ECONOMICREVIEW
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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

UK inflation at lowest level for 55 years

In a development that had been flagged by Mark Carney, the Governor of the Bank of England, inflation in the UK turned negative in April for the first time since March 1960, 55 years ago. Back then prices were recorded as being 0.6% lower.

The latest report from the Office for National Statistics (ONS), released in mid-May, said that the Consumer Prices Index (CPI) turned negative at -0.1%. The main factors in this drop were the reduction in oil prices - contributing to lower air and sea fares - and lower food prices. The ONS figures show that transport costs were 2.8% lower than the same time last year and the overall price of food was 3.0% lower. The Retail Prices Index (RPI) remained at 0.9%.

Cost of living drops

The Chancellor of the Exchequer, George Osborne, commenting on this historic moment, said that whilst CPI was now in negative territory, this should not be interpreted as *"damaging deflation"* and that given the fall in oil prices, that started in late 2014, most consumers are now experiencing a lower cost of living.

However, he went on to caution: *"of course we have to remain vigilant to deflationary risks and our system is well equipped to deal with them should they arise."*

Echoing this sentiment Mark Carney said that whilst he expects inflation to stay low for the next few months: *"over the course of the year, as we get towards the end, inflation should start to pick up towards our 2% target."*

Long-term deflation is always a danger to economic growth, as should it continue month after month, consumers are minded to stop buying goods and services, on the assumption that those same goods and services will be cheaper in the future, thus stagnating overall growth. Therefore the Chancellor of the Exchequer, together with the Governor of the Bank of England, have a delicate strategic path to tread over the next few months.

Service sector continues to thrive

The UK's service sector, which consistently represents at least 70% of the country's economic output, saw its fastest growth in eight months, according to the latest figures from the Markit/Cips Purchasing Managers' Index (PMI).

The PMI reported that April saw their index rise to 59.5, up from the previous month's 58.9 figure. Here any number above 50 represents growth in the sector. This sector has now seen sustained growth for the last twenty-eight months. April's figures indicated the fastest rate of growth seen in services since August 2014, even though the industry recorded falling prices for the first time in six months.

However, there was a strong caveat to this good news in that both the manufacturing and construction sectors continued to decline in April.

Commenting on their findings, the Chief Economist of Markit, Chris Williamson, said: *"the economy is showing robust growth momentum, expanding at a rate of 0.8% at the start of the second quarter."*

Speaking just before the general election, he did, however, go on to add: *"Rather than rebalancing towards manufacturing, economic growth has been increasingly reliant on the service sector and the consumer is having to drive growth as investment spending remains disappointingly weak amid heightened political uncertainty.*

"Prices are also falling amid signs of intense competition. The surveys are showing the steepest drop in average prices charged for goods and services since 2009, which will revive worries about deflation."

Given this sanguine scenario in relation to underlying inflation, the Bank of England is most unlikely to increase interest rates, from their historically low level, in the short-term. This should ensure that the UK can look forward to enjoying continued economic expansion in 2015.

Service sector drives the economy forward

Markets: (Data compiled by The Outsourced Marketing Department)

With some exceptions, equity markets globally fared well in May. Here in the UK the FTSE100 breathed a sigh of relief as election fears of a hung parliament receded and, helped by the CBI's latest monthly indicator showing the best economic growth for a year, it managed a modest gain of 0.34%. Whilst off its recent highs, it closed the month on 6,984.4. The wider FTSE250 surpassed this with a 3.89% rise to 18,154.42 and the junior AIM market following suit with a 2.57% improvement to finish at 772.6.

Across the pond the Dow Jones Index trod water closing May at 18,010.68 for a modest 0.95% gain, but the technology focused Nasdaq bettered that with a rise of 3.17% to 5,097.98.

The Japanese market continued its five-month bull run with the Nikkei225 gaining another 5.34% ending the month on 20,563.15.

The Eurostoxx50 index let the party down a little, as continuing worries of a possible Greek debt default and subsequent Grexit overshadowed the market. It finished at 3,570.78 to record its second monthly decline at 1.28%.

The foreign exchange markets were subdued. Sterling weakened by 1.3% against the US Dollar to $1.52, but improved against the Euro to €1.39. The Euro therefore lost ground against the US Dollar as well, slipping 4.4% to $1.08.

Despite increasing demand for jewellery and bullion across China and India, the Gold price saw little monthly movement, closing just 0.64% higher at $1,191.40 a troy ounce.

Black gold - Oil, as measured by the Brent Crude benchmark, fell slightly in price to $65.30 a barrel. Although off 2.17% for the month, it still managed to close 5.1% higher over the last three month period.

Equity markets showing optimism

Strong growth of retail sales in April

Primarily thanks to the balmy April weather, retail sales grew strongly, rising by 1.2% in the month and recording their strongest growth since November 2014. The annual increase was shown to be 4.7%.

In its latest report, the Office for National Statistics (ONS) cited an increase in the sale of textiles, footwear, and clothing, with this group of goods seeing sales grow by 5.2% since March and recording their highest increase in four years.

These figures, reflecting a general increase in consumer confidence and rising earnings levels, have resulted in the 25th consecutive month of year-on-year retail sales growth, which itself represented the longest period of sustained sales growth seen since May 2008.

The quantity of sales was estimated to have grown by 1.2% since March 2015, whilst the amount spent in April 2015 also increased by 1.8% from April 2014 and by 1.1%, compared with March 2015. Non-seasonally adjusted, this amounted to an average weekly retail spend of £6.9 billion. This was an unchanged figure from the previous month and the April 2014 figure.

Sales continue to boom

The online market continued to grow, seeing an increase of 3.7% (by value), compared with the previous month. Online sales in April accounted for 12.2% of all retail sales, which reflects a 13.1% volume increase year-on-year.

Compounding this consumer feel-good factor and reflecting the country's dip into a negative inflation rate (as we report elsewhere) of minus 0.1%, the average store price of goods - including petrol stations – fell for the 10th month in a row. Falling by 3.2% year-on-year. Given the fall in oil prices over this period, it is not surprising that the largest contributor to this fall came from petrol station sales which recorded an 11.5% fall in prices; the 20th consecutive month of such falls.

Seven year low for UK unemployment

There was good news for the incoming new Government in mid-May as the Office for National Statistics (ONS) released the latest January to March unemployment data. Employment continued to increase and unemployment continued to fall, reinforcing the trend set since 2011.

The rate of unemployment in the UK fell to 5.5%, from its previous level of 5.7%; this is the lowest rate seen since 2008 and which represents 1.8 million people. This is a reduction in the number of unemployed of 35,000. Compared with a year earlier that is a fall of 386,000. However, there were 8.98 million people aged between 16 to 64 years, who were out of work and not actively seeking or available to work. This group of people are known as the *'economically inactive'*, this is 69,000 fewer than in the October to December 2014 period. The important figure of the number of people claiming the Jobseeker's Allowance also fell by 12,600 to 764,000.

On the employment front, there are now 31.1 million people in work in the UK, which represents an employment rate of 73.5%, its highest level since records began in 1971. The incoming new Work and Pensions Minister, Priti Patel, commenting on these latest figures from the ONS said: *"This is testament to our long-term economic plan, the work the government has been doing with our focus on job creation, creating the right economic conditions for businesses to expand and grow so they can employ people again, so this is very welcome news today."*

Given that with inflation remaining around zero, workers are now seeing real pay rises, as the ONS also disclosed in mid-May that average pay for employees, excluding bonuses, rose by 2.2% in Q1 2015, compared with the same period last year and average pay including bonuses also rose by 1.9% over the same period.