

special update:

A perspective on 2010

by Mark Lloydbottom



The AB Series **SPECIAL UPDATE**

Recession, recovery and the future for businesses and individuals

In November 1949, Frank McNamara, head of the Hamilton Credit Corporation, and Alfred Bloomingdale met at Major's Cabin Grill, a well-known New York restaurant next to the Empire State Building. Over lunch, they discussed a problem Hamilton customer: someone who had borrowed money but was now unable to repay. At the end of the meal, McNamara was embarrassed to discover himself in a not dissimilar predicament. Reaching into his pocket to settle the lunch bill in cash, he found that he had forgotten his wallet. A hurried call to his wife solved the problem, but McNamara vowed never to allow the situation to arise again. With Bloomingdale and Ralph Schneider, his attorney, McNamara pooled a sum of money to invest in a new project.

On 8 February 1950, the three met again at Major's Cabin Grill, but this time they paid using their new business idea: the Diners Club card. No interest was charged on the card, but the balance had to be paid on receipt of the statement. The credit charge card was born. Some years later the Bank of America launched a credit card which allowed debt to be rolled over and interest to be charged. In 1966, the Bank of America licensed their system to Barclays who introduced Barclaycard and ready access to unsecured debt for millions of Britons.

Household debt

By 2004—40 years on—the nation's UK's household debt had exceeded £1 trillion. But in just four more years, that debt level had climbed by another 50 per cent to £1.5 trillion—debt that had, to a large extent, given rise to increases in corporate profits and partly fuelled the increase in stock market values.

Today many are in the grip of debt. By the end of 2009 households with unsecured loans or credit had amassed an average debt of more than £22,000. Meanwhile the Government's own debt, already substantial, has been further inflated by the £200 billion that has so far gone into the quantitative easing programme.

In 1992 the average household savings rate was 11.2 per cent of income, a rate that had reduced to about 3 per cent before the global financial crisis. At one point in 2009 the savings rate fell to zero before recovering to just over 5 per cent in the final months of the first decade of the twenty-first century.

The world-wide response to the global banking crisis has been to cut official interest rates, a move that provided relief to those with mortgages but, on the flipside of the coin, resulted in those with capital, especially those who depend on a return from their life's savings, having to accept a much lower yield on their money.

The backbone of long-term saving has been a pension fund or, increasingly, property, often through buy-to-let mortgages. Both have failed to deliver in accordance with expectations. The collapse in the market value of shares has pulled down capital values and interrupted investors' hopes of year-on-year compounded growth. Meanwhile property investors have seen property values decrease albeit against the backdrop of a stronger demand for rental property.

The nation's finances



As of the end of November 2009, the Government had borrowed to the tune of £830 billion, or 59.2 per cent of GDP; the planned budget deficit for the year is £178 billion. While most people appreciate that we continue to face unprecedented and onerous financial challenges, addressing the problem of

debt is an immense task, especially since, in the short term, the government continues to extend borrowing and to make limited endeavours to cap or reduce public expenditure. As a country, our spending on state benefits is now greater than the total amount of income tax paid; one in five households are on some form of housing benefit, while approaching one in six households are estimated to have no income from employment.

Are we coming out of recession?

While the likelihood is that the recession may have technically ended in the final quarter of 2009, following six consecutive quarters of contraction and the severest slump in modern history – as forecast recently by the CBI – the fact is that the additional spending power in the economy has, to a large extent, come from an increase in government debt and surplus household money produced by lower interest rates.

Unlike the last deep recession of the 1980s, now, the money entering the economy has often primarily been 'monopoly' or 'phantom' money – money that has to be eventually repaid.

Prospects - what lies ahead?

*This year sees a General Election. If the Conservatives regain power, we are told they will introduce a 'Budget for Growth.' The reality, as most commentators see it, is that in 2010 there will be one and maybe two **serious** Budgets.*

These Budgets will have to grasp the nettle of the harsh measures needed to deal with the economy's root and branch problems. In other words, the measures are likely to increase taxation, reduce public expenditure and reduce benefits; but also to introduce limited, targeted increases in certain areas in order to fulfil election promises.

The result of all these measures?

While it is never easy to predict outcomes, there is a strong risk that these measures could herald the second phase of a double dip recession as a combination of cuts in Government expenditure and a continuing trend among businesses and consumers towards saving and paying down debts dampens spending power in the economy. Efforts to tackle the UK's systemic debt could ripple through every business and household as well as the economy.



Interest rates

When will interest rates return to a more 'normal' level? No one knows for sure. Certainly, interest rates have reduced globally, though not universally. As other countries come out of recession, interest rates may start to rise. So long as interest rates remain low, people may be tempted to start incurring debt again and to up their spending; equally, while interest rates remain low, those who depend on their savings will continue to see reduced returns on their capital.

Planning action

How does the ongoing uncertainty of the economic outlook – bearing in mind that what you have read is no more than a perspective on the future – affect the action you should take in 2010? Planning, for every business and individual, is important at the best of times; in our uncertain times, it is imperative.

It is imperative because only with well thought through planning can you or your business face a 2010 that may or may not see us on the road to recovery. With planning, though, it will at least be a 2010 for which you are prepared.

There are a number of areas where we can help you plan. These include: cash flow management; profit enhancement; capital expenditure; debt management; and investment portfolios. Please don't hesitate to contact us for expert, professional advice and guidance.

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Mark Lloydbottom is an acclaimed commentator within the accounting profession