ECONOMICREVIEW

of June 2014

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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

Industrial output highest since 2011

Further encouraging evidence of an improving and more widely balanced economic recovery in the UK came in June, as the Office for National Statistics (ONS) reported that industrial output here has risen to its highest level since 2011, which is a rise of 3% from the same month last year, whilst the narrower manufacturing measure also saw a rise of 4.4%.

April, the latest month covered by these figures, saw both manufacturing and industrial output increase by 0.4% in that month alone, with manufacturing seeing improved output in transport equipment, rubber, electronic goods, and plastics.

Three-year peak for output

The Deputy Chief Economist at EEF, the manufacturers' body, Neil Prothero, commenting on this data, was quoted as saying: *"Robust momentum in manufacturing shows no sign of easing, with activity across the sector broadening out impressively over the past year."*

He went on to add: *"Production is now at its highest level in five years, highlighting industry's prominent role in the economic upturn, despite the subdued trend in external trade."*

Whilst this is an encouraging sign of the continuing economic recovery, the ONS data does show that both industrial and manufacturing output were still, respectively 11.3% and 7% below the Gross Domestic Product (GDP) peak of the first quarter of 2008, which marked the starting point of the recent economic downturn.

Having said that, the respected National Institute of Economic and Social Research (NIESR) released independent data in mid-June that reported UK GDP growing by 0.9% in the March – May period, following growth of 1.1% in the February – April period. If that is the case, UK GDP will have risen 0.2% above its pre-recession peak of January 2008.

The NIESR unchanged forecast for the UK's GDP is 2.9% for 2014, and 2.4% for 2015.

UK GDP to be revised up

Adding to the bullish sentiment in the UK economy, the previously estimated first-quarter Gross Domestic Product (GDP) figure of 0.8% could well be revised upwards to 0.9% as a result of better than expected growth in the construction sector.

The Office for National Statistics (ONS) had originally estimated the construction sector output to be 0.6% in Q1, however, their latest estimates for the period have been more than doubled to 1.5%, representing its strongest growth since 2010.

The ONS also stated that growth in the sector rose by 1.2% in April, compared to the previous month.

Whilst private sector housing saw output grow by 2.5% in April, and private sector industrial work increased by 3.8%; the public sector saw a dramatic decline in activity, dipping by 45.7%, which is the greatest fall seen in this area for 50 years.

However, new orders in Q1 were seen as being 6.3% lower than Q4 2013 and there were also falls in infrastructure, and private commercial work.

The ONS, commenting on this, said that they believe the main factor in this decline in public work was the fact that new investment in housing associations was now coming from private funds, rather than public money.

This data adds credence to the comments made by the Governor of the Bank of England (BoE), Mark Carney, this month, when he warned that the growth in the UK housing sector is beginning to overheat, and that he may well have to raise interest rates sooner than previously advised to address this. At the same time the Chancellor of the Exchequer, George Osborne, said he would give the BoE additional powers to limit the loan to income ratios that lenders apply to mortgage applications, but he did not set a target for these.

Construction sector shines

Markets: (Data compiled by The Outsourced Marketing Department)

Geo-political events, such as continued unrest in the Ukraine and Syria and renewed sectarian unrest in Iraq, managed to subdue most global equity markets, with many investors deciding to sit on their hands to await resolutions.

The FTSE100 declined 1.47% to finish June on 6,743.9, with the wider FTSE250 falling a similar 1.79% to close on15,723.56, whilst the junior AIM market fared worse, losing 3.67% to end the month on 785.39.

Across the pond, despite disappointing economic predictions, and a downward revision of their 2014 gross domestic product growth prospects, the Dow Jones index managed to rise a modest 0.65%, finishing the half-year at 16,826.6. The Nasdaq market, meanwhile, rose strongly, closing at 4,408.1 to record a respectable 3.9% advance.

In Europe there was little investor activity, as the Eurostoxx50 lost a modest 16 points, to close little changed at 3,228.56.

Japanese markets saw a little stronger demand, with the Nikkei 225 gaining 3.62% across the month, to close June at 15,162.1.

On the foreign exchange markets, slightly contradictory comments from the Governor of the Bank of England, Mark Carney, on possible interest rate rises, resulted in sterling seeing strong demand, gaining 2.4% against the greenback over the month to finish at $1.71. Sterling also improved against the Euro, where at €1.25 it saw a 1.63% rise. The Euro itself remained almost flat against the US Dollar, closing June at $1.37.

The same geo-political events resulted in oil spiking to $115 during the month, but falling back to close at $112.3 a barrel, as measured by the Brent Crude benchmark and Gold saw demand, ending the month on $1,325.63 an ounce, for a healthy 6.5% gain.

World events temper equity markets

Manufacturing powers ahead

The respected Markit/CIPS UK Manufacturing Purchasing Managers' Index (PMI) has reported that UK factory output has increased at its strongest pace for 22 years.

This was in marked contrast to the data they released about the Eurozone, which recorded a decrease in factory output growth to its lowest level for six months.

The UK centric PMI, whilst down fractionally at 57.0 from the previous month's 57.3, remained strongly above the 50 mark, which indicates growth in the sector.

Strong demand meant that manufacturers had to increase their staffing levels and production rates in May to about the same level required in April.

This demand was seen across the board with machinery, equipment and consumer goods in demand. Also export demand was reported as rising for the 14th consecutive month, with respondents seeing increased demand from regions such as Europe, the USA, the Middle East, Canada, and New Zealand.

Strongest growth for 22 years

This export demand was welcomed as its shows a more balanced business model is emerging.

Commenting on these figures, Rob Dobson, the Senior Economist for Markit said: *"Sustaining the rebound and continuing to push towards rebalancing the UK economy towards manufacturing therefore remains critical. On those scores the latest survey provides some real positives."*

He went on to add that given the fact that manufacturing represents about only 10% of the UK economy, such rebalancing here should not, by itself, induce the Bank of England to consider raising interest rates from their current historically low level of 0.5% immediately, but may have such an influence in the medium term.

At the same time the manufacturing industry body the EEF's Deputy Chief Economist, Neil Prothero commented: *"The sector is firmly on track to expand for a fifth consecutive quarter, its strongest performance in four years."*

Further encouraging unemployment figures

The three months to April saw unemployment in the UK continue to fall. The unemployment rate now stands at 6.6%, with the number of people out of work falling by 161,000. This resulted in the lowest number of people for over five years being unemployed. Compared with the same period last year, there were 345,000 more people in employment.

Another encouraging statistic was that those claiming Jobseeker's Allowance – 1.09 million - fell by 27,400. This is the lowest number recorded since 2008.

In total there are now 30.54 million people in employment, 5.4 million in the public sector and 25.1 million in the private sector. These figures are slightly skewed, as the recent sale of TSB Bank by Lloyds Bank, has resulted in 11,000 TSB staff being reclassified as now being in the private sector.

The Prime Minister, David Cameron, intimated that the UK Government had reached a *"major milestone"* for its long-term economic strategy and that: *"two million new private sector jobs since 2010"* have been created as a result of their actions.

More encouragingly, the latest figures, released by the Office for National Statistics, show that the increase in employment was from those now in full-time employment and moving from part-time to full-time and not an increase in those becoming self-employed, which had been the case with recent statistics.

There are now 8.82 million people, aged 16-64, who are either not looking for work or not able to work. This is a reduction of 80,000 on the quarter and 178,000 on the year.

Unfortunately, wage growth has not kept pace, with average weekly wage growth of only 0.7% (excluding bonuses) as against an expected growth rate of 1.2%. When including bonuses, wage growth was 0.9%, when compared with the same February-April period a year earlier.