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ECONOMIC **REVIEW**

OF FEBRUARY 2020

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. We hope you will find this review to be of interest.

THINK-TANKS ISSUE BUDGET WARNING

The new Chancellor has been warned he will either need to increase taxes or break the government's borrowing rules when he delivers the country's first post-Brexit Budget on Wednesday 11 March.

Rishi Sunak was installed as Chancellor of the Exchequer following Sajid Javid's shock resignation during the mid-February cabinet reshuffle. Mr Sunak is widely believed to be under intense pressure from the Prime Minister and his chief adviser, Dominic Cummings, to loosen the Treasury purse strings when he sets out the details of his first Budget.

However, the new Chancellor has been urged by his predecessor to keep spending under control and retain the fiscal rules outlined in the Conservative election manifesto. In a personal statement to Parliament, Mr Javid argued against any watering down of commitments to fiscal discipline saying it would be wrong to pass the bill for current day-to-day spending to future generations.

This view has been echoed by two respected think-tanks, the Institute for Fiscal Studies (IFS) and the Resolution Foundation. Both independent institutions suggested that, if Mr Sunak does decide to increase spending significantly, he will have to raise taxes or risk undermining the government's fiscal credibility.

IFS director Paul Johnson stated: *"We have already had 16 fiscal targets in a decade and fiscal targets should not just be for Christmas. Mr Sunak should resist the temptation to announce another and instead recognise that more spending must require more tax."*

The latest public sector finance statistics have also delivered a pre-Budget blow to the Chancellor. January is typically a strong month for public finances due to seasonal flows of Income Tax and this year Office for National Statistics (ONS) data revealed a £9.8bn surplus. However, this was 18% lower than January 2019 and also significantly below the consensus forecast in a Reuters poll of economists.

CORONAVIRUS DENTS RECOVERY HOPES

Data released by ONS has confirmed the UK economy stalled in the final quarter of 2019 and the economic fallout from the coronavirus outbreak looks set to hinder prospects of an imminent recovery.

Gross domestic product (GDP) statistics published by ONS showed the UK economy saw zero growth across the final three months of 2019, down from a rise of 0.5% in the preceding quarter. This left last year's annual GDP growth rate at 1.4%, marginally up from 2018, but still one of the weakest rates of expansion recorded since the 2008 financial crisis.

The sluggish fourth quarter performance, though, was largely a result of the political turmoil gripping the country at that time. Survey evidence since the general election result was announced has pointed to a significant improvement in business sentiment and growth in consumer confidence.

However, while analysts have expressed growing optimism that the UK economy has enjoyed a much-improved start to 2020, the anticipated economic problems caused by the coronavirus outbreak look set to hamper any potential recovery. While producing reliable estimates of the likely economic impact of the Covid-19 outbreak is extremely challenging, it will undoubtedly hit global growth prospects over the coming months.

Economists believe China is facing a potentially short-lived but sharp first quarter shock and given China's significance on the global economic stage, the impact will undoubtedly reverberate around the rest of the world. Although the ultimate extent of the shock will clearly depend on the success, or otherwise, of international efforts to control the spread of the disease, the impact of the coronavirus already looks set to severely dent prospects of a quick and meaningful UK economic recovery.

MARKETS: (Data compiled by TOMD)

As February ended, markets completed a seven-day losing streak, the worst since the 2008 financial crisis. Several major global indices fell as panic selling relating to the escalating coronavirus outbreak prevailed. On 28 February, the World Health Organization upgraded the global risk of the coronavirus outbreak to *'very high'* but said that it had not seen evidence that the virus was spreading freely enough for it to be a pandemic.

Many global indices are now in correction territory, which means they have lost 10% since recent all-time highs. The FTSE 100 fell over 11% in the last week of February alone, and finished the month down 9.68% on 6,580.61, the FTSE 250 lost 8.57% during the month.

On European markets, the Euro Stoxx declined 8.55% in the month and in Asia the Nikkei ended down 8.89%. In the US, the sell-off saw the Dow Jones register consecutive days of 1,000-point losses, to close on 25,409.36, down 10.07%. As calls intensified for governments and central banks to coordinate a policy response, Jerome Powell the Federal Reserve Chairman pledged to *"use our tools"* to backstop the US economy as fears impact markets and threaten growth prospects.

