ECONOMICREVIEW
of November 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

Manufacturing index rises to three-month high

The latest Markit UK Manufacturing Purchasing Managers' Index (PMI) released in October has reported a level of 53.2 against a level of 51.5 recorded in September. Any number above 50 represents improving business conditions in the sector.

Whilst good news and representing the highest figure for three months, there was disappointment at the level of export orders. These fell at their fastest pace since January 2013.

Seventh consecutive quarter of growth expected

Markit commented that several factors were responsible here: the strength of Sterling against the Euro currency, slower economic growth in key export markets, such as China and the USA and *"a near stagnant"* eurozone.

However, overall the pick-up in growth was welcomed and is thought to reflect the resilience of the UK manufacturing market. Also affecting the results was the reported slowdown in the average output prices, which were rising at their slowest pace for sixteen months, but also the number of jobs being created in the sector also accelerated, especially at small and medium-sized companies.

Most economists thought these figures were better than they had anticipated.

Markit's Senior Economist, Rob Dobson, commenting on their findings, said that the October figures were a *"positive marker"* for Q4 of the year. He went on to add: *"It is positive to see the sector break its recent sequence of slower growth. Continued growth of employment, especially at SMEs, suggests that the recovery in the labour market is holding sway."*

Echoing these positive comments, Ms Lee Hopley, the Chief Economist at EEF, the manufacturers' organisation, was quoted as saying the sector was *"pretty resilient"* and that: *"With domestic demand providing a good boost to production levels across a wide base of manufacturing activities, we should see the sector post its seventh consecutive quarter of growth in the final three months of this year."*

UK average wage growth finally beats inflation

Average wage growth in the UK finally rose above the inflation rate in the year to September, according to the Office for National Statistics (ONS).

With the Consumer Prices Index (CPI) at just 1.2% in September, wages excluding bonuses, rose by 1.3% in the same period, but wages including bonuses only rose by 1%.

This is the first time that wage growth has outstripped inflation since 2009, as whilst it stagnated as a result of the global financial crisis, over the last few months wage growth has been rising at the same time as inflation has been declining.

The ONS also stated that there were now 30.7 million people in employment in the UK, which is the highest number seen since records began back in 1971.

This news was welcomed by the Work and Pensions Secretary, Iain Duncan Smith, who said this recent turn of events was *"remarkable"*.

At the same time, Esther McVey, the Employment Minister, commented: *"Record numbers of people in work means more people with the security of a regular wage who are better able to support themselves and their families.*

"With the vast majority of the rise in employment over the last year being full-time, it's clear that thanks to the government's long-term economic plan, we are helping businesses to create the jobs that people need."

Reinforcing this bullish development, a Deputy Governor of the Bank of England, Ben Broadbent, believes that this trend of higher wages will continue to outpace inflation beyond the end of 2014 and well into 2015.

In their latest inflation report (for which they are held accountable for by the Government) they state that by their estimates CPI could fall below 1% in 2015 and they see wages growth to rise to about 3%.

Higher wage growth seen

Markets: (Data compiled by The Outsourced Marketing Department)

After October's market volatility, some confidence returned to the equity markets in November, buoyed by the continuing fall in global energy prices.

The FTSE100 edged up 2.69% to close November at 6,722.6, with the wider FTSE250 following suit, rising 2.26% to 15,851.76. The junior AIM market trod water, finishing the month at 725.66, up a marginal 0.76%.

Across the pond and reflecting the strong performance of the US economy, the Dow Jones index gained a similar 2.52%, closing out at 17,828.24, and the technology based Nasdaq up 3.47% to 4,791.63.

Continuing this positive trend, the eurozone saw renewed investor demand, as the Eurostoxx50 climbed to 3,250.93, to record a strong gain of 5.45%.

Star of the show, however, was the Nikkei225, as continuing fiscal easing from the Bank of Japan drove the index 11.51% higher to close the month at 17,459.85.

On the foreign exchange markets Sterling continued to lose admirers, falling by just over 2% against the US Dollar to finish the month at $1.57. It also lost ground against the Euro, finishing at €1.26, down 1.72%. Meanwhile, the Euro itself was virtually unchanged against the US Dollar at $1.25.

Oil has had a turbulent month with the benchmark Brent Crude price dropping to $70.15 a barrel and the US West Texas Intermediate benchmark price dropping further to $66.15 a barrel. This is due to global oversupply, with Saudi Arabia (and thus OPEC) declining to reduce production levels and a continuing drop in demand from China and other developing economies. Given this scenario the market sees further price declines possible in the coming months.

Gold had a quiet month, ending little changed on $1,165.33 per troy ounce, down just 0.62%.

Investor confidence returns

Scotland to get new tax and spending powers

Lord Smith, the chairman of The Smith Commission, which was set up by David Cameron, the Prime Minister, in the wake of the Scottish Independence Referendum, released his findings in late November.

This ground-breaking report has suggested multiple recommendations; the most important being that the Scottish Parliament should be given powers to set income tax rates and bands on earned income and that it should be allowed to keep and use all of the income tax raised in Scotland, as it sees fit.

However, whilst recommending the above, the Smith Commission also stated that the Westminster Parliament would retain the absolute right to set the tax-free allowances.

On revenues received from Value Added Tax (VAT) on spending in Scotland, the first 10% of such will be allotted directly to the Scottish Parliament.

Furthermore the Scottish Parliament should be able to create new welfare benefits in their devolved areas and also to be able to make discretionary payments in any area of welfare. This will include the housing cost element of the soon to be introduced Universal Credit, benefits for carers and the disabled, together with future cold weather payments.

Whilst the majority of recommendations are of a fiscal nature, another important one is that the Scottish Parliament should be given powers to allow 16 and 17-year-olds to vote in Scottish elections. This element may prove most controversial in other parts of the United Kingdom.

Importantly, this proposed fiscal framework will ensure that both the Scottish and the UK's budget, as a whole, will be neither bigger nor smaller as a result; therefore, the current Barnett formula payment to Scotland from Westminster will either be increased or reduced according to revenues generated by Scotland through this process.

The devil is in the detail

UK borrowing down in October

Given that around Budget time in March the Office for Budget Responsibility (OBR) predicted that the UK Government's borrowing would fall by more than 10%, it must have come as a great disappointment that in fact, to date, borrowing has increased by 6.1% compared with the same period last year.

The latest figures from the Office for National Statistics (ONS) show that the total public sector debt was £1,449.2 billion in October, which represents 79.5% of Gross Domestic Product.

However, there was some light at the end of the tunnel, in that October's borrowings fell to £7.7 billion, which is down £200 million from the same month last year.

As warned by the independent OBR in September; the ONS goes on to cite the fact that whilst unemployment has fallen over the period in question, there are large numbers of people now in employment who are earning wages below the current threshold for income tax and as a result, income tax receipts have seen a fall.

Despite the economy growing by about 3% and the increase in the number of people in employment, income tax receipts fell by £300 million from the same month last year to £81.5 billion.

Having said that, the OBR believes that both wage levels - and therefore income tax receipts - will begin to pick up before the end of this financial year.

But, they went on to say: *"Factors such as weaker-than-expected wage growth, lower than expected residential property transactions and lower oil and gas revenues make it unlikely that the full-year receipts growth forecast from March will be met."*

In response to these figures a Treasury spokesperson was quoted as saying: *"While today's public finance figures show borrowing is down this month compared to last year, the impact of the great recession is still being felt in our economy and the public finances.*

"At the same time, we have to recognise that the UK is not immune to the problems being experienced in Europe and other parts of the world economy."