Government Actuary's Department

Investment News

Monthly Bulletin from the Investment & Risk Team

January 2015

Last Month in Brief

Oil prices continued to fall during December with Brent Crude dropping as low as $55 barrel. This has led to increased economic concerns for Russia and saw the rouble continue to depreciate - despite drastic monetary policy seeing interest rates reach 17%. Russian inflation jumped to 11.4% (initial estimate for 2014) largely as a result of imported food price inflation and it is widely expected that the Russian economy will enter recession in first quarter of 2015.

Janet Yellen, the chair of the US Federal Reserve, suggested they will be patient over increasing interest rates despite some signs of a strengthening US recovery. Meanwhile, the Swiss central bank announced negative rates to try to weaken their 'safe haven' currency which has experienced upwards pressure as a result of Eurozone worries. Pressure to raise rates in the UK lifted as CPI inflation fell to 1%, a 12 year low, led by recent falls in oil prices.

House price growth fell to 7.2% p.a. from 8.5% p.a. in November according to Nationwide. However, they also predicted that activity in the housing market is likely to pick up in the months ahead off the back of continued gains in employment, a pickup in wage growth, low mortgage rates and, for at least parts of the market, the stamp duty change announced in December's Autumn Statement which will effectively reduce the cost of purchasing a house for most buyers.

Chart 1: Equity Indices

Volatile equity markets ended December lower

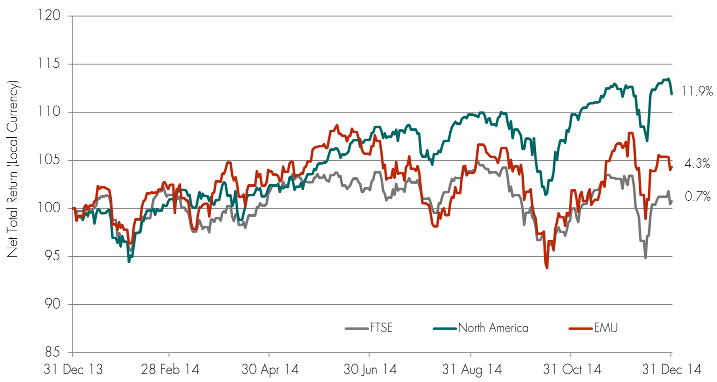


Chart 2: Sterling Credit Spreads

Spreads ended December relatively unchanged

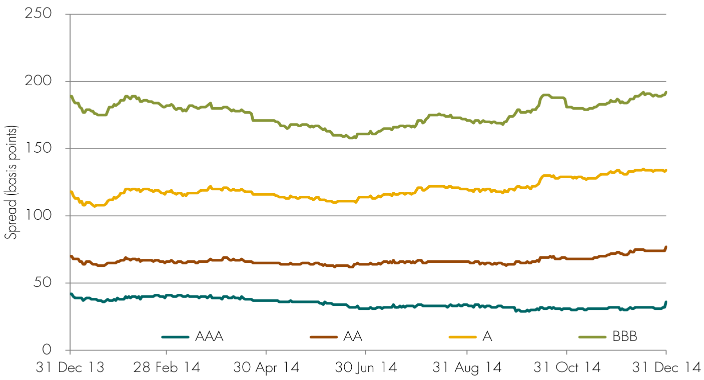


Chart 3: Gilt Yields

Gilt yields continued to fall during December

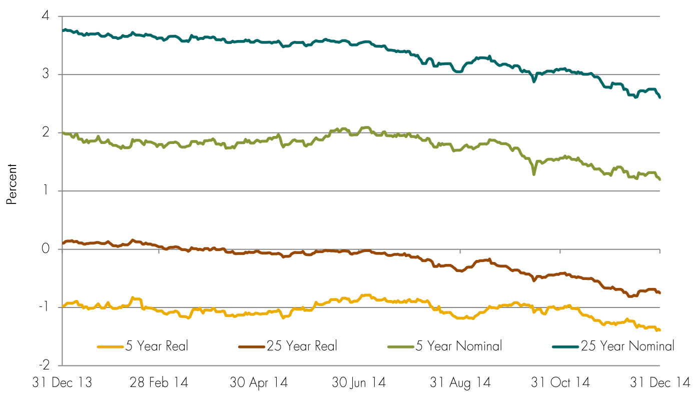
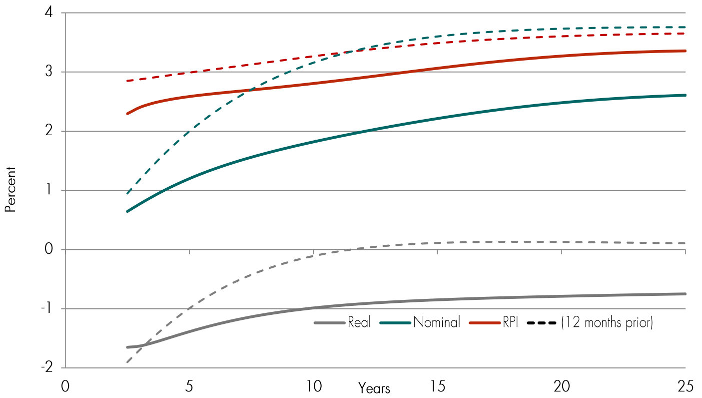


Chart 4: Gilt Spot Curves

Gilt yields remain upward sloping



Source: Financial Times, MSCI, Merrill Lynch Bank of America, & Bank of England

	Latest	Previous		Latest	Previous
CPI increase (annual change)	1.0%	1.3%	**Base rate**	0.5%	0.5%
PPF 7800 funding ratio	84.8%	87.9%	**QE Level**	£375bn	£375bn
Halifax house prices (monthly change)	0.4%	-0.4%	**VIX (volatility) index**	19.20	13.33
IPD TR property index (monthly change)	1.3%	1.5%	**$/£ exchange rate**	1.56	1.57

For monthly published indices "Latest" and "Previous" refers to the two most recently published statistics, otherwise numbers are quoted as at the month end.

A Look Back on 2014

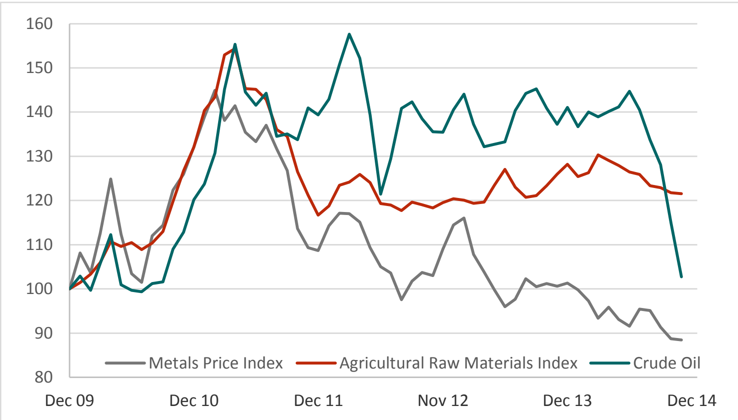
The economic landscape of 2014 has been generally one of a stop-start recovery occasionally pegged back by major geopolitical events (or lack thereof), notably Ukraine-Russia, Syria, and lack of a conclusion to problems in the Eurozone. The rapid fall in oil prices has been a significant feature of the second half of the year. This helped inflation to fall in most economies and to worryingly low levels in the Eurozone.

In the UK, job production was strong and unemployment fell every month. However, GDP did not show the same improvement and, despite the strengthening job market, wage growth remained weak despite many employers warning of a skills shortage.

Nominal and real yields on low risk bonds continued to fall, with gilts and investment grade bonds showing strong returns over the year. However, performance of high yield bonds and most equity markets were more modest.

Commodities

Change in commodity indices over last 5 years (*Dec 2009 = 100*)

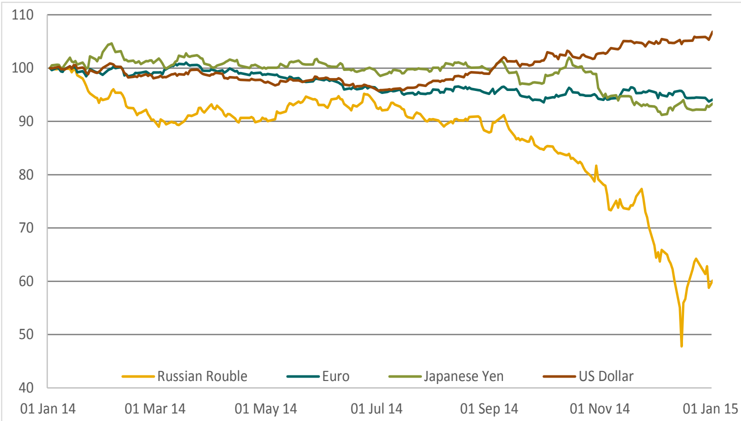


Source: IMF

The significant fall in the oil price reflected weak demand, with confidence in emerging markets slipping, and buoyant supply, with production in the US doubling since 2010. OPEC announced that they would maintain their supply in the face of these low prices driving prices even lower.

Currencies

Change in foreign exchange spot rates against GBP (*01 Jan = 100*)

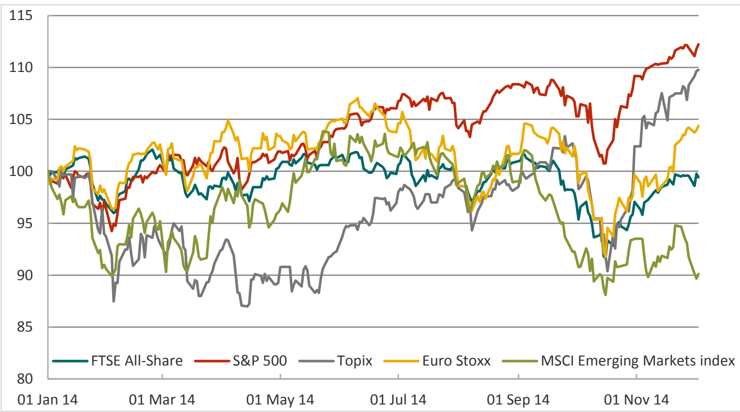


Source: Bank of England,

Oil exporting economies saw their currencies depreciate significantly in 2014. The Russian rouble fell particularly sharply with falling oil prices and the introduction of sanctions. The US dollar, meanwhile, strengthened in the second half of the year as investors expectations for the date of a rate hike drew earlier.

Equity Returns

Change in equity indices over the year (*01 Jan =100*)



Source: Bank of England

US equities performed well throughout the year on reports of strengthening economic data. However, European stocks performed poorly and the FTSE struggled due to its large exposure to poorly performing economies and its inclusion of a large number of oil and mining companies.

Average UK forecasts

Headline economic forecasts for the UK

	2014	2015
GDP growth	3%	2.5%
CPI	1.2%	1.7%
RPI	2.1%	2.5%
Claimant unemployment	0.95 m	0.83 m
Current account	£-82.9 bn	£-77.1 bn
PSNB	£96.9 bn	£80.9 bn

Source: Forecasts for the UK economy: a comparison of independent forecasts, HM Treasury December 2014

GDP forecasts have been revised lower as downward pressure from adverse Eurozone and emerging markets looked to be more significant and lasting than had originally been thought. As the UK economy approaches full employment wages are predicted to rise which would, in turn, cause a rise in inflation which may or may not need to be dampened by an interest rate hike in 2015.

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