ECONOMICREVIEW of July 2016

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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

AHEAD OF BREXIT VOTE, UK'S ECONOMY THRIVES

The UK's economy, in the three months ending June this year, grew by a better than expected 0.6% (2.2% on a yearly basis), according to the latest data released from the Office for National Statistics (ONS).

Better than expected data from ONS

These figures showed an increase in economic growth in the period – just prior to the Brexit referendum on June 23rd – albeit most of this being seen in April, before falling off in May and June.

One of the major driving factors of this growth in the overall Gross Domestic Product (GDP) was the biggest increase in industrial production seen since 1999, which was estimated to have grown by 2.1% in the quarter. Most of this came via the pharmaceutical and car industries. There was also strong growth within the services sector, which makes up over 75% of the country's GDP, as it grew by 0.5%, with the retail sector leading the way.

However, on the negative side, the agricultural and construction sectors contracted by 1% and 0.4% respectively.

The Chief Economist at the ONS, Joe Grice, commenting on these findings, was quoted as saying: *"Any uncertainties in the run-up to the referendum seem to have had a limited effect. Very few respondents to ONS surveys cited such uncertainties as negatively impacting their business."*

Meanwhile, the new Chancellor of the Exchequer, Philip Hammond, in one of his first public utterances said: *"It is clear we enter our negotiations to leave the EU from a position of economic strength."*

Whilst this (as always) retrospective data is encouraging, immediate post-Brexit data, coming from the closely followed Markit Purchasing Managers' Indexes (PMIs), showed a sharp drop in economic output from the industrial sector, with it actually registering negative growth.

As a result of these contrary economic indicators, the British Chambers of Commerce commented that it was *"far too soon to draw firm conclusions"* with regard to the UK's immediate future growth.

BANK OF ENGLAND HOLDS INTEREST RATE AT 0.5%

Despite most market watchers, and the financial markets generally, pencilling in an 80% chance of the Bank of England reducing its benchmark interest rate at July's Monetary Policy Committee (MPC) from its current historically low 0.5%, the members of the MPC voted 8-1 to leave the rate unchanged, with Jan Vlieghe being the one member voting for a rate reduction. However, it is believed that most of the committee think that some action may need to be taken at the August meeting.

As the subsequent press release stated: *"The precise size and nature of any stimulatory measures will be determined during the August forecast and Inflation Report round."*

The economic dilemma the MPC members face is the contrary effects of a reduction in economic activity, or growth therein, after the Brexit vote, which may have a recessionary effect and the possibility of a rate reduction inducing inflationary pressure on the economy as a result of any interest rate cut putting further downward pressure on Sterling.

The Bank added that it saw *"significant weakening"* in housing market activity with interest from UK homebuyers falling to its lowest level seen since the middle of 2008.

Because of this the Bank went on to add: *"Taken together, these indicators suggest economic activity is likely to weaken in the near term."* It also expects to see short-term *"sizeable falls"* in commercial property prices.

At the same time though, surprisingly, the Bank raised its expectations of the UK's economic growth in the second quarter of 2016 to 0.5% from its previous estimate of 0.3%.

The immediate market reaction to the MPC's decision was positive for Sterling with the pound rising to $1.3480, against the US Dollar, before falling back to $1.3320 at the close of the day (July 14th) and the FTSE100 index finishing at 6,670.4, down just 0.24%.

(See 'Markets' article)

BoE surprises the markets

MARKETS:
(DATA COMPILED BY THE OUTSOURCED MARKETING DEPARTMENT)

Post-Brexit July saw the dust settling a little over the global equity markets as investors re-found their buying enthusiasm. The FTSE100 fared well, improving just over 220 points in the month to close at 6,724.43, recording a 3.38% improvement and, more importantly, an increase of 7.72% in the year to date. The FTSE250 also gained 6.22% to 17,282.9, reversing its June losses, as the weaker pound was interpreted as boosting the overseas earnings of many of the constituent companies. However, given the large sell-off seen in June, the index has lost a nominal 0.84% in the year to date. The junior AIM market joined in the enthusiasm, lifting to 755.89 for a 6.78% improvement on the month.

