Monthly

Economic Review

Economic review of: December 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. Statistics relate to the end of the full calendar month of issue unless otherwise stated.

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.

Economic review of December 2009

December's Pre-Budget Report could perhaps be described as "too little, too late". There are some increases in taxation including a doubling of the already known 0.5% hike in National Insurance contributions for employers, employees and the self employed (which does not cut in until April 2011) and a new 50% income tax rate for those earning in excess of £150,000 a year from April 2010. Personal allowances are also to be frozen in April and VAT reverted to 17.5% from the start of January.

No easy challenge for the Chancellor

What was missing, for most commentators, was any realistic plan to reduce public borrowing within the short term. Indeed, there will actually be an increase in spending for 20010/11. Of course, the Chancellor faces a difficult challenge. He has to help businesses to recover from the effects of recession as well as the credit crunch, while planning to balance the Government's books. Since supporting business usually involves either spending money or at least reducing the burden of taxation on them, this leaves no scope for reducing his borrowings.

The problem facing the country is that we are now borrowing some 60% of Gross Domestic Product (GDP), up from less than 50% this time last year. In fact we had to borrow £20.3 billion in November alone. It has been estimated that the government will have to sell £18 billion worth of gilts each month throughout 2010 in order to service the debt.

Quantitative easing… In view of the slow growth in money supply (which has recently seen its smallest expansion for five years) and exports, the Bank of England's Monetary Policy Committee is reported to be considering increasing its quantitative easing programme by a further £25 billion next year. So far the Bank has spent £190 billion on buying in gilts, corporate bonds and commercial paper and it will need to ask the Chancellor if it wishes to extend the policy beyond the £200 billion limit so far allowed.

Unfortunately, many people consider that this strategy is potentially inflationary as more money chases a finite supply of goods. The Bank of England says that this is not a problem, because there is spare production capacity, which means that manufacturers could increase supplies in order to match demand, thus avoiding rising consumer prices. However, there is little evidence that this would be the case and it could be described as wishful thinking.

… and inflation Consumer price inflation is currently running at 1.9%, but this has risen sharply from 1.1% just two months ago. The broader Retail Prices Index is now back in positive territory, rising at 0.3% a year; but again this is sharply up on two months earlier, when it was -1.42%. With a 2.5% rise in VAT in January and the prospect of higher oil prices never very far away, this is a matter of concern.

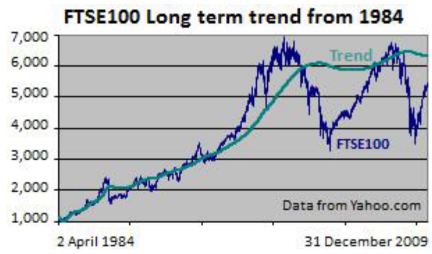
The Bank of England's governor may feel that it is safe to "look through the short-term rise in inflation" towards a period of greater stability which will allow him to increase quantitative easing in the medium term, but recent inflation figures, should they continue to grow, could easily act to destabilise the economy.

Interest rates have remained constant within the main economies but the CBI apparently believes that we are likely to see a 2% increase during 2010 before things level off again. This could be of concern to mortgage borrowers because lenders are likely to take the opportunity to increase their rates by ***at least*** the same margin. The potential impact on the housing market is incalculable, with some people suggesting that prices will continue to rise and others anticipating a further fall.

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

Such uncertainty is paralleled by a degree of ambiguity over what will happen within the broader economy; while most major economies are now back in growth, our own continued flat-lining could presage a weaker period world-wide. Global GDP is actually down 1.1%, according to the International Monetary Fund, so anything could happen.

Markets (Data compiled by the Insurance Marketing Department Ltd.) The FTSE100 ended the month 4.28% higher, 22% up on the start of 2009; likewise, the mid-cap FTSE250 gained 4.36% during December to finish a massive 46.32% up over the year. The Dow Jones only managed 0.8% growth over the month, but its performance over the year was a more respectable 18.82%, while the Nasdaq100 grew by 5.81% (43.89% on the year) and the Eurostoxx50, 6.04% (21% over the year). The Nikkei225 gained 10.18% in December but since it has performed poorly for a long time its annual growth was just 19.04%, so the late sprint was helpful.



The FTSE100 is still well below its long term trend

Nobody can tell what the next twelve months will bring but, although some pundits say that shares are overpriced, it is worth noting that the FTSE100 is still some 14.77% below its long term trend. While it is impossible to predict what impact uncertain economic conditions will have on markets, there appears to be some scope for further growth.

Oil prices rose by 1.1% during the month during December, but are 71.16% higher than at the start of 2009. Gold actually fell by -7.16% in the month, but is still almost a quarter higher than a year ago. We are indebted to the Times for pointing out that a pound of gold purchased on its launch day (1st January 1785) for £62.24 would now be worth some £19,859.

Are we becoming a nation of savers again? As we have previously noted, a time of recession is usually accompanied by an increase in savings. 18 months ago, the savings ratio was zero – that is, families were saving nothing from their household income. Now it has risen to 8.6% (Source: Times online 29/12/09), its highest level since 1998.

Unfortunately, the figures are not necessarily an indication of more saving, rather that people are reducing their debt. This, in itself, could be a positive move although it suggests that there is less spending going on, and such an outcome could be bad for retailers.

On the other hand, anecdotal evidence suggests that we ended 2009 with a massive spending spree – to gladden the retailers' hearts and beat the 2.5% increase in VAT. So unless all the household savings went on Christmas, we could find that we can, for once, have our cake and eat it.

Are we saving more, now?

Are we shrinking in world importance? There is something of a parallel between the banks telling us how important they are to us and the suggestion that by 2015 we will have fallen from being the fourth largest economy in 2005 to no longer being in the top ten (Source: Centre for Economics and Business Research - December 09). Would it really matter? It might hurt our pride and make us feel less secure, but it would make little practical difference. If we lost our status as a world-leading banking centre, would that actually hurt our economy? Or is it time to re-create ourselves, yet again, into something fit for the 21st century?

Scrappage allowance One of the more successful initiatives in the early days of the recession was to create a scrappage scheme for older cars. For some time, it appeared that it was not working, but recent data from the Society of Motor Manufacturers and Traders quoted in *The Times* (5/12/09) show that new car sales in November were up 57% year-on-year and that a fifth of these were part of the scheme. Unfortunately, all but one of the cars listed amongst the top-ten sellers were manufactured largely or entirely overseas, so it is arguable that the scheme has mainly benefited overseas firms. But this would be simplistic, because there have undoubtedly also been benefits for UK-based parts manufacturers as well as the distribution networks within the domestic market. So on balance, the money was probably well spent.

Selling cars can help the wider economy

Issued by: **CBK (Colchester) Ltd.**

Bentley House, Forge Lane, Great Bentley, Colchester, Essex. CO7 8GD

Telephone: 01206 257501 - Fax: 0270 0631072

Email: info@cbkcolchester.co.uk - Website: www.cbkcolchester.co.uk