Monthly

Economic Review

CBK COLCHESTER

Economic review of: March 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.

Any thoughts that this Budget was something of a non-event should be set aside. It was vital to our national interests that the government should be seen clearly to address the size of its borrowing. Failure to do so could have resulted in rating agencies reducing our credit worthiness ranking as well as institutional investors around the world seeking a higher interest rate for our borrowings.

What happens in Westminster affects us all

The fact remains that every political party knows that whoever wins the next election, there will have to be cuts in government spending and an increase in taxation, if borrowing is not to increase further.

The extent to which the Chancellor succeeded has yet to be seen but at least sterling appears to have survived the day with just a 0.9% fall against the dollar. His updated forecasts suggest that public sector net borrowing, predicted in the Pre-Budget Report to reach £178bn this year, will actually undershoot by £11bn at £167bn, falling to £163bn next year despite a 2.2% real-terms increase in spending.

The main highlights of the Budget have been exhaustively discussed in the press over the past week, so we will limit commentary here to a discussion of how it could play out for the economy at large.

Businesses

The business rate relief scheme and doubling of the annual investment allowance are likely to help many businesses – along with the requirement that the partly state-owned banks must boost lending to small firms in particular. However, it may be that the immediate 2.2% increase in national minimum wage and a steadfast refusal to reverse – or at least delay – the 1% rise in national insurance contributions due next April will combine to reduce the ability of the SME sector to grow sufficiently to help the economy recover its strength.

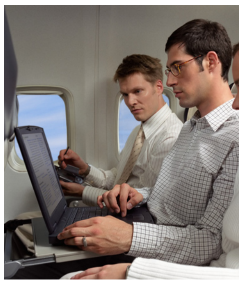
If, however, the burden falls disproportionately on those businesses that have previously formed the engine room of economic growth, any rise in tax revenues normally associated with business success resulting from increased corporation tax payments (and higher income tax from employees earning more) could be lost. This would make the recovery very short lived.

Investors

Businesses face major challenges

Doubling the Entrepreneurs' relief against capital gains tax that will now see qualifying lifetime gains up to £2 million taxed at 10%, rather than the usual 18%, will please many. It is unlikely in the short term, however, to do much towards helping the economy. In any event the Treasury's own figures suggest that the saving will only be £5 million in 2010/11 and £75 million the following year.

What will be of more immediate benefit is that ISA investment limits will increase in line with inflation from next year, with everyone now gaining from the £10,200 limit, not just the over 50s. Unfortunately, this is offset by a freezing of personal allowances and tax thresholds which means that, thanks to inelegantly-named fiscal drag, we will all effectively end up paying more tax; not just those earning over £100,000, who gradually lose their personal allowances, or over £150,000, who also now have to pay 50% tax and also stand to lose higher rate tax relief on pension contributions.



Investors keeping on the move

The net effect of this could be to damage net investment levels at a time when the savings ratio has only recently recovered from negative territory. Individual investment is an essential part of keeping the economy going, as is spending, which will also be hit by consumers having less disposable income.

Economic growth

The economy contracted by 6% during the recession, but is forecast to grow by about 1.25% in 2010 and about 3.25% in 2011. It might be argued that these remain somewhat ambitious targets, in view of the need to take money out of the economy to reduce national borrowing. On the other hand, past experience suggests that the economy can prove highly resilient. Even if a new administration (of whatever complexion) comes in after the forthcoming election and slashes government spending – which everyone says is essential, although not everyone agrees over timing – it is by no means certain that this will hamper the recovery because the chances are that, provided spending cuts are carefully targeted, the private sector will expand to fill the gap in public spending.

The future could be bright if we work at it

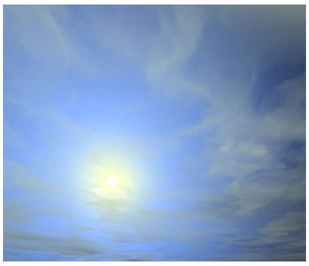
What is essential is that, while protecting essential public services, maximum effort is invested in cutting not just obvious forms of waste, but the millions of pounds spent on quangos, Whitehall consultants, unnecessary administration and needless targets that have to be reported on, but seldom improve the quality of service.

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

The FTSE100 has experienced fairly steady growth throughout March, to end a creditable 6% higher, building on last month's rise, although it has fallen slightly since the Budget. It is now 4.9% higher than at the start of the year. The mid-cap FTSE250 had an even better month achieving 9% growth to end the quarter some 9.4% higher, while the AIM market gained 5.3% during March to settle 7.5% higher than at the start of the year.

Elsewhere, the US Dow Jones and NASDAQ100 gained 5.1% and 7.1% respectively during March, both in positive ground for the first three months of the year, while the EuroStoxx50 gained 7% in March and Japan's Nikkei225 was star performer with a strong 9% growth. Overall, the indices we track are now between 32.7% and 70% higher than twelve months ago.

On the downside, the price of oil has soared up another 6.6% to reach US$82.70 per barrel for Brent crude 1-month futures – not far off its highest level for 18 months and 65% up on a year ago – while gold lost almost 1%.



Markets have not shared our extended winter!

Inflation and interest rates

Interest rates appear to have lost the ability to move – except that some lenders appear to be increasing the rates they charge borrowers despite base rate having remained static for a year. The problem is that this inertia hits savers hard; anyone relying on deposits to form part of their income continues to suffer from very lean pickings.

The annual rate of inflation fell in February from 3.5% to 3% for the Consumer Prices Index, while the Retail Prices Index – which includes housing costs - remained at 3.7% - well above its level at the end of last year. Inflation has always been a threat exacerbated by quantitative easing and the reduction in at least one of the main indices is something to be welcomed. It is important, however, that this trend continues and that the CPI returns to its 2% target. After all, we do not want the Governor of the Bank of England to get writers' cramp with monthly letters to the Chancellor for overshooting by more than 1%, do we?

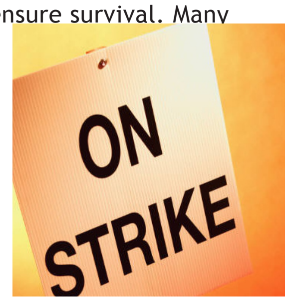
Are we really heading for a Spring of discontent?

Businesses have been complaining for some time that banks are simply not lending them enough; banks on the other hand say that businesses do not want to borrow (at least on the terms they are prepared to offer).

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

But some commentators believe that the real threat to the survival of some businesses could come from a resurgence of industrial action of the type recently seen on British Airways and threatened on the railways. It is, however, far too simplistic to suggest that employee action alone is harmful to businesses – even threatening their very survival – just as it is wrong to suggest that managements are taking advantage of recent economic conditions to impose draconian changes on employees.

What is more to the point is that both sides of industry need to take account of adverse conditions and take whatever steps are necessary to ensure survival. Many businesses have weathered the economic storm by doing just this. But it should also be recognised that, where employees have made sacrifices in order to help their employers through the recession, there needs to be some significant recognition that allows both sides to benefit from the ensuing prosperity.



Is this what we have to look forward to?

This is mirrored by the way we will all have to tighten our belts to get through the period of reducing national debt; whichever government achieves this must recognise that a return to the old ways of operating the economy will simply result in the same problems happening again. We need consensus; greater recognition of shared responsibility and the will to move the economy forward for the benefit of the entire community.

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