Monthly

Economic Review

Economic review of: January 2010

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; my colleagues and I are always ready to discuss your individual requirements. I hope you will find this review to be of interest.

Should you require any additional information about your investments, pension planning or family / business protection, please do not hesitate to contact us using the details at the foot of the next page.

Economic review of January 2010

The economy grew by 0.1% in the last quarter of 2009, bringing to an official end the longest recession since records began in 1955, but this in not something that we should get too excited about – either way. On the one hand, people are disappointed that the growth in Gross Domestic Product (GDP) was only a tenth of one percent – a quarter of the level expected by many commentators. On the other, there was relief that we are at least back in positive territory now.

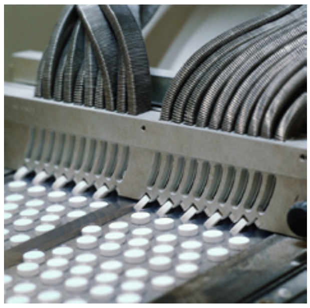
How much impact will the snow have on GDP?

The reason for a degree of optimism for those who were disappointed is that the Office for National Statistics has a habit of reassessing the figures as it goes and in both the second and third quarters of 2009, the revisions were upwards – mind you, for the four preceding quarters, the revisions were downwards, but that was simply following the trend; since we are now moving upwards, we can be (reasonably) confident that the revisions will be positive. If not, the next general election could be even more interesting!

The potential fly in the ointment, however, is that there were special circumstances that may have increased consumer spending in the final months of last year, especially the impending VAT rise on 1st January and deep discounting by retailers, both of which will have added to GDP growth. Equally, with an eye to the first three months of this year, the VAT increase may have an impact on manufacturing and sales and the bad weather we have experienced will have slowed retail spending – although it will also have increased expenditure on heating. Mind you, according to the Centre for Economics and Business Research, the extreme winter of 1962/3 may have reduced manufacturing output by 7% in February, but there was actually no overall impact on GPD due to increased spending in other areas.

Manufacturing

Manufacturing was actually up by 0.4% in the last quarter of 2009 (compared with -0.2% in the previous quarter), which is good news because with the UK being the last of the G20 countries to exit recession, we really need to take advantage of sterling's weakened condition to increase exports. With sterling some 20% lower in value against the dollar than it was in September 2007, our exporters are in a position to take advantage of the growth that other markets have already enjoyed (provided foreign retailers pass on the savings to their consumers).



Manufacturing growth could help stabilise the economy.

And it is not just manufacturers who are benefiting; consultancy firms and service providers are also able to compete more effectively at the moment. There are many, however, who would be pleased to see a growth in our manufacturing base, as the economy has become increasingly dependent on banking and insurance, of late. Importantly, there is evidence that businesses that had previously moved production overseas are starting to reverse the process.

Markets (Data compiled by the Insurance Marketing Department Ltd.)

January has proved to be a difficult month for markets, not least because of uncertainty over the Chinese economy, which is becoming increasingly important to world markets. There is also uncertainty over how the leading economies will move forward in the post recession climate.

The roller-coaster ride continues

The FTSE lost -4.15% of its value during January although this might be seen as a correction of the exuberant growth seen in December. Conversely, the mid-cap FTSE250 lost only -1% of its value during the month, leaving its three-month performance up 3.69%. The Aim market continues to dance to its own music by steadfastly refusing to follow the other markets closely, adding 2% during January.

Elsewhere, the Dow Jones and Nasdaq100 lost -3.46% and -5.37% respectively, while the Eurostoxx50 and Nikkei225 were down -6.64% and -3.30% respectively. In all cases, the three-month figures are in positive territory.
Sterling has continued its downwards trend, which is good for exports and now stands at $1.59 and €1.39. Oil has also fallen by -8.42% and ended January at $71.46.

Inflation

December's inflation figures were discouraging with the Consumer Prices Index (CPI) rising by 2.9% (a full percentage point up on November). Rising inflation is something that we have warned about as being a possible consequence of quantitative easing and the Bank of England's Monetary Policy Committee will need to keep a very close watch on this.

Control over inflation will be important - but difficult to achieve

One cloud on the horizon is that factory gate prices appear to be on the rise and this could push up inflation even further. However, the Bank of England says some of the recent rise was caused by the fact that the late 2008 VAT cut has now 'fallen out' of the figures, making December 2009 worse than would otherwise have been the case. The January 2010 VAT increase will affect the next inflation figures.

Interest rates

Interest rates have remained stable for some time, but some commentators believe that rises are now inevitable, with some expecting them as early as February or April. There is, however, no consensus about how much the rise will be; some say 2% in six months time one suggests that we could still be at 0.5% by the end of 2010. Most, however, predict anything from 1.5% to 3.5% by the middle of 2011.

Interest rates round the world		
UK	0.50%	No change
USA	0.25%	No change
Europe	1.0%	No change
Japan	0.10%	No change

That may please savers and those approaching retirement who may wish to buy an annuity, but not borrowers or businesses.

Taxation

One consequence of the slow climb back into economic growth is that tax revenue will almost inevitably fall below Treasury forecasts. This will mean either that we will have to pay higher rates of tax, spending will have to be cut or borrowing increased. None of these are particularly attractive, but the reality is that we entered the crisis already having massively high levels of public borrowing, so there was no 'slack' to be taken up by the very necessary emergency action that the Government took on our behalf.

Who is picking your pockets?

There is, however a further area for potential savings which, while not massive, should be relatively easy to tackle, given the will of the nation to do so. This is the area of tax evasion which is costing us £15 billion a year. That is fifteen times as much as benefit fraud, so it really is very significant indeed, when you consider that this represents about 3% of total tax liabilities.

In other words, evading tax is not a "victimless crime", it is one which affects every one of us and yet it appears to be condoned by society, because too many of us are prepared to "pay cash" for a discount and to avoid paying VAT. Were we to insist on paying by cheque (as long as these are allowed to remain in use) or direct credit transfer, then the potential for abuse would be significantly reduced and we would all be better off – even those who end up paying a small amount more for the work they have done. The Government is rightly targeting benefit fraud, but the real problem is those who are below the tax horizon.

House prices

According to Halifax, house prices have more than doubled over the past decade, despite recent market reversals. While this may please homeowners – and has certainly contributed towards consumer spending and inflation, as we all felt better off throughout the first ten years of the century – there are many who are worse off. Not least of these are the first time buyers.

In fact, it has been suggested that rising house prices are actually a way of transferring money from the young to the old. This is because older people have houses that they eventually sell to younger people, who have to borrow massively in order to pay for the profits that their parents' and grandparents' generations are making. Of course, this money will eventually pass back down the generations through inheritance – at least to those lucky enough to have property owning parents – but this is potentially subject to inheritance tax and also involves massive interest payments by younger generations in the meantime.

Rising house prices do not benefit everyone

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