

News & Views



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Exceptional Times

In an exceptionally surprising year, it is probably not surprising that 2008's pre-budget report has mutated into a fully-fledged emergency budget containing measures to help the Treasury withstand the worst effects of the recession and kick-start the UK economy. The government is bringing forward £3 billion-worth of capital spending from 2010 and 2011 in order to boost the economy. Overall, they plan to inject £20 billion; however, these plans will create a massive budget deficit. The UK's borrowing will hit £78 billion during 2008 and £118 billion during 2009. Borrowing is forecast to fall to £105 billion from 2010 and to £54 billion by 2012.

From April 2010, those earning more than £100,000 will see their tax allowances cut in stages. In addition, from April 2011, those earning more than £150,000 will be hit by a new higher income-tax rate of 45%. Meanwhile, from 2011, National Insurance contributions will increase by 0.5% - although tax bands are being changed so that those on less than £20,000 pay no more. In a controversial move, VAT has also been cut temporarily, from 17.5% to 15% until the end of 2009.

The Chancellor expects the economy to grow by 0.75% during 2008 and to shrink by between -0.75% and -1.25% during 2009. By 2010, he anticipates that the economy will start to recover and should demonstrate growth of up to 2%, although comments from some independent bodies suggest that not everyone is quite so optimistic.

Welcome to the latest edition of News & Views. Financial headlines may not be the most comforting reading at the moment but please do get in touch with your queries or concerns. We are always happy to help.

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What is an MVA?

Market value adjustments (MVAs) are, for many, the devil in the detail of with-profits investing – particularly following their seemingly prolific use in recent years. The reason for their introduction was to help protect existing investors in the fund from shorter-term investors seeking to take advantage of the annual bonus and then selling out - they do not hold their investment long enough to earn the bonuses that are allocated to them. Because the unit price does not move directly with asset prices (as it would in a unitised fund), a specific adjustment needs to be made - or these investors would be walking off with existing holders' profits.

Heading towards recession

It's official: Britain is teetering on the brink of recession. After 16 years of uninterrupted growth, the UK economy declined by 0.5% during the third quarter of 2008, according to the Office for National Statistics. The economy's contraction was widely expected, but the drop was somewhat greater than many analysts had expected. Share prices fell heavily on the news, and sterling was badly hit, dropping to a five-year low against the US dollar. The Governor of the Bank of England (BoE), Mervyn King, has warned, "It now seems likely that the economy is entering a recession".

A recession is widely regarded as two consecutive quarters of negative economic growth. The UK economy neither grew nor shrank during the second quarter of 2008; however, if the economy contracts during the final three months of the year – and it is widely expected to do so – then Britain will officially be in recession.

Faced with the effects of the global credit crunch, high food and energy prices and falling house prices, the British consumer appears to be leading the economic downturn. The services sector is the single largest contributor to the UK economy; however, the third quarter of 2008 saw the services sector experience its first drop in 18 years, pulled lower by lack of demand in the distribution and hotels & restaurants sectors. Manufacturing, construction and transport also contributed to the economy's contraction. Government spending and agriculture, forestry & fishing were the only areas of the economy to demonstrate growth during the third quarter.

Prime Minister Gordon Brown has admitted that the worldwide financial slowdown is likely to lead to recession in the UK. Meanwhile, the Deputy Governor of the BoE, Charlie Bean, has described the situation as "a once-in-a-lifetime crisis", although he also believes that, "compared to the early 1990s, we are in a better position in that we [the BoE] are free to set monetary policy to try and stabilise the economy".

The BoE's Monetary Policy Committee (MPC) has incurred criticism for curbing economic growth by not cutting interest rates more aggressively. They finally faced their critics head on in early November by slashing 1.5% off rates to bring them down to just 3%, the lowest level in over 50 years. Whether this helps restore confidence in the UK consumer and reduce the effects of the slowdown, however, only time will tell.



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