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Provident Solutions Monthly Economic Review February 2007

Interest rates if Japan doubled overnight – Shock Horror. OK, the actual increase was only from 0.25% to 0.5% so few people are likely to suffer. What it does tell us is that this major world economy is taking a positive view, and feels able to increase rates twice in a year, after so long at zero, without fears of damaging the economy. Of course a trade surplus that has sat above ¥1billion for the last two and a half years has probably got something to do with it.

Japanese interest rates are starting to thaw

As you will know, rates here have been left at 5.25% for a further month, although some are predicting another 0.25% rise within a month. This is because the Bank of England fears the spectre of continued inflation despite a fall in the Consumer Price Index (CPI) during January from the scary level of 3% to 2.7%, largely due to lower fuel prices. Many commentators believe that the rate will fall even further during this year, possibly dipping below 2%, largely due to lower gas prices. However a contrary view, which may be shared by the Bank, is that such savings could be balanced by higher import prices as Sterling falls in value and the Far East ceases to represent such a cheap source of goods, due to internal demands for better pay and conditions.

The current account (see below), which has been deteriorating for some time, is currently partly buoyed by a strong pound which encourages inwards investment, due to high interest rates. It could be that the Bank feels a further hike could protect sterling from weakening further than it has recently, in order to protect the inwards flow of capital. However, this cannot go on for ever; the more we depend on "invisible exports", the more exposed we are should capital start to flow outwards.

Personal indebtedness

According to recent data, personal insolvencies in the UK rose by 59% last year to more than 107,000, despite unemployment falling by 13,500 to a rate of 2.9% last month. To some extent this could be due to the increasing availability of individual voluntary arrangements; but household debt, which was £500 billion in 1997, is now almost £1.28 trillion. Of this, 17% is unsecured debt – which rose by 6.2% last year.

If, as expected, the cost of servicing mortgages rises to 6% later this year, it will be the highest level since the days of Nigel Lawson – we still had mortgage interest relief at source (MIRAS) in those days. If this is the case, falling inflation will hardly help middle class families, who tend to have heavy mortgages and are thus exposed to inflation that is not measured by the CPI. The RPI (which the government does not like any more) includes mortgage costs, but only on an "average basket" basis, which is why most higher-earners suffer a much higher actual inflation rate than the headline figures suggest.

Personal debt is at an alarming level

Current account weakens still further

The trade gap (the difference between imports and exports of goods) widened last year to £84.3 billion from £60 billion the previous year. To put this into context, it represents £5,600 for an average family of four people, flowing out of the county each year. Net.

We import far more than we export and invisible earnings do not fill the gap

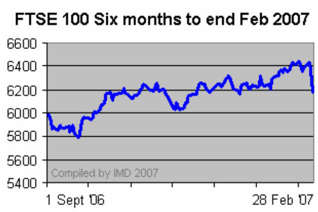
The balance of trade has been deteriorating for many years – it is a quarter of a century since UK was a net exporter of goods; since then we have relied on earnings from insurance banking and inwards investment to keep our balance of payments (or the current account) in equilibrium. However, during the past decade even this has proved inadequate and we have been a net importer of everything from goods to money.

To some extent, the financial security that Gordon Brown claims to have authored (at the expense of higher taxation and massive public spending) has encouraged inflows of capital and this is now more important than earnings from banking and insurance. Unfortunately, he is also vastly increasing regulation of the City and this could ultimately result in capital being withdrawn from London, as corporate bosses worldwide seek softer-touch regulation elsewhere.

It is partly for this reason many are concerned that the London Stock Exchange needs to continue as an independent body; should it be taken over by a US bourse, where regulation is even tighter, the inflow of capital could suddenly become a deluge in the other direction. Only the Americans or Europeans could win in such a scenario.

Markets

Equity markets were moving well throughout February … until the last few days. Tremors in the Far East rippled through world markets cutting values, although commentators feel this is a correction, rather than a long term trend. Time will tell.



The FTSE100 suffered a late fall along with many other markets

As a result, the FTSE100 ended 0.51% down over the month, giving it 12-months growth of 6.56%. The mid-cap FTSE250 fared a little better at 0.43% down, but has increased by more than 16.5% over the past 12 months.

Elsewhere, the Dow Jones finished the month 2.8% down, but is 11.6% up over the past year while the Nasdaq100 (1.94% down on the month) is almost 6% higher than this time last year. The Eurostoxx50 lost 2.19% during February but the Nekkie225 ended the month 1.27% to the good.

Oil prices rose by 7.82% during the month, reaching US$61.89 per barrel for Brent crude 1-month futures, putting the price roughly back where it was a year ago, and Sterling weakened against the Dollar (down 0.3%) and Euro (down 1.74%) during February.

Killing the high street

The internet is a great thing and excellent for finding information. The problem is that it can also be a great way of buying things – which more and more of us are doing according to recent statistics. These show that while the volume of goods sold on the high street fell by 1.8% in January, the value of good sold plummeted by 33.7% as retailers fought to retain market share against internet and other direct sales.

Should we be concerned? Well it depends on how you view society. For many people, a decline in the centres of towns and villages brought about by competition from the internet is a natural progression of the way people live. For others it is a very real threat to the fabric of our culture, where the shopping centre is a place to congregate and socialise as well as to buy.

It takes little stretch of the imagination to anticipate the closure of hundreds of shops with nothing to replace them except estate agents and mobile telephone outlets. Were this to happen, town centres could degenerate into ghettos occupied only by 'hoodies' and hooligans, where ordinary people – and even the police - fear to tread.

Buying online could damage the environment

Much needed employment, and the entrepreneurial spirit that built a 'nation of shopkeepers', are under threat from the internet. So, too, is the nature of our town centres. If we fail to support local businesses in the interests of saving a few pounds (to buy often complex products, sight unseen) we risk losing much that makes society what it is today.

It may make sense to use our cars less, going shopping on-line instead, but are we damaging the micro-environment more that we benefit the macro-climate?

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