ECONOMICREVIEW
of September 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

GDP in the UK sees strong rise in Q2

Economic growth in the UK, as defined by the Gross Domestic Product (GDP), for the second quarter of the year (the three months ending in June), which was initially estimated in July at 0.7%, after a strong rise in oil and gas production, remained unchanged in late August, after further analysis, according to the Office for National Statistics' (ONS) latest press release. However, this was still an improvement on the 0.4% growth recorded in the first quarter.

Economic strength confirmed

The Q2 figures were also boosted by an improvement in international trade, with exports seeing their best performance for four years. Sadly, this may prove only a short term boost, as the current strength of Sterling will make the competitiveness of British goods abroad diminish via the exchange rate, and the recent turmoil in the Chinese equity markets - as a result of fears of their economic slowdown persisting - will also dampen the overall global appetite for exported goods.

On a more positive note, UK business investment rose by 2.9%, as compared with the first quarter and at the same time household spending, boosted by our continuing low inflation rate and the double-edged sword of the strength of Sterling, was reported to have risen by 0.7%, all be that down from the 0.9% seen in Q1.

With GDP growth recorded by the ONS at 3% in 2014, its best outcome since 2006, the Bank of England (BoE) now expects a similar outcome for 2015, as they predict 2.8% growth looking forward.

Hopefully, the good omen of the United States revising the estimate of their GDP for the same second quarter sharply up from an initial annualised figure of 2.3% to 3.7%, will rub off on our own domestic economic prospects.

George Osborne misses his borrowing target

The Chancellor of the Exchequer, George Osborne, has disappointingly failed, so far, to reduce the UK's deficit by 25% this year, as he had hoped to do.

In the latest figures released by the Office for National Statistics (ONS) it has been disclosed that the Chancellor missed last year's deficit target, as their revised figures showed public borrowing was £90.2 billion in the 2014-2015 financial year. This is considerably higher than the July estimates from the independent Office for Budget Responsibility (OBR) of £89.2 billion. In addition, August saw this years public sector net borrowing, after stripping out public sector banks, rose by £1.4 billion to £12.1 billion, compared to the same period last year. Many economists had been hopefully predicting that the government's net borrowing would fall to only £9 billion.

A 3.5% fall in income tax receipts to £11.9 billion, mainly as a result of a 53% drop in self-assessment payments from the inflated July receipts, was a primary reason for this deficit. There was also a fall in corporation tax receipts, by 14% to £1.4 billion. At the same time public borrowing rose by £2.2 billion in the April-July period. Most of this rise was attributed to a steep increase in local government borrowing.

On the positive front, borrowing of £38.4 billion in the financial year to date is down by 10%, a reduction of £4 billion compared to the same period last year.

Having said that, however, for the government to reach its original 2015 borrowing forecast, it will have to reduce its ongoing borrowing by 35% over the remainder of this financial year, compared to its total spend last year.

Chancellor adrift with his sums

Markets: (Data compiled by The Outsourced Marketing Department)

On the global equity markets, September followed the trend of August, with enhanced geo-political issues taking centre stage. Middle Eastern unrest in Syria, Iraq, Afghanistan and beyond, together with continued worry over the Chinese economy and steel closures at home, spooked the markets somewhat.

Here in the UK the FTSE100 was volatile, as it gyrated 5.5% throughout the month. It recorded 11 trading days showing losses and 11 days reversing some of those. Overall, it lost 2.89% to close at 6,061.9, having recovered from a month's low of 5,909.2. The wider FTSE250 fared much the same, closing at 16,683.0 for a loss of 2.49%. Losing 1.31%, the junior AIM market finished at 725.3.

Across the pond, the Dow Jones index also lost ground to 16,284.7 to record a 1.47% loss, whilst the technology based NASDAQ slipped by 3.27% to 4,620.16. Fears of a rise in interest rates from the Federal Reserve diminished a little in September, tempering the market unrest.

European markets were not immune, as the Eurostoxx50 ended the month on 3,100.67, to record a loss of 5.49% for the month.

The Japanese Nikkei225 index continued to fall, losing another 7.95% to close at 17,388.15. This represents a fall of 14.1% over the last quarter.

On the foreign exchanges, Sterling remained out of favour, sliding 1.31% against the US Dollar to $1.51 and a marginal 0.74% against the Euro to €1.35. The Euro currency itself slipped a little against the greenback to $1.11, a 1.77% fall.

Gold lost its appeal, seeing a fall of 2.46% to close at $1,113.41 and recording a quarterly fall of 5%.

Oil, as measured by the Brent Crude benchmark, lost the small gains it made last month, finishing September at $48.76 a barrel, down 7.34% for the month and a more serious 23.4% drop in the last quarter.

Equities lose ground in the month

A difference of opinion on rates

Could the Bank of England actually cut interest rates?

In an interesting disclosure, the Chief Economist of the Bank of England (BoE), Andy Haldane, has stated that because the inflation rate in the UK may not pick up in the third and fourth quarters of 2015, towards their target level of 2% and the threat to the global economy from sluggish emerging economies, such as China, it may be viable to actually cut interest rates from their current historical low of 0.5%.

Given that interest rates have been set at 0.5% for over six years now, it was thought by most observers that any future movement in the rate would be up, not down.

Mr Haldane's argument is centred around the facts that the recent Markit Purchasing Managers' Indexes (PMI) have softened in both the UK's construction and manufacturing sectors, indicating a possible slow down across the second half of the year and that problems in Greece and the emerging markets, such as China, could be a drag on UK growth moving forward.

He was saying that these problems were: *"the last leg of what might be called a three-part trilogy.*

"The balance of risks to UK growth, and to UK inflation at the two-year horizon, is skewed squarely and significantly to the downside."

To reinforce his opinion, he went on to add that the case for raising rates was: *"some way away from being made.*

"Were the downside risks I have discussed to materialise, there could be a need to loosen rather than tighten the monetary reins as a next step to support UK growth and return inflation to target."

However, Mr Haldane's theories were strongly challenged by a former member of the BoE's Monetary Policy Committee, Andrew Sentance, as in response he Tweeted: *"Sorry to say but Andy Haldane's spouting rubbish here."*

UK Inflation continues its meandering around zero

UK inflation, as measured by the Consumer Prices Index (CPI), fell to zero again, following the previous month's level of 0.1%.

As recorded by the Office for National Statistics (ONS), this main gauge of inflation has now meandered around the zero level having reached a high of 0.3% in January and a low of minus 0.1% in April, with four months of the year registering a rate of zero. It has, therefore, remained statistically unchanged for the year to August 2015.

The main reason for this fall to zero in August was a smaller rise in clothing prices, compared with the previous year, there was also a small fall in the prices of motor fuel and sea fares. However a rise in the price of soft drinks and furniture partially offset this. Over the year to date food prices in the UK have fallen 2.8%, whilst the prices of motor fuels have fallen by 12.9%. These factors alone have had a major influence in the subdued nature of inflation generally.

The wider measure of inflation, the Retail Prices Index (RPI), which includes housing costs, stood at 1.1%. This measure, although not meeting the required standard for designation as 'National Statistics', is important, as it is used by the government to index any increase in welfare payments, such as pensions, rents and the rates paid on index-linked UK Gilts. It is also used as a benchmark for any rise in rail fares nationally.

Annual inflation stubbornly at zero has given the Bank of England (BoE) a dilemma, as its own target for inflation is set much higher at 2%, compounding its problems with regard to its monetary policy (see: Could the BoE actually cut interest rates?).