Monthly

Economic Review

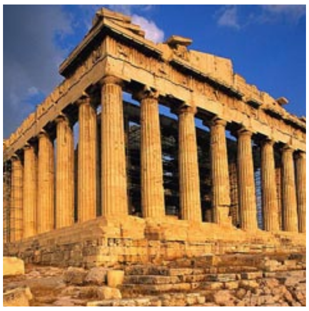
Economic review of: April 2010

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.

Following recent developments in southern Europe has been a little like watching a slowly developing Greek tragedy - in the original language. Early in the month, Germany's Angela Merkel prevented Greece from falling into the abyss by promising support – which has yet to be formally agreed by all Eurozone parliaments – in the hope that Athens would get a grip on its finances. In response, Greece says it wants to cut its budget deficit from 12.7% to 8.7% of GDP; but it is difficult to see how it can do so in the face of such strong internal opposition.



Will the economy last as long as the architecture?

Conversely, German academics had objected to any participation in the proposed €110 billion bailout, the first tranche of which is €45 billion, a third of which will come from the IMF (part of which we have to put up, even though we are not part of the euro). To add insult to injury, the Eurozone contribution will charge 5% interest, while the IMF proportion only charges 3%.

There is a warning for us in what has happened, because part of the problem facing Greece is that it cannot afford to replace its current borrowings from the normal sources because its credit ratings have been slashed by the main agencies – by the end of the month to 'junk' status – making interest rates too high for it. If we fail to get spending under control quickly enough, the same could happen here.

Could the euro be running out of steam?

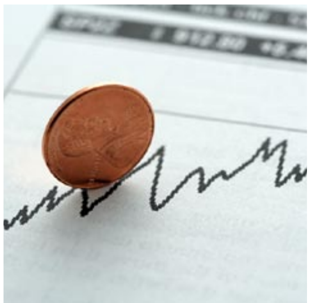
Is this the end for the euro?

The question remains whether these events reveal an underlying weakness within the euro; that the politicians have been too keen to expand its sphere of operations, but too slow to impose accompanying controls over new entrants.

If this proves to be the case, we could see Greece – and even other countries – leaving. In a worst case, the common currency could even collapse. 'Worst case' because, whatever we may think about it as individuals, the disruption that would almost certainly accompany its demise could severely impact on the UK economy, which trades significantly with the Eurozone.

Economic Growth

News that the UK economy only grew by 0.2% in the first quarter of 2010 came as a mixed blessing to the politicians. For the government, it gave an opportunity to say that Conservative policies would lead to a double dip recession; while the opposition claimed this as proof that the government's policies were not working.



Recovery is not certain, but seems strongly indicated

Both could be proved wrong as revisions to the last quarter of 2009 proved early estimates tend to be pessimistic; the economy could actually have grown at a faster pace, for all we will know by the time we have voted. One thing is clear; the first quarter figures have been hit by very bad weather and most people no longer expect a return to recession. However, consumer spending has fallen back after a more encouraging 2009 and while employment within the private sector remains stable, according to the Bank of England Agents' April Summary, public sector employment intentions are 'downbeat' due to expectations of cutbacks after May 6th.

Markets pulling both ways

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

Markets had continued their growth during the early part of April, until concerns over Greece started to worry them again. By the end of the month, both the FTSE100 and Eurostoxx50 were weaker, by -2.22% and -3.9% respectively, although both remain in positive territory over three and twelve months. The mid-cap FTSE250 actually managed 1.77% growth during April, while AIM continued its 14-

month run of continuous growth with 3.7% during April, to stand 52% higher than a year ago.

Elsewhere the Dow Jones ended 1.4% higher, having grown more slowly than the FTSE100 initially, but then sustaining its value in relative terms during the last week or so. The Nasdaq100 rose by a creditable 2.64%, while the Nikkei225 ended the month just -0.29% lower.

Sterling continued its recovery against the dollar with a modest 0.51% rise, while against the euro it gained 2.57% - largely due to the crisis in Greece.

House prices have continued their modest rise with the Nationwide index showing another 1% gain this month, taking the annual rate of growth to 10.6%. Oil jumped a further 5.73% in April, making it 72% higher than a year ago; the relative strengthening of sterling to the dollar being insufficient to mitigate fuel prices at the pumps to any noticeable degree.

Iceland

Will the Eyjafjallajökull eruption damage the climate more than the saving in aviation CO2?

Economic and personal disruption resulting from the eruption of the Eyjafjallajökull volcano in Iceland has been considerable but while it seems unlikely that the insurance industry will suffer financially, for once, the rest of the economy could do so. It is not just that airlines will have suffered considerable loss of income - and had to meet significant claims for accommodation and food for trapped passengers. In addition, employers will have had many employees unexpectedly unavailable to them, disrupting work and potentially damaging their own business relationships (although most people are likely to be reasonable).

The other question that has already been raised by some airlines is whether they should receive compensation from governments for their losses. If they do, it will be the hard pressed taxpayers who will carry the can and even without the costs involved in bailing out the banks, it is difficult to see why we should do so. The airlines are important to the economy, but not in the systemic way that the banks are.

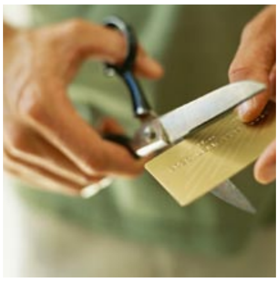
The problem was not their fault but, while it is possible for them to argue that governments over-reacted by shutting down the entire UK (and much of European) airspace for several days, a single crash would have been devastating in terms of financial and human loss and it is difficult to see that the government had much alternative.

Inflation and interest rates

With the Consumer Prices Index rising at an annual rate of 3.4% (March - 3%) and the Retail Prices Index rising at 4.4% (March - 3.7%) we could be forgiven for fearing that inflation is rearing its ugly head again. There are several reasons for the increases, including the high cost of oil - partly thanks to the pound being weaker against the dollar until recently, but also because this time last year prices were falling. However, it can be all too easy for the Bank of England's Monetary Policy Committee, which voted unanimously to hold interest rates again in April, to hide behind these issues and ignore the massive threat posed by the low cost of money. At least they held back on further quantitative easing, which seems largely to have benefited the banks, rather than the economy at large. But savers continue to suffer, while borrowers and businesses appear not to be benefiting.

Interest rates round the world		
UK	0.50%	No change for 13 months
USA	0.25%	No change for 16 months
Europe	1.0%	No change for 11 months
Japan	0.10%	No change for 16 months

Public sector debt



Perhaps the government should cut up its credit card

Without wishing to make political points at such a sensitive time, there can be little doubt that public sector borrowing must be cut sooner, rather than later. We now, as a nation, owe 62% of our annual gross domestic product; about 7% or 8% of this relates to the bank bailout - on which we may even make a profit, one day, but it has to be paid for now and money spent servicing this debt cannot be allocated to re-generation. Only by helping the private sector to generate more jobs can the economy recover. Some economists say that governments should spend their way out of recession, but this somehow assumes that public sector jobs are equivalent to private sector ones. They are not; they do not create wealth for the economy, and simply lay up additional debt, not least in the form of open ended pension commitments.

Individually we owed £1,464 billion at the end of February (latest data available) which is almost the same as at the end of January. This includes mortgages and represents £58,083 per household. Excluding mortgages, the figures are £225 billion and £8,920, respectively. Anecdotal evidence suggests that these figures reflect the fact that many people are choosing to repay borrowings.

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