ECONOMICREVIEW
of June 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

Greece plays its last card?

The closing days of June saw dramatic and unprecedented events unfold in the Greek drama being played out between its *'Troika'* of lenders – the International Monetary Fund (IMF), the European Union (EU) and the European Central Bank (ECB) – and the new far-leftist Government of Greece, led by its Prime Minister, Alexis Tsipras.

As Greece declared a surprise referendum of its people (scheduled for July 5th) over the terms of any proposed bail-out, it at the same time imposed a closure of its banks and the punitive introduction of capital controls on the Greek people.

Debt talks have broken down

This impasse was described by Jean-Claude Juncker, the EU Chief, as them being *"betrayed"* by the *"egotism"* shown by Greece, as the long-running bail-out discussions broke down yet again late on Friday June 26th.

He went on to add that these negotiations were not *"a game of liar's poker…Either all win or all lose."*

Because of the breakdown of these negotiations, Saturday saw the ECB stating that it would no longer extend emergency finance to the Greek banking sector, which has proved to be essential to maintain an effective (and solvent) banking sector in the country.

The Greek people will suffer heavily as a consequence, limiting their access to funds on a daily basis and thus further depleting their spending power and denting further the already struggling Greek economy.

Furthermore, wealthy individuals and large multinational corporations with funds held in Greece will pay close attention to the safety of these and, at the same time, other funds held in weaker eurozone economies.

At midnight (Athens time) on June 30th, Greece defaulted on €1.5bn (£1.1bn) of its debt to the IMF and, as a result, joined an ignominious defaulters club that includes Zimbabwe, Sudan, Zambia and Peru.

Lowest Government borrowing for eight years

The resurgent UK economy has provided the Government with a welcome rise in both Value Added Tax (VAT) and income tax receipts in May. This reflects the robust consumer spending habits and long-awaited rise in average earnings.

VAT receipts rose by 5.6%, or £600 million, to £10.7bn in May, whilst income tax receipts also rose to their highest level in four years to £10.8bn, to record an increase of 5.3%, or £500 million over the same period last year.

This has allowed them to reduce the UK Government borrowing to £10.13bn, down from £12.35bn the year earlier, according to the latest data released by the Office for National Statistics (ONS). This figure represents the lowest borrowing figure seen for eight years.

As a result of this reduced monthly borrowing, the net public sector debt (excluding the public sector banks), is now standing at £1.5 trillion, representing 80.8% of Gross Domestic Product (GDP).

The ONS now estimate that total public sector borrowing in the financial year to March 2015 equated to 4.9% of GDP, which was a figure of £89.2bn. This itself was slightly higher than previously estimated. However, is was still £9.3bn lower than the year before.

As a timely caveat to this good news, a spokesperson for the ONS was quoted as saying: *"While the deficit in the financial year ending 2015 has fallen by more than a third since its peak in the financial year ending 2010, public sector net debt has maintained a gradual upward trend."*

Because of this fact, the Chancellor of the Exchequer, George Osborne, is still expected to have to shave £40bn of costs from the unprotected Government departments' budgets over the next three years, to enable him to meet his stated objective of eliminating the budget deficit by 2019.

Government borrowing lower

Markets: (Data compiled by The Outsourced Marketing Department)

With Greece finally defaulting on €1.5bn (£1.1bn) of its debt to the International Monetary Fund at midnight (Athens time) on June 30th, and the likelihood of further defaults to follow from them, equity markets globally retreated.

The FTSE100 dropped by 6.63% during June to end at 6,521.0, pushing its quarterly fall to 3.8%. The wider FTSE250 also suffered, closing at 17,531.5 to record a 3.43% decline and the junior AIM market dipping by 2.19% to 755.68.

Greek default deflates global equities

The American markets followed suit as the Dow Jones lost 2.17% to 17,619.51, whilst the Nasdaq index closed June at 4,986.87, a drop of 2.18%.

With the widely anticipated Greek default impacting the Eurozone heavily, the Eurostoxx50 suffered the largest falls of 4.1% as it closed at 3,424.3. It has now fallen for three consecutive months and lost 7.4% of value in the process.

The Japanese market was more stoical with the Nikkei225 only losing 1.59% to 20,235.73, but ending its five month bull run seen since January.

Again reflecting the negative Greek impact, the Euro currency fell to €1.41 against Sterling, a dip of 1.44%, but gained a little against the US Dollar at $1.11. Sterling improved by 3.29% against the greenback to end June at $1.57.

Given that gold is usually in demand as a safe-haven investment in times of stress, it was strange that bullion was not in demand, as its price fell by $20.40 an ounce in June to $1,171.00.

Black gold - Oil -, as measured by the Brent Crude benchmark, fell slightly in price to $63.59 a barrel. Although off 2.62% for the month, rises earlier in Q2 left it 14.9% higher over the last three month period.

Manufacturing output edges up in May

The latest data from the Markit - UK Purchasing Managers' Index (PMI), released in early June, revealed that UK manufacturing - which represents about 10% of the UK economy - rose to 52 in May, a marginal increase from the 51.8 recorded in April. However, any figure above 50 still represents growth in the sector.

Whilst good news, this small increase was a disappointment to many analysts, as they had anticipated a stronger recovery from the lower April figure, which at the time marked a seven-month low.

As a result of this data release, Rob Dobson, the Senior Economist at Markit *"called into question"* the widely held view that there would be a broad rebound in UK economic growth in Q2 2015. He went on to add: *"Manufacturing looks on course to act as a minor drag on the economy, as the sector is hit by a combination of the strong pound and weak business investment spending."*

At the same time and adding to this report, the EEF, the manufacturing and engineering employers' body, cited a weakening demand for goods from the domestic UK market and flat export demand.

Their Chief Economist, Lee Hopley, said that whilst manufacturing output was improving it was not expanding: *"at the pace anticipated at the beginning of the year.*

"The sector is still in positive territory, but the ground is looking a lot less firm beneath its feet.

"Much of this weakening is down to the impact of the decline in oil and gas activity on the supply chain."

Still broadly positive news then, but a disappointment to the Chancellor of the Exchequer, George Osborne, who has been advocating a strong desire for the UK economy as a whole to be more balanced across all of the business sectors.

UK Inflation returns to form

After a very brief flirt with deflation in April - when it fell to minus 0.1% - UK inflation, as measured by the Consumer Prices Index (CPI), turned positive again in May, rising by 0.2% to plus 0.1%.

In the latest figures, released by The Office for National Statistics (ONS) in June, they cited several factors for this rise. The main culprit being the rise in air fares, as a direct result of the timing of Easter this year and increases in the oil price over the period, reversing the trend seen in April. However, there was also an increase seen in food prices across the country, although these are still lower than seen a year ago.

Philip Gooding, the ONS Statistician, said of these figures: *"Last month CPI turned negative, mainly because of falling transport fares due to the timing of Easter. This month, that fall has been reversed."*

He went on to add that the overall fall in fuel and food cost seen over the year: *"have eased this month, helping to push inflation up."*

At the same time, the ONS announced that the Retail Prices Index (RPI), the wider inflation measure that includes housing costs, also rose from the 0.9% recorded in April to 1.0% in May.

Mark Carney, the Governor of the Bank of England, who is ultimately responsible for managing the inflation rate, commented that he believes UK inflation will remain low in the short term and that he thinks the current near-zero rate will be a boon to the economy as a whole and help to improve the increasing spending power of households. Meanwhile, the Chancellor of the Exchequer, George Osborne, echoed this sentiment as he added: *"a powerful mix of low prices and rising wages (was) good news for working people and family budgets."*

He went on to say: *"of course the job is not done and we will continue to remain vigilant to all risks, particularly when the global economic situation is so uncertain."*

Deflation didn't last long