On the foreign exchanges, sterling closed the month at $1.28 against the US dollar. The euro closed at €1.16 against sterling and at $1.10 against the US dollar.

Gold is currently trading at around $1,585 a troy ounce, a loss of 0.27% on the month. The coronavirus impacted demand for raw materials. A combination of slowing global growth, investors reducing exposure to risk and accommodative monetary policy are likely to support gold prices. Crude prices also slipped in the month. Brent crude is currently trading at around $50 a barrel, a loss of over 10% on the month. Faced with a slump in demand and falling prices, OPEC's (Organization of the Petroleum Exporting Countries) top producer is asking members of the OPEC+ group to consider an additional collective cut of 1 million barrels per day when the coalition next meets in Vienna (early March).

INDEX	VALUE (at 28/02/20)		% MOVEMENT (since 31/01/20)
FTSE 100	6,580.61	⮟	-9.68%
FTSE 250	19,330.92	⮟	-8.57%
FTSE AIM	856.64	⮟	-9.92%
EURO STOXX 50	3,329.49	⮟	-8.55%
NASDAQ Composite	8,567.37	⮟	-6.38%
DOW JONES	25,409.36	⮟	-10.07%
NIKKEI 225	21,142.96	⮟	-8.89%

PAY BACK AT PRE-CRASH LEVELS

The latest batch of labour market statistics shows that the average UK weekly wage has now finally risen back to pre-financial crisis levels.

According to data from the Labour Force Survey, the average weekly wage stood at £512 in the three months to December 2019. After adjusting for inflation, this means that pay is now at its highest level since March 2008.

Commenting on the figures, ONS statistician Myrto Miltiadou said: *"In real terms, regular earnings have finally risen above the level seen in early 2008, but pay including bonuses is still below its pre-downturn peak."*

While the fact that one measure of pay is now above pre-crash levels does certainly represent an economic landmark, it also means the average wage can still only buy a little bit more than it could before the banking crisis. Indeed, a study by the Resolution Foundation has shown that, if pre-crisis trends in pay rises had continued, the average wage would now be worth £141 more a week in real terms.

The latest ONS data also confirmed that pay growth has slowed in recent months. Average weekly earnings excluding bonuses grew at an annual rate of 3.2% in the three months to December 2019; this was the slowest rate of growth since the third quarter of 2018 and slightly below the consensus forecast in a Reuters poll of economists.

Furthermore, a recent industry survey suggests downward pressure on pay awards has increased with employers currently offering staff the lowest annual rises in over a year. XpertHR, an organisation which specialises in analysing pay settlements, found that the median pay deal offered by major UK companies in the three months to January 2020 was 2.1%, the lowest figure since the last three months of 2018.

INFLATION AT SIX-MONTH HIGH

Official data has revealed that the headline rate of inflation in the UK has unexpectedly risen to a six-month high largely as a result of higher fuel prices and a smaller-than-usual drop in airfares.

Data from ONS shows that the Consumer Prices Index (CPI) 12-month rate – which compares prices in the current month with the same month a year earlier – rose to 1.8% in January. This was up from 1.3% in the previous month and marks the first rise in this measure of inflation since July 2019. While economists had predicted an increase, the rise was sharper than expected; the consensus forecast had suggested a jump to 1.6%.

Commenting on the figures Mike Hardie, head of inflation at ONS, said: *"The rise in inflation is largely the result of higher prices at the pump and airfares falling by less than a year ago. In addition, gas and electricity prices were unchanged this month, but fell this time last year due to the introduction of the energy price cap."*

The inflation statistics also reported more pressure in the consumer price pipeline than economists had previously thought. Manufacturers' costs for raw materials, for instance, were 2.1% higher in January 2020 compared to year earlier levels, reflecting a surge in imported precious metal prices. This was a significant jump from the 0.9% rate recorded in the previous month; in comparison the consensus forecast had pointed to a 0.1% fall.

Despite the larger than expected rise in inflationary pressures, the latest CPI figure does still remain below the Bank of England's 2% target level. The rate was also broadly in line with the Bank's latest projections produced in January and this has led some analysts to conclude that the data will have a relatively limited impact on the future interest rate outlook.

It is important to take professional advice before making any decision relating to your personal finances. Information within this document is based on our current understanding and can be subject to change without notice and the accuracy and completeness of the information cannot be guaranteed. It does not provide individual tailored investment advice and is for guidance only. Some rules may vary in different parts of the UK.