Monthly

Economic Review

Economic review of: September 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.

In an increasingly global economy – especially in the wake of the Credit Crunch – we need to consider what is going on in other parts of the world. It is therefore with some trepidation that we may view developments in Germany where Chancellor Angela Merkel's Christian Democrats have won a significant election victory over their Social Democrat rivals. She might now throw off the more left-wing policies adopted to satisfy her previous coalition partners and move more to the right, in order to appease her new ones.

This could suit her natural propensities; but what effect it will have on the wider economy has yet to be seen. It is likely that cost cutting could be easier for her than a more left-leaning government but, in the current climate, her commitment to curbing the power of the banking community could be overcome by the urge to encourage them to move to Germany, thus weakening London as a world financial centre.

On the other hand, if this caused our own government to start focusing on manufacturing and what we might call the 'real economy' instead of simply making the city easier for massive financial institutions to operate in, this could be a long-term bonus for the UK.

Will Germany now move further towards the right?

While we are on the subject, let us not forget the increasing influence of China and other 'emerging' markets; although given its history as a major (if somewhat insular) economy for millennia, perhaps 're-emerging' might be more appropriate. The old G7 and G8 groupings appear to fast be receding into the rear view mirror of history, to be replaced by the G20 (with Gordon Brown as its first Secretary General?), so the influence of China, India, Brazil and other countries will become more important. Hopefully this will lead to greater cooperation.

The savings ratio has not recovered as much as expected

Interest rates and inflation

Interest rates have remained level for several months now, although the gap between base rate and LIBOR (the London Inter-Bank Offer Rate that is so important to banks themselves) appears to have closed, recently. In fact, there are indications that interest rates will remain at a low level for some time to come, which will not please savers.

This could be one reason why the 'savings ratio' (the proportion of disposable household income that is put aside for the future) has failed to rise as much during this recession as in previous ones. During the early 1980s and 1990s recessions, the savings ratio hit 12%. The latest figures (Source: Sunday Times 27/9/09) suggest that it has recently recovered from about zero, a year or so ago, to only 3% at the end of the first quarter of 2009. On the other hand, if it did return to its highest levels, this could spell disaster for the economy, because consumer spending could be about the best way out of recession.

Inflation is not expected to rise soon, although the Consumer Prices Index (CPI) could show some volatility over the next few months as some of last autumn's price cuts feed out of the data and the VAT rate returns to 17.5% in January.

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

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

Twelve months on from the collapse of Lehman Brothers, the FTSE100 has enjoyed its strongest three-month period ever (up 20.82%) and most other markets have done similarly well. In fact the FTSE100 gained 4.58% during

September; slightly less than during both July and August. This is only to be expected after the relative depths to which markets had fallen but it is worth sounding a note of caution that, as the weather deteriorates in October, so too could investment markets. We mention this not to spread doom and gloom – far from it – but simply to anticipate the natural reverses that will inevitably occur in investment markets. The FTSE100 is now 4.72% higher than a year ago.

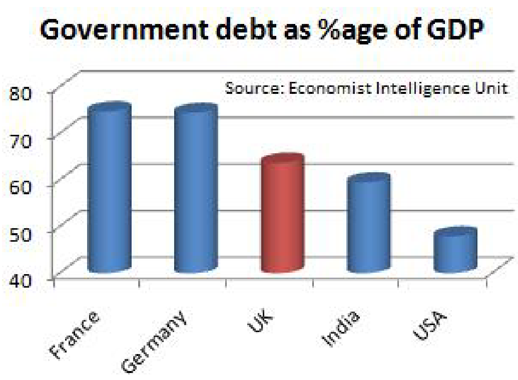
Fast growing plants can be susceptible to reverses

The FTSE250 gained 3.68% in September, while the Dow Jones ended the month 2.27% higher and the Nasdaq100 was 5.65% up. Elsewhere, the Eurostoxx50 gained 3.51% and, of the indices we track, only the Nikkei225 was down (-3.42%). Even this index has gained 1.94% over the past three months.

Gold has crossed the $1,000 per ounce barrier, ending September 5.52% up at $1,007.20, while Brent Crude oil 1-month futures eased (-5.11%) during the month, dipping under $70 per barrel.

The recession

Sterling has recently suffered compared with the dollar and euro, after having recovered some of its losses of early in 2009, it has fallen back again on concerns that there is too much government borrowing. While the increasing level of government debt looks frightening – in August, it increased by £16.1 billion – and has had a major impact on sterling's value it is worth noting that in terms of Gross Domestic Product (GDP) the level is well below that of France and Germany. In fact at 63.7% it is less than half the 185% in Japan.

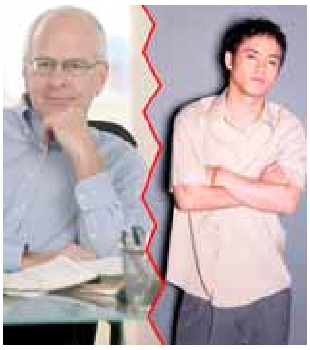


We are by no means the largest borrower in GDP terms

Despite this, there are indications that we are on our way out of recession and there are hints that the Office for National Statistics (ONS) will show in its third quarter figures that GDP is increasing. In its latest revision, the ONS now says GDP fell by 0.6% in the second quarter, up from its previous estimate of 0.7%. The National Institute for Economic and Social Research says that output is already in positive territory, having grown by 0.2% in the three months to August, compared with the previous three months. This represents the first increase for 18 months.

It is important, however, that government spending is brought under control – which all parties now appear to accept – if we are ever to be able to repay the borrowing enforced by the government's previous borrow-to-spend policies and its inability to apply adequate regulation to the banking sector that would have averted the credit crunch in the first place. Cutting ID cards – which few people believe will do anything to protect us against terrorism – would be a good start. But there will be much further to go and we can all expect to see a reduction in public services.

Employment



Young and old are differently affected this time

While the jobless total rose by 210,000 to just under 2.5 million in July (representing a rate of 7.9%) the Bank of England Agents' Report for September indicates that employment intentions are improving, particularly as wage costs are down. In fact unemployment appears to be disproportionately hitting younger people (this is bad for consumer demand, because they tend to be more willing to spend than their elders).

Wages are failing to rise largely because people are less afraid of inflation and in any event trade unions do not now have the power that was once the case, which enabled them to push up wages even in a recession. This is evidenced by the public sector – in which unions are still relatively strong – where wage inflation at 3.6% (Source: Sunday Times 20/9/09) is about twice the level in the private sector.

Mortgages

According to the Council of Mortgage Lenders, lending was up in July with 56,000 house purchase loans, 19% more than in the same month last year. At £7.5 billion, lending for house purchase was 6% higher than a year ago. This represents the first year-on-year increase in both the number and value of loans for house purchase since February 2007 (Source: www.cml.org.uk).

The housing market is moving from the bottom end

In August, Bank of England figures indicate that £1 billion more was lent by banks than was repaid by borrowers. Its September Agents' Report suggests that the bulk of the growth is at the bottom end of the market, including the buy-to-let sector.

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