

ECONOMIC REVIEW

NOVEMBER 2018

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.

MAY'S BREXIT D-DAY LOOMS



After 20 months of negotiations Theresa May finally secured a deal on the terms of the UK's departure from the EU; but whether she has sufficient parliamentary support for her deal remains to be seen.

The UK and the EU have now reached agreement on how the Brexit divorce will work. This deal is contained within a legally-binding 585-page withdrawal agreement that officially sets out the terms of the UK's departure on 29 March 2019.

Included within the agreement are details of the £39bn 'divorce bill' and a 21-month transition period following the UK's departure; future commitments over citizens' rights, and, controversially, the 'backstop' arrangement to ensure the Irish border remains unmanned, if trade talks don't provide a mutually agreeable solution.

Alongside the withdrawal agreement is a 26-page joint statement which provides a rough outline of how future relations might work when the transition period ends. This political declaration is based on the premise of continued close co-operation between the UK and EU, although the document is not legally-binding and formal negotiations on its contents will only commence once Brexit has taken place.

Despite initial suggestions to the contrary, Theresa May managed to secure Cabinet backing for her deal, albeit with two senior ministerial resignations, including Brexit Secretary Dominic Raab. However, the Prime Minister now faces the daunting task of convincing MPs that her deal is the best the UK can achieve.

The arithmetic currently suggests Theresa May is unlikely to secure safe passage of her deal through the Commons on 11 December. Indeed, not only have Labour and all other opposition parties vowed to vote against the deal, but the Democratic Unionist Party and dozens of Tory MPs have also voiced their opposition.

If the Prime Minister does win the day, then an EU Withdrawal Agreement Bill will be introduced to Parliament in early 2019 and, if that is passed, the European Parliament and EU Council will then be asked to approve the UK's departure. If the deal is voted down, then it would appear negotiations are pretty much back to square one, leaving four potential outcomes: a 'no-deal' Brexit, re-entering negotiations, a General Election or a second referendum.

BREXIT HOLDS MONETARY POLICY KEY

Recent comments from the Bank of England (BoE) firmly reinforce the message that near-term monetary policy will be inextricably linked to Brexit.

Members of the Monetary Policy Committee (MPC) unanimously voted to leave rates unchanged at 0.75%, following their meeting on 1 November. And a similar outcome is widely anticipated when the MPC next reconvenes on 20 December, with policymakers expected to 'sit on their hands' until the full implications of Brexit become clear.

Comments made by BoE Governor Mark Carney immediately following the November meeting also made it clear that the monetary response to Brexit could involve either a tighter or looser stance. Specifically, Carney said: *"Since the nature of EU withdrawal is not known at present, and its impact on the balance of demand, supply and the exchange rate cannot be determined in advance, the monetary policy response will not be automatic and could be in either direction".*

Further comments made by Michael Saunders, another MPC member, reinforced this view. Saunders suggested that a smooth Brexit would boost the UK economy and could therefore lead to rates rising more quickly than money markets currently envisage. However, he also warned this was not inevitable as the inflationary pressures of a stronger economy could be offset by the disinflationary impact of sterling appreciation.

While it does therefore appear clear that future monetary policy will largely be dictated by Brexit, it is less clear what the specific monetary response to Brexit will actually be.



MARKETS:

(DATA COMPILED BY THE OUTSOURCED MARKETING DEPARTMENT)

European stocks closed lower at the end of November, recording a second consecutive monthly loss. Weak data from China hit investor confidence ahead of the G-20 summit in Buenos Aires; where trade developments between China and the US were a key focal point.

The weak construction data and stalling factory output from China, weighed heavily on the mining sector, particularly in London. UK-traded mining stocks are susceptible to any signs of a slowdown in the Chinese economy, a major consumer of resource products. The FTSE100 index closed 2.07% down over the month to 6,980.24 and the FTSE250 closed November down 2.31% to 18,480.83. The junior AIM also ended the month down, losing 4.68% at 930.17. The Eurostoxx50 fell by 0.91% over the month to finish on 3,173.13.