All other markets covered here improved with the Dow Jones rising by 2.8% to finish at 18,432.24, and the technology based Nasdaq closing at 5,162.13 for a 6.6% lift.

On the continent even the Eurostoxx50 saw gains of 4.4% eliminating some of June's losses to end July at 2,990.76. Likewise, in Japan the Nikkei225 saw a gain of 6.38%, or just short of 1,000 points to end the month at 16,569.27, although this is still 12.95% down on the year to date.

After the savage sell-offs in June the pound Sterling stabilised a little, losing 2.22% against the US Greenback to $1.32 to record a *De facto* devaluation of 10.2% since the turn of the year, in the main due to the Brexit decision. It also lost one cent against the Euro to €1.18 for a small dip of 0.84%.

Global markets recover their equilibrium

Market analysts confirmed the glut of oil in the markets with national global reserves at record levels. This dampened the price of Brent Crude, as it fell to $42.46 a barrel, down 16.33%, but this is still up 13.89% since the turn of the year.

Gold continued in demand, relishing its safe-haven status, lifting $26.89 a Troy Ounce to $1,349.03. The precious metal has now enjoyed a rise of 25.81% since the end of 2015.

INFLATION (CPI) RISES TO 0.5%

The price of air fares which rose by 10.9% between May and June, possibly inflated as a result of the recent Euro 2016 soccer tournament in France, according to the Office for National Statistics (ONS), motor fuels, both petrol and diesel, and recreational goods all pushed the UK's Consumer Prices Index (CPI) up to 0.5% from the previous month's reported 0.3% rate.

At this level the CPI matched the March 2016 level and it was last higher back in November 2014. However, this was still considerably lower than the Bank of England's (BoE) target level for inflation, set at 2%. This fact will entail the Governor of the BoE, Mark Carney, having to write another letter of explanation to the new Chancellor of the Exchequer, Philip Hammond.

It should be noted though that these latest CPI figures were based on data gathered prior to the Brexit vote in June. The impact of this will be discussed in greater detail when the BoE releases its quarterly inflation forecast in August.

Given that the immediate impact of the Brexit vote was savage devaluation of Sterling (approximately 10% to date) the effect of this will be inflationary, as the increased costs of imported goods will suppress consumer demand and thus overall economic activity. Therefore, some analysts see the CPI rate possibly increasing to nearer 5% sometime next year as a result.

As a likely consequence of such a scenario happening, the BoE may be tempted to reduce interest rates even further from their current historical low of 0.5%, in an attempt to combat any such slowdown in domestic economic activity, although last month's meeting of the Bank's Monetary Policy Committee saw only one member voting in such a way.

UK EMPLOYMENT RATE HIGHEST FOR 45 YEARS

The UK's unemployment rate fell from 5.6% a year earlier to 4.9%, which represents 1.65 million people. Of these, 903,000 were men and 742,000 were women.

The latest data, released by the Office for National Statistics (ONS), shows that 31.7 million people were in work during the period covered (February 2016 to May 2016), of which 23.19 million people were in full-time employment and 8.52 million in part-time work. This represents an increase of 176,000 people since the previous quarter. At 74.4% this represents the highest employment rate seen here since comparable records began 45 years ago.

The number of people aged over 18 years claiming the Jobseeker's Allowance was 590,200, which was a fall of 0.6% on the May 2016 figure and down 21.1% on a yearly basis.

The 'economically inactive', those aged between 16 to 64 and not working and not seeking or available to work, was calculated at 21.6%.

On the wages front, average weekly earnings in nominal terms (not adjusted for inflation) for UK employees rose by 2.2% during the previous 12 months, excluding bonuses, and by 2.3% including bonuses.

Lowest rate of unemployment for many years