ECONOMICREVIEW
of March 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.

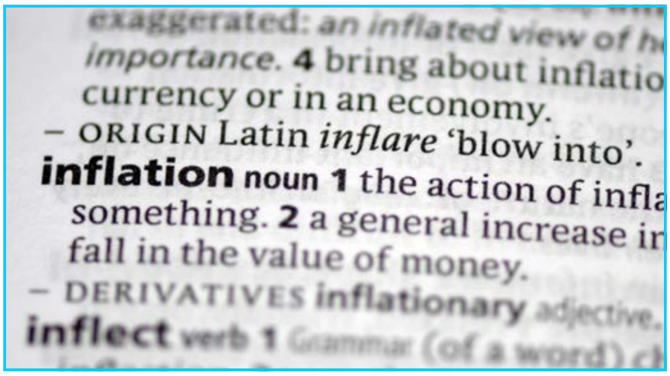
It is not intended that individual investment decisions should be taken based on this information; we are always ready to discuss your individual requirements. I hope you will find this review to be of interest.

Paul Smith

The new 'Zero' game

As warned earlier in the year by Mark Carney, the Governor of the Bank of England, the UK inflation rate, as measured by the Consumer Prices Index (CPI), fell to zero in February, for the first time since 1998, when the last comparable figures were available. This was a fall from the 0.3% rate recorded in January.

This fall to zero was greater than expected by many economists, whose consensus estimates were for a figure of 0.1%.



Low inflation invokes a feel-good factor

The main factors behind this fall in the CPI were the continuing decline in the global price of oil – thus petrol, diesel and energy costs – and the price of food. The major supermarkets continue to compete on price against the discounters, as evidenced by Morrisons cutting the price of over 100 items by 22% in February. The price of computer games also fell.

Most consumers will welcome this fall in the CPI as they will feel richer and are, therefore, likely to continue spending in the short-term, boosting the general economy, sometimes described as *'good deflation'*. However, economists warn that should inflation fall and stay below zero for a longer term, then there is a danger of deflation setting in, which would result in consumers holding back on purchases, hoping for lower prices in the future. This is so-called *'bad deflation'* which could easily turn to stagflation, a combination of negative inflation and stagnant consumer spending.

Mr. David Kern, the Chief Economist of the British Chambers of Commerce, commenting on these latest statistics from the Office for National Statistics (ONS), was quoted as saying: *"We remain convinced that there is very little risk of a long period of deflation."* He went on to add: *"Inflation in the service sector, which accounts for 80% of the UK economy, remains firmly above the Government's 2% target and core CPI inflation in February was 1.2%.*

"Together with higher earnings, lower inflation is boosting people's spending power and will contribute to economic growth in the year ahead."

Housing market recovery lifts retail sales

UK retail sales rose more strongly than forecast in February, showing a 5.4% improvement from the same period last year. The Office for National Statistics (ONS) reported February retail sales rising by 0.7% from the previous month.

One of the main factors behind this overall rise in spending was the resurgent housing market which has precipitated an increase in the purchase of household goods and furniture. This was due to the lagging effect of the improvement in house sales last year, as householders furnish their new homes.

Sales volumes, or changes in the amount of goods sold each month, as measured by the ONS, also grew in February, rising by 0.3% from the January figure and by 2.2% from the previous year. Non-food retail outlets saw the largest rise in sales by volume.

This steady increase in retail spending by consumers reflects the increasing confidence in the UK economy, however, there is still concern that the economy is heavily reliant on consumer spending as its main driver.

Reinforcing these concerns, the Chief Economist of the British Chambers of Commerce, Mr. David Kern, opined that: *"Although these figures are good news and will strengthen confidence, we must remember that the UK's economic growth remains unbalanced and is too reliant on consumer spending."*

Another concern is that UK exports, particularly to the Eurozone - which currently accounts for over 50% of our total exports – are declining, primarily due to the strength of Sterling against the Euro currency.

Mr Kern also added the caveat that: *"UK exports are still facing huge challenges, particularly in the Eurozone, which is one of our largest trading partners."*

Many economic observers put this increase in consumer spending down to the dramatic fall in inflation in the UK, the average wage increases and the overall feel-good factor that these events have invoked.

New home owners boost sales

Markets: (Data compiled by The Outsourced Marketing Department)

Following last month's all-time high, the FTSE100 flirted with further improvement in late March, exceeding the 7,000 mark for the first time ever on March 24th, when it closed at 7,037.7. However, it lost momentum as the month closed, finishing at 6,773.00 to record a 2.5% fall on the month. The FTSE250 followed suit, ending the month at 17,090.64 for a loss of 1.06%, while the junior AIM market finished on 716.2 to show a marginal monthly gain of 0.24%.