US stocks ended the month in positive territory. The tech-focused Nasdaq Composite closed November up 0.34% to 7,330.54 and the Dow Jones closed on 25,538.46, up by 1.68%. Tokyo's main index, the Nikkei225 gained 1.96%, to close the month at 22,351.06, with advances by the pharmaceutical sector leading the way.

On the foreign exchanges, sterling closed the month at \$1.28 against the US dollar. The euro closed at €1.13 against sterling and at \$1.13 against the US dollar.



Brent crude closed the month lower at \$58.71 a barrel, a fall of 23.14% in November, one of the largest monthly declines since the financial crisis, on concerns the global markets are oversupplied, with the US now producing more oil than both Saudi Arabia and Russia. Russia has signalled it is considering joining OPEC (Organization of the Petroleum Exporting Countries) and other producers to cut output, a positive development for discussion at the next OPEC and allies meeting in Vienna on 6-7 December. Gold closed the month up 0.64% at \$1,222.18 a troy ounce.

ECONOMY GROWS STRONGLY BUT SLOWDOWN EXPECTED

The latest data shows the UK economy recorded its fastest rate of growth in almost two years during the third quarter, although it also provided worrying signs of an imminent slowdown.

Data released by the Office for National Statistics (ONS) shows that gross domestic product (GDP) rose by 0.6% during the July-September period – the UK economy's fastest quarterly expansion since the final three months of 2016. This strong performance was largely due to a surge in consumer spending thanks to the unusually warm summer and England's strong World Cup performance.

However, the third quarter growth rate is likely to represent a peak in the UK's economic performance during 2018. Indeed, the data shows that GDP growth actually flatlined during August and September highlighting how the latest quarterly expansion was heavily skewed towards a particularly strong July and pointing to an anticipated slowdown during the fourth quarter.

Business investment also fell unexpectedly during the third quarter, recording its largest decline since early 2016. This will inevitably act to restrain growth during the coming months and adds to signs of rising caution across the business sector ahead of the UK's impending departure from the EU.

Meanwhile, the BoE has released forecasts outlining the likely economic impact of a disorderly 'no-deal' Brexit. The BoE warned that such a scenario could trigger a recession worse than that endured during the global financial crisis, with the UK economy shrinking by 8% in the immediate aftermath if there was no transition period.

This pessimistic 'worst-case' scenario followed hot on the heels of the government's own post-Brexit economic warning. New government analysis estimates that the UK will be poorer economically under any form of Brexit compared with remaining in the EU, with the economy likely to be 3.9% smaller after 15 years under Theresa May's Brexit plan while a 'no-deal' Brexit is expected to deliver a 9.3% hit to the economy over a similar time frame.

MILD AUTUMN HITS RETAIL SALES

The latest retail sales statistics proved to be weaker than expected while early indications suggest Black Friday sales were down on last year's levels.

Official data released by ONS showed that retail sales volumes fell 0.5% in October when compared with September, much weaker than the consensus market forecast of a 0.2% monthly rise. In the three months to October as a whole, which smooths out monthly data volatility, the growth in sales was 0.4%, a significant slowdown in sales growth compared to the strong summer levels which peaked at 2.3% in the three months to July.

Commenting on the data, ONS Senior Statistician Rhian Murphy said: "Retail sales slowed after a buoyant summer with the mild autumn hitting winter clothes sales".

The latest monthly retail sales survey published by the Confederation of British Industry (CBI) did provide some encouraging signs that sales may have picked up in November. Indeed, the monthly retail sales balance reported in the CBI survey rose to +19 in November from +5 in October.

However, the survey was conducted prior to Black Friday and anecdotal evidence appears to suggest that spending in this year's promotional pre-Christmas event declined from last year's levels. Barclaycard, for instance, said shoppers had spent 10% less by mid-afternoon this Black Friday compared to last year, while shopper monitoring company Springboard reported a 6% decline in footfall compared to 2017.

The apparently contradictory messages regarding November's data can partly be explained by the fact that consumers were able to spread this year's bargain hunting over a longer time period as retailers began discounting earlier. However, the overall message appears to be that this year's Black Friday sales will do little to lift the gloom in the retail sector.

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