# Monthly

# Economic Review

## Economic review of: July 2009

**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 and 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.**

**The Chancellor of the Exchequer has expressed concern that banks are charging small businesses too much, despite historically low interest rates.** According to the Bank of England's Agents' Summary of Business Conditions (BofE AS), banks are more willing to lend, but only to what they see as better risks – and then they charge high arrangement fees with larger spreads than before.

So while the British Bankers' Association says total lending to small companies rose £391m in June, anecdotal evidence suggests that inexperienced bank managers are making decisions that can adversely affect established firms whose operations they simply do not understand.

*The Bank of England's Agents meet local businesses regularly*

Banks must re-capitalise to meet new criteria set for them by the regulators. But they need to understand public anger over their behaviour and concern about high salaries. Most people simply do not believe that massive rewards are essential to get good quality senior staff; after all, it was these very people who brought about the crisis in the first place.

On the other hand, we must allow that if the banks remain too weak to support economic recovery, then it will be slower than necessary. And with the level of government borrowing that needs to be repaid (see below), only increased productivity will generate sufficient tax revenues for them to avoid even more debt, unrealistically slashed spending or higher rates or tax.

### The Economy

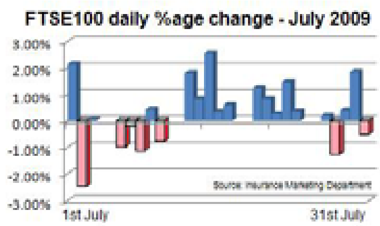
Gross Domestic Product (GDP) has always been difficult to track because so many of the figures are estimates at the end of each quarter and have to be adjusted later on. This is not normally much of an issue, but in the current climate, it has been all too easy to get the headline figures wrong. However according to the Office for National Statistics, GDP fell by -0.8% in the second quarter of 2009, compared with -2.4% in the first quarter and -1.8% at the end of last year.

*Shopping can help economic recovery*

The National Institute of Economic and Social Research, which frequently proves accurate in hindsight, estimates that output fell by 0.4% in the three months ending in June. The decline in the three months ending in May was 1.3%, so March can no longer be considered the trough of the recession. NIESR believes the UK economy is now stagnating, rather than continuing to contract sharply; in June the UK economy was around 5½% smaller that at its peak in March 2008.

As if to reinforce this view, High Street sales volumes appear to be 1.2% higher than in June (2.9% higher than last year) and the Purchasing Managers' Index suggests that the recession ended in May with that index rising above 50. However, investment intentions remain very weak according to the BofE AS, although the rate of de-stocking has slowed and many businesses report being happy with inventory levels. Unfortunately, export levels continue to fall on weaker global demand (although there are more positive signs from China).

**Markets** (Data compiled by the Insurance Marketing Department Ltd.)
That was the month that was, to misquote the title of a popular 1960s television programme. The FTSE100 gained a massive 8.45% during July; not its largest rise ever, but up amongst the best performances for a long time. In fact there was a record-equalling 11-day run of rises, as the chart shows. Interestingly, markets were clearly not so confident that they could sustain the extra




*11 consecutive 'rising market' trading days* day's growth required to create a new record. Given underlying economic conditions future months could easily reverse part or all of the gains; but then that is what investments are all about.

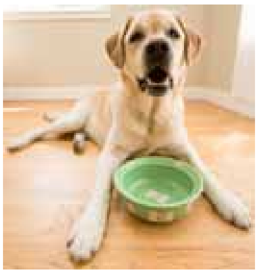
The FTSE100 is now only 14.85% below its value of a year ago and actually 3.93% higher than at the start of the year.

The mid-cap FTSE250 gained 7.9% in value during July, but the AIM market continued its underperformance with just 2.23% growth.

Elsewhere, the Dow Jones gained 8.58% and the Nasdaq100, 7.82%, while the Eurostoxx50 rose 9.84% and the Nikkei225 a rather less impressive 4.19%. Like the FTSE100, all are in positive ground since the start of January.

Sterling gained a further 1.66% against the US dollar, continuing its 4-month recovery and latest data from Nationwide indicates that the housing market continues to strengthen, with the average house price up 1.3% over last month, so that the annual fall has slowed to 6.52%. Mortgage approvals rose to 47,584 in June according to BofE, their highest level since April 2008 and the fifth successive monthly rise. However, they remain well down on market peak of 114,000 in mid-2007.

One blot on the horizon is an increase in oil prices, which gained 3.46% to end the month at US$71.70 per barrel for Brent crude 1-month futures.


*If we do not get spending under control, the bowl will be empty*

## Government borrowing

The recession and financial crisis pushed UK government borrowing to a record £90bn in the last financial year and the figures for each of the next four years are likely to be higher.

It has been estimated by the Daily Telegraph (22/7) that by 2013 interest repayments will account for 9p in every pound paid in tax by UK individuals (up from about 5p now). This is money that could otherwise be spent on hospitals, schools and welfare. One effect could be that instead of VAT returning to 17.5% in January 2010 it could go even higher, perhaps to 20%. This would be consistent with basic rate of tax, leaving only corporation tax at a higher level (21% for smaller firms, rising to 22% next year).

But spending cuts must accompany tax increases (despite what Gordon Brown thinks – or says he thinks) if debt is to be reduced without further damaging the economy. Public sector net debt is likely to reach 55% of GDP this year, which is unacceptably high.

## Interest rates and inflation

The Consumer Prices Index is now below 'target' of 2% (at 1.8%), while Retail Prices Index is 1.6% lower, year-on-year. Sharper falls are not expected by the Bank of England, although other commentators are of the opinion that deflation remains a threat.

| 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 |

This could result in people hanging on for lower prices, which could affect productivity and result in a downwards spiral. Of course, if interest rates were to be increased, this would hit the RPI quite quickly as it includes mortgage interest; however, it would also reduce the amount of money people had to spend.

The Monetary Policy Committee clearly decided not only to hold interest rates at their historic low, this month, but also to avoid seeking to inject more money into the market by purchasing a further £25 billion in gilts as had been widely expected. Next month could see a return to quantitative easing … or not.


*A national institution is under threat*

## Business

According to the British Beer and Pub Association, 52 pubs are closing every week throughout the UK. There are several reasons for this including recession, higher alcohol duty and the smoking ban. This last raises an interesting question whether it might be appropriate to suspend the ban in pubs for the duration of the recession.

Doing so might help slow the decline in this British institution which, even those who do not use them, can recognise make an important contribution towards not just local communities – already threatened by the closure of local shops and post offices – but also tourism in many parts of the country.

Conversely, can the threat to public health that smoking represents be justified on purely economic and social grounds?

## Employment


*Unemployment is rising more gradually than some had feared*

The unemployment rate was 7.6% for the three months to May 2009, up 0.9% over the previous quarter and 2.4% year-on-year. This is the largest quarterly increase in the unemployment rate since 1981. The number of unemployed people increased by 281,000 compared with the previous quarter to reach 2.38 million. However, labour costs per capita remain below the level of a year ago, due to lower hours, bonuses and commission. Most pay settlements are zero with only a few up to 3% or more.

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