A mixed outcome for global equities

The Eurozone saw positive investor sentiment, as the Eurostoxx50 continued its positive three-month trend, gaining 17.5% since the turn of the year to end March at 3,697.38.

Conflicting economic signals from the US Fed in America - where the threat of higher interest rates in the near future tempered the overall bullish sentiment - saw the Dow Jones lose 1.97% in March to close at 17,776.12, whilst the technology driven Nasdaq lost 1.26% to 4,900.88.

The continuing bull-run in Japan saw the Nikkei225 index rise to 19,206.99, a gain of 2.18% for the month and to record a rise of 10% over the first quarter of 2015.

On the foreign exchange markets, the Euro currency continued to fall against the mighty greenback, flirting with parity at $1.07, a 4.63% loss. Sterling also slipped against the US Dollar to $1.48, to record a monthly loss of 3.9%.

Continuing global unrest and increasing US shale gas production saw the oil price, as measured by the Brent Crude benchmark, falling to $55.32 a barrel, to record a fall of 10.95% since February.

Gold bullion attracted few admirers in March, closing the month at $1,187.00 a troy ounce for a fall of 2.22%.

UK Balance of Trade dips in January

Further good news for the UK economy was released in March, as January saw a dramatic reduction in the UK's balance of trade deficit. It fell to £616 million, from the five-year high of £2.1 billion recorded in December last year.

The deficit on trade in goods of £8.4 billion was partially offset by a surplus of £7.8 billion seen on services.

This overall reduction was primarily thanks to the rapid fall in the global price of fuels and oil. January saw a reduction of £1.2 billion in the value of those imports into the country, to a more modest total of £2.2 billion, which itself represents the lowest level seen since May 2009.

However, this fall in the price of oil was a double-edged sword, as the UK also saw a decline in its own exports, primarily from the North Sea, of refined fuels and Brent Crude oil in January.

According to the official figures, released by the Office for National Statistics (ONS), the value of imports dropped by £2.5 billion from December 2014, which was the largest monthly reduction in the trade balance since July 2006.

The UK trade deficit with the European Union (EU) countries, which represents over 50% of our total global trade, fell marginally to £6.67 billion. Here, the continuing strength of Sterling influenced the figures, as at an exchange rate of €1.41 to the Pound our exports to them are more expensive and likewise imports from the region are cheaper.

On a quarterly basis, the three months to January 2015 saw a deficit on trade and services of £4.4 billion – the smallest deficit seen since the three-month period ending October 2000 – and is almost half the deficit recorded in the previous three-month period, which was £8.0 billion.

Construction industry powers ahead

The closely watched Markit/CIPS purchasing managers' index (PMI), where any score above 50 represents growth, has risen to 60.1, which is the highest level seen since October last year.

The UK construction sector – which represents around 6% of the UK's economy – housing, and commercial and civil engineering, all showed higher growth levels.

The Senior Economist of Markit, Tim Moore, commenting on their findings said: *"The latest survey highlights renewed vitality within the UK construction sector, as output growth picked up further from the soft patch seen at the end of 2014."* He went on to add: *"However, some construction companies noted that the uncertain general election outcome could prove a temporary bump in the road for new work."*

Of these companies, house builder, Taylor Wimpey, reported that they currently have an order book of £1.66 billion and that 51% of the houses they are currently building have been pre-sold. Both they and Travis Perkins, the builders merchant, whose subsidiaries include the DIY chain Wickes, City Plumbing, and Keyline, a major tile retailer, have reported increased profits. Taylor Wimpey showed a 67% increase and Travis Perkins raising their profits by £8.8 million.

All of these figures bode well for the Prime Minister, David Cameron, who, in early March, added the ambition to build 200,000 homes to his party's election manifesto. At the same time he declared that the Government hopes to build 100,000 new homes specifically for first-time buyers.

Furthermore, those first-time buyers aged under 40, will be able to register to buy *"starter homes"* that will be built on existing *"brownfield"* sites around the country. These properties will be offered at a 20% discount to the normal price. There would be no compromise on the quality of these houses, as to achieve this discounted price the Government proposes waiving the current local authority fees for house builders (currently around £45,000 per house) for properties built on such *"Brownfield"* sites.

House building leads the way