ECONOMICREVIEW of May 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

Is the jobs market cooling off?

Whilst the UK's unemployment rate remains at 5.1%, in the latest figures released by the Office for National Statistics (ONS), the number of unemployed people was 1.69 million between January and March this year, a fall of 2,000 from the previous quarter. Senior Statistician at the ONS, David Freeman, cautioned that: "The employment rate has hit another record high, but this time the increase is quite modest.

Fewer vacancies seen

"With unemployment very little changed, that is further evidence the jobs market could be cooling off."

His comments were reinforced by the fact that the data showed current job vacancies have dropped to 745,000, a fall of 18,000, the largest quarterly fall since Q2 2011.

Having said that, the statistics also reveal that there are now 31.58 million people in work, which represents an increase of 44,000 from Q4 2015, the employment rate is now sitting at 74.2%. Of this total, 23.12 million were in full-time employment, an increase of 328,000 from a year earlier, whilst there were 8.46 million in part-time employment, itself an increase of 81,000 from a year earlier.

Of the unemployed, the number of those claiming unemployment related benefits to April 2016 fell to 737,800, a decline of 2,400 from March 2016 figures and 57,600 fewer than one year earlier.

On the earnings front, average earnings – including bonuses – rose 2% year-on-year. Here the ONS added that they believed the timing of 2016 bonuses had affected this figure. Meanwhile, average weekly earnings – excluding bonuses – rose by 2.1%.

The Government's response came from Stephen Crabb, The Secretary of State for Work and Pensions, who was quoted as saying: *"These are another record breaking set of figures, with more people in work than ever before and the unemployment rate is the lowest in a decade at 5.1%".*

UK inflation dips

April saw the UK's Consumer Prices Index (CPI) fall for the first time since September 2015 to 0.3%. Last year was, according to the ONS, who compile the data, a year of historically low inflation, with the CPI hovering around zero.

Globally, inflation has been muted, with some Eurozone countries flirting with deflation.

Here in the UK, the main factors in the fall in CPI were a large drop in the price of air fares between February and March this year, a reduction of 14.2%. This is set against a rise of 4.5% seen in these prices in the same period last year. The cost of clothing and footwear also fell as retailers dropped prices to boost sales following April's cold weather.

If the costs of food, energy, tobacco and alcohol are stripped out of the calculation, the so-called core inflation rate, fell to 1.2%.

Following this trend, the wider Retail Prices Index (RPI), a barometer measure still used for some future rent and pension calculations, also fell from an annual rate of 1.6% in March to 1.3% in April.

These falls in inflation, to below the Bank of England's target level of 2%, required the Governor, Mark Carney, to write his sixth letter to the Chancellor of the Exchequer, to explain the reasons. In this he said: *"The underlying causes of the below-target inflation of the past year and a half have been: sharp falls in commodity prices, the past appreciation of sterling, and to a lesser degree the subdued pace of domestic cost growth."*

Inflation falls again

Markets: (Data compiled by The Outsourced Marketing Department)

Global equity markets – with the exception of the FTSE100 – continued their three-month recovery.

Having itself recorded three months of gains, the FTSE100 drifted on the last day of the month by 40 points to close down marginally 0.18% at 6,230.8. This late dip was attributed to 'Brexit' fears as polls indicated the leave campaign taking a small lead for the first time. The FTSE250, however, rose by 2.28% to end May at 17,184.7, whilst the junior AIM market also gained 1.62% to 739.5.

Across the pond the Dow Jones marked time, rising a nominal 0.08% to 17,787.2 as market watchers analysed the latest missives from The Federal Reserve regarding the direction and timing of any interest rate rise. The technology based Nasdaq closed the month at 4,948.05 to show a rise of 3.62%.

On the continent the Eurostoxx50 also recorded its third month of improvement, lifting 1.16% to 3,063.48, again with all eyes here on the UK's 'Brexit' referendum campaigns.

The Japanese market saw the Nikkei225 recover strongly, ending May at 17,234.98 for a rise of 3.41%

The currency markets were sanguine in May with Sterling unchanged against the US Dollar at $1.45, but up 2.36% against the Euro at €1.30. The Euro also weakened by 2.63% against the greenback to $1.11.

Equities have a good month

The price of oil (Brent Crude) continued to improve as the lack of a decisive production quota policy from the Organisation of Petroleum Exporting Countries (OPEC), terrorist action in Nigeria and Canadian bush fires dampened global output somewhat. At $49.51 a barrel 'black gold' rose 4.47% in the month and now sits up 35.12% over the last three months.

Gold meanwhile lost its sparkle, dipping 6.01% in May to $1,215.15 a Troy ounce.

Decision Day beckons for the UK

On June 23rd, eligible UK citizens can make their voices heard on a major issue that has been making global media headlines and providing politicians, economists and heads of state with sound bites for over a generation. Should the UK remain within the European Union (EU) or leave and make its own way in the world?

The great uncertainty in this debate, now universally referred to in the media as 'Brexit', is the lack of real tangible evidence as to what a vote for either side would mean in practice. Since the inception of the EU (and its multiple antecedent monikers), no member state has ever left, so no-one can accurately predict what the outcome might be. What is clear is if the UK does vote to leave, it will be major world political, social and economic news.

Clearly, there is much for each voter to consider before they cast their votes on the 23rd. From the EU's perspective, if the UK votes to leave then this might pave the way for voters in other countries to stage their own similar referenda. However, it is also possible that if the UK wants to opt out, the EU may give way on a number of negotiating fronts in a bid to convince us to stay.

One thing is certain, on June 23rd, the eyes of all the world will be focussed on the UK, as this is a major political and economic issue with domestic, European, and global ramifications.

In reality, however, politicians, economists, bankers, and fund managers globally may try to confidently predict the long-term implications of the UK staying in or leaving the EU. At this point in time, nobody really knows.

In or out?

Government borrowing higher than expected in April

The Chancellor of the Exchequer's pledge to continue to bring down the UK's borrowing, took a dent in April, as borrowing – whilst down from the £7.5bn recorded in March – was still £7.2bn (excluding support for state-owned banks) and higher than the consensus of most forecasts of £6.6bn.

At the same time, the ONS has revised upwards its estimate of the total borrowing in the financial year to March to £76bn, which is £2bn more than their past estimate and £3.8bn more than the estimate given by the Government's independent Office for Budget Responsibility (OBR).

However, the ONS did reiterate that annual borrowing in the UK has indeed been falling in general since the financial year 2009/10, when it peaked following the recession, and that the figure for 2015/16 (ending March 2016) was £15.7bn lower than the previous financial year and half the borrowing figure recorded in 2009/10.

The worse than expected April figures were a result of a 5.1% reduction in receipts from Corporation Tax, to £5.8bn and public sector net debt (again excluding public sector banks) standing at £1.596 trillion, which represents 83.3% of the country's Gross Domestic Product (GDP).

On the plus side, the April borrowing figures were enhanced by an increase in Stamp Duty receipts to £1.3bn, as a result of the newly introduced higher rates for second home and buy-to-let property purchases.

Given these latest results, the Chancellor's long-term wish to achieve a budget surplus of £10.4bn by 2019/20 looks somewhat doubtful.

Martin Beck, Senior Economic Adviser to the EY ITEM Club, was quoted as saying: *"This looks to be a tall order, particularly given that the recent weakness in activity appears to be dampening growth in tax receipts… if it is to have a realistic chance of keeping its deficit reduction plan on track."*

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