years, and be an indication that the jobs market is set to slow.

What effect these figures will have on the timing of a likely interest rate rise remains to be seen, although in July the Governor of the Bank of England Mark Carney gave the strongest signal yet that rates may be set to rise within a matter of months.