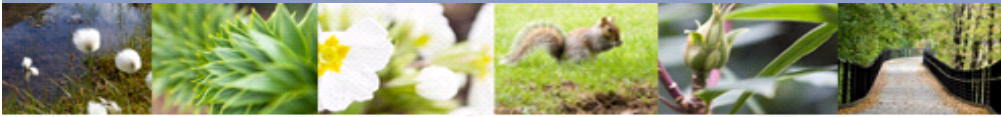


# News & Views



Autumn 2010

## Inflationary pressures rise

UK interest rates have now remained at their all-time low of 0.5% for over a year. The UK appeared to creep tentatively out of recession but the new Government is now anxiously looking at ways to cut costs without derailing a still fragile recovery.

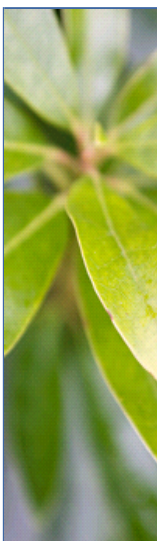
However, the UK Consumer Price Index (CPI) was still 3.1% in July. In his most recent open letter to the Chancellor of the Exchequer, in May, the Governor of the Bank of England (BoE), Mervyn King considered these levels to be the result of "temporary factors" and suggested inflation will fall back below the Government-set target level of 2% "within a year". Even taking King's explanation for the rise into consideration, it is worth remembering the CPI rate is still 50% higher than November 2009. Indeed, only a few months ago, deflation seemed the more credible risk. In normal circumstances, the BoE would increase the cost of borrowing in order to cool inflation. However, rates are unlikely to rise in the short term because policymakers fear higher interest rates could endanger that economic recovery.

Low interest rates are generally good news for borrowers, but are bad news for savers, who have already endured a year of exceptionally low interest rates. Returns on cash are meagre and relatively high inflation is eroding the real value of cash. At least in the short term, Britons face the combined problems of high inflation and rising taxes, both of which will put additional – and unwelcome – pressure on disposable income.



Welcome to the latest edition of our newsletter, our update on developments in the world of financial services.

If you have any questions about the issues raised in this issue, please do not hesitate to contact us.

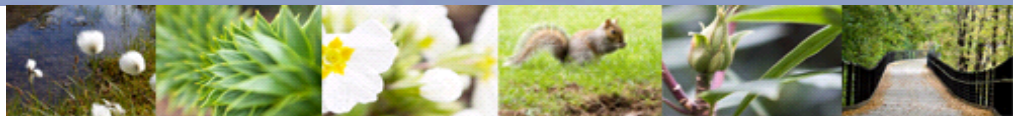


## What does it mean?

What does our new coalition Government mean for your financial plans? The UK economy is running an unprecedented deficit so we always knew that somewhere, one or two taxes would rise. In the spirit of compromise, there has been no imminent rise in the Inheritance Tax threshold and the priority instead appears to be an increase in personal income tax allowances. Alongside, however, the Chancellor has increased the rate of Capital Gains Tax for higher rate tax payers and given notice of a rise in Value Added Tax from next year. This comes alongside some significant cuts in public spending, the full details of which are only just emerging. Time to start a review of your plans to make sure they can adapt.

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## Mitigating income tax

Benjamin Franklin's view that nothing is certain except death and taxes has yet to be disproved.

However, using the tax allowances granted by the Government can help mitigate one side of that equation. For income tax, everyone gets a personal allowance. Therefore, if your spouse earns less, it makes sense to transfer, say, investment income into their name to use their full allowance as well as your own. Income tax can also be offset by payments into a personal pension or through Gift Aid to a charity.

Alternatively, you can reduce what you pay on investment income by using a tax efficient wrapper such as an Individual Savings Account to shelter your savings - and thereby remove any income they earn from your liabilities.

## The Coalition settles in

The UK's new coalition Government may not be quite what investors would have wished for but, then again, it is not as bad as they might have feared. Nevertheless, this is uncharted territory, with the UK coping with an economic crisis and a political set-up not seen for at least a generation. As such, one key area to consider is the likely impact on financial assets.

First up, it has to be said that some measure of certainty is welcome. Markets hate uncertainty and the mere fact that a Government has been formed has allowed them to concentrate on other areas – not least the crisis in the eurozone. The pound has seen a small rally against the euro since the election, though this may be more a function of the potential weakness across the Continent than a vote of confidence in the new administration.

A more certain Government is good for gilts, as is the fact all the major rating agencies have announced the outcome of the election has not changed their view on the outlook for the UK. Even so, many other problems persist. Over-supply continues to be an issue and the rating agencies may not remain so benign if credible steps are not taken relatively quickly to deal with the deficit. In that respect, the cuts announced in the