



Budget 2010 – Belize, pot holes and £167 billion

Well what a damp squib.....

....again

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To be fair Mr Darling's job was close to impossible. There will be an election in a few weeks and a true austerity budget à la Ireland / Greece would have been political suicide for the Labour Party. A Budget based on borrowing coming in at "only" £167 billion and giving away the "surplus" £11 billion would have been rightly greeted with derision by both opposition parties and electorate. Plus influential figures keep coming up with quotable phrases about the UK gilt market and the likelihood of Moodys and the other agencies downgrading our credit rating.

The £167 billion figure is just vast. Many of you will remember when Dennis Healey went to the IMF in 1976. He came away with £2billion. Yes I know - inflation and economic growth since then - but it is still a huge chunk of national wealth. There was not a huge amount of commentary on this in the speech itself. Predictably the talk was of Stamp Duty and even Belize - electioneering.

Having now reviewed most of the papers, there is not even a huge amount of detail in the supporting documents.

The most (only?) interesting item that I have found so far was hardly mentioned in the speech. The UK Debt Management Office (the organisation that deals with the issuance of gilts) is going to issue more index linked gilts and more long dated gilts than it has done in the past. This is interesting and I suspect shrewd. There is a huge amount of debt that needs to be financed and the DMO believe that they can persuade the market to lend them the money over the long term and are willing to offer an inflation guarantee. One conclusion is that the government thinks this will be a cheap way to finance debt. They think that inflation will stay low, or perhaps that interest rates will rise. Somehow I doubt this was the primary motivator; that sort of long term thinking has with some glorious exceptions been almost completely absent for years. More likely the government are nervous about avoiding a Greek style crisis (will anyone buy the gilt at any price? though in the event someone did)



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and calculate that pension funds particularly with their huge index linked pension liabilities will be forced by a combination of legislation and actuaries to buy stacks of index linked gilts almost regardless of the price. Nothing is guaranteed. The UK is not the only government debt issuer that offers inflation linked debt. The need amongst so many Western economies to finance government debt must put pressure on government bond prices.

You may want to know how all the new Budget measures are going to affect your way of life. Well the answer is that they will not affect you much at all in the short term.

Strong scrumpy drinkers have been hit hard with a 10% hike in duty. Smokers and drinkers have been hit again with increases above inflation and more to come. The absence of increases in allowances is effectively an increase in taxation by stealth as long as we all agree that inflation is positive.

The widely forecast increase to Capital Gains Tax did not appear and Entrepreneurs Relief (a relief for business owners) was doubled to £2,000,000. Good news but watch out in the next Budget – income tax at 50% (or 60% depending on how we do the sums) and Capital Gains tax at 18% is unlikely to be a long term option. (Not relevant for most wealth management clients but the destructive pension changes announced last year will all go ahead)

All the previously announced income tax measures were confirmed. Trustees and other 50% income tax payers must consider how to organise their portfolios tax efficiently.

The freezing of the inheritance tax nil rate band for four years is nasty. The number of households liable to inheritance tax will rise again. There are pages of press releases on anti (tax) avoidance but as we have mentioned before there are a good selection of non aggressive planning techniques that can be used to reduce your estate's potential inheritance tax liability. The secrets are not to start too early and not to leave it too late. And please remember that taking out life assurance policies reduces your estate by precisely 0p and usually generates profit for life assurance companies. If we had an accurate notion of our date of death we could plan with more precision.



If your children or grandchildren are buying property then they will escape stamp duty if they are first time buyers and purchase at less than £250,000. And stamp duty on houses over £1,000,000 rises to 5%.

The various other points from the Budget are really only of passing interest to wealth management clients. The ISA limit is going to rise each year in line with inflation. The annual investment allowance for smaller businesses has been doubled to £100,000. None of these are very interesting.

The key question for clients and markets was really “Has the Chancellor come up with a credible plan to manage the debt mountain?”

Markets would like to see how the UK is going to pay back the money it has borrowed. They would like to see what combination of taxation increases and spending cuts are going to be made that will give UK plc a good chance of steady growth. And of course this is a debate that economists enjoy because there are multiple variables. We still do not really know in any scientific sense whether fiscal tightening is the correct tactic. Perhaps fiscal tightening exacerbates the situation because tax revenues fall faster than government spending. There was the letter to the Sunday Times on Valentine's Day signed by 20 extremely eminent economists which argued that the structural deficit must be cut and cut quickly. This was followed on 18 February by a letter to the FT signed by 64 extremely eminent economists which argued, roughly, the reverse. While there is some humour in here it is also a desperately important debate. We simply do not have the data. Keynesian economics sometimes seems to be back in fashion which suggests spending our way out of a recession. But in the UK in the early 80s deficits were cut during the recession and we popped back out onto the growth path.



The absurdly powerful rating agencies seem to like the concept of debt reduction. Take tough medicine now to get better quickly.

Despite a one hour speech there was not a lot of new information in the Budget. The widely trailed actions were confirmed. The projections are optimistic and detail of the cuts is scant.

Where does all this leave investments?

The markets' initial reaction was a dip and then a recovery. Housebuilders led the recovery; perhaps they expect the removal of stamp duty for our children's first foray in the property market will assist their fortunes.

I expect that we are in for volatile times. We do not really know whether we should be cutting deficits or spending our way out of a recession. Markets do not like uncertainty. We do not really know what the

plan is for the next year or so because post election whoever is in power is likely to have a mini or emergency Budget. More uncertainty. As the opinion polls see the clear Tory lead whittled away a hung parliament begins to look at least more likely than a few weeks ago. Yet more uncertainty. And with election and mini Budget to come, Moodys and co may downgrade the UK credit rating in which case interest rates throughout the market will rise. Finally, even based on optimistic assumptions about economic growth and vaguely sketched out "efficiencies" government debt is still going to be £74 billion in 2014 and that is still a big number. Using these rose tinted assumptions the ratio of public sector debt to GDP rises until 2014/15. Yes, these are uncertain times.

Stockmarkets rarely reflect current economic conditions. They are at the most basic level meant to be forward looking. If the paragraph above leaves you wondering why you should own equities and property I offer two answers:

1) Timing markets does not work in any consistent manner. Timing markets is far higher risk and more expensive than buy and hold. Equities and property have historically provided good returns over long time periods

2) Look at the demographic data on India and China. The globe has a huge supply of young ambitious labour and those two economies do not have the ghastly worker to pensioner ratios with which the Western world is saddled. The engine of growth will move East and international businesses know this and plan to profit from this move.



PS Your inbox is probably full of Budget Summaries and Budget Commentaries. For other Hillier Hopkins commentary including our managing partner's irreverent analysis try <http://www.hillierhopkins.co.uk/blog>

For more information on any of the issues raised please contact Ben Sherwood on 01442 220713.

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