Monthly

Economic Review

Economic review of: October 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.

One thing we can be certain about following the Spending Review is that it will take a very long time time before we know whether what has been called a "big gamble" has paid off. The latest GDP figures, while indicating a slowdown in growth for the third quarter of 2010 to 0.8%, are dramatically better than many economic forecasters had predicted and, since they are frequently revised upwards, we could be in an even stronger position than this result suggests.

Sometimes the effort can seem too much – but we must try

The debate will, nevertheless, continue between those who wish to see the state 'rolled back' and so-called 'Keynesians', who believe in spending their way out of a recession. Actually, as Lord Rees-Mogg writes in the Times (25th October), John Maynard Keynes was probably more flexible than this interpretation of his views suggests and might not have been averse to some cost cutting where it was essential.

Some will argue that the cuts were (variously): right/wrong; too much/too little/just right; fair (progressive)/unfair (regressive). What few people should be prepared to deny is that we simply cannot go on borrowing at recent levels and the coalition has at least tried to be fair, even if, in some areas, it may have missed the mark.

Selling off the family silver

Many people may have mixed feelings about selling off publicly-owned assets just to raise some money to cover current government shortfalls. After all, you can only do this once and the easy targets such as British Telecom, British Gas and so on have already gone. Now the coalition is preparing to off-load the Post Office, which has something of a chequered financial history; perhaps that is why Dr Vince Cable is looking at it becoming a mutual organisation, at least in part.

What, no silver spoon?

What is difficult to see is how this would benefit the community; ever since recently departed chief executive Adam Crozier took over at Royal Mail in 2003 (after a stint at Saatchi & Saatchi, followed by the FA), we seem to have seen the decline of this as a focus for local communities and a resource for the elderly in particular, who may find it difficult to travel to supermarkets, where so many Post Office counters now seem to be.

But more worrying by far is the state of its pension scheme, which has a massive deficit. The government has decided to sell off £26 billion worth of assets from within the scheme, while accepting that it will remain the taxpayer's responsibility to cover its liabilities, which are currently £34 billion – i.e. a shortfall of some £8 billion. This does seem rather like selling off the silver for a short term gain, whilst saddling future generations with a massive debt.

Thanks to a recent High Court ruling relating to BT, the taxpayer is already potentially carrying the can for that scheme's deficit, because a guarantee given to the scheme some years ago applies to new members as well as those in place when the offer was first made.

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

For the second consecutive month, the main indices we track are all in positive territory, with the exception of the Japanese Nikkei225 which is -2.15% down on the month. Despite some jitters over the Spending Review, the FTSE100 is 2.28% ahead over the month; in fact the day after the announcements it peaked at 5,786.70, almost 4.3% higher than at the end of September. The FTSE250 performed slightly better, gaining 2.96%, while the AIM continued to outperform both, as it has for the past three months, adding 4.12%.

The investment road is always bumpy!

The Dow Jones, which had been moving largely in line with the FTSE100, gained 3.06% during October, having escaped the slight downturn suffered by the leading UK shares towards the end of the month, while the Nasdaq100 was 'star

performer' gaining 5.86% during October. The Eurostoxx50 grew by a respectable 3.53%.

Looking at the last twelve months, the FTSE100 and Dow Jones are 12.5% and 14.47% ahead, respectively, while the FTSE250 and Nasdaq100 are both more than 22% ahead.

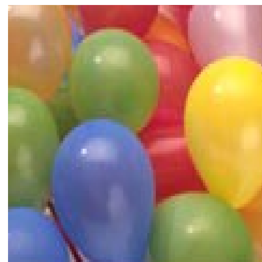
On the downside, the price of Brent Crude 1-month futures in oil is now 10.57% higher than a year ago, having risen by an additional 1.02% in October. Sterling is 2.26% lower against the US dollar than a year ago, despite rallying 2.06% during October.

Interest rates and inflation

Calls for the Bank of England variously to raise interest rates or increase quantitative easing (QE) may have receded in light of relatively encouraging third quarter growth figures. However, Monetary Policy Committee member Andrew Sentance continues to argue for a rate hike. He has now been joined as a dissenting voice from the majority line by Adam Posen, who (in common with the Institute of Directors) wants to see QE increased, fearing that we are facing the prospect of a 'lost decade' similar to that experienced in Japan during the 1990s. But David Smith, writing in the Sunday Times (3/10/10) suggests that simply pumping more money into the economy would be inflationary unless manufacturing is able to get hold of some of the money and increase output.

Interest rates round the world		
UK	0.50%	No change for 19 months
USA	0.25%	No change for 22 months
Europe	1.00%	No change for 17 months
Japan	0.10%	No change for 22 months

Inflation measured by the Consumer Price Index has been running above 3% for some time, while the wider Retail Price Index is higher still at an annual rate of 4.6%. According to Sentance, this is making the Bank lose credibility over its core task of managing inflation – as he points out, confidence could be severely damaged if consumers think the Bank no longer has the desire – or ability – to hold inflation in check. On the other hand, he argues, savers need to be given a boost and this could be achieved by tightening monetary policy (i.e. raising interest rates) gradually.

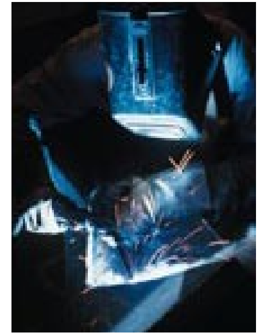


Is inflation beyond the Bank's control?

However, many commentators – including the Ernst and Young ITEM Club – believe that there will be no real change in interest rates for up to three years and that inflation will fall below its 2% target by January 2012.

Employment

One of the areas of the Spending Review that caused most comments – before and afterwards – has been the impact that it will have on employment. There can be little doubt that the cuts will hit public sector jobs hard; of course, the cuts will be phased in over time, but even so, it cannot all be down to natural wastage. There will be fewer opportunities for new employees to come on board to cover natural attrition, so the impact will be felt relatively quickly. While it is essential that front-line jobs are protected, it seems likely that those making the individual decisions will be tempted to protect their own positions – and those of colleagues – before moving the burden of cuts down the food chain.



More jobs needed to close the 'trade gap' as well as replace lost state jobs

Perhaps this is as well, because the tens of thousands of new jobs that the private sector is expected to create to fill the void may not be suitable for those with a 'public service' mentality. Who, for example, was responsible for the government signing irrevocable contracts for two aircraft carriers last year, in order to protect Scottish jobs? Not front-line workers, you may be sure.

As the Governor of the Bank of England has recently pointed out, the economy needs to create about half a million new jobs in the export sector, anyway, if we are to make up the gap between what we import and export.

Re-jig at the International Monetary Fund

It is, perhaps, unsurprising that China has finally (some might say about three thousand years too late) been admitted to the top table of world finance. The IMF is made up of 187 countries, working to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce poverty around the world. Its resources come mainly from the money that countries pay as their capital subscription when they become members and this upgrading of their membership (along with Brazil, India and Russia) propels them into the top ten shareholders for the first time.

Has the army been waiting too long?

Europe has given up two seats on the executive board to make way for the new entrants and ceded some of its voting power to developing nations. China is now the third most powerful country in the IMF, after the US and Japan. How this might affect the UK is difficult to determine, but it is to be hoped that China will eventually allow its currency to find a more natural level and facilitate even greater international trade.

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
It is important always to seek independent financial advice before making any decision regarding your finances.
If you would like any assistance, please contact us.
NOTHING CONTAINED IN THE ARTICLES SHOULD BE CONSIDERED AS GIVING INDIVIDUAL FINANCIAL ADVICE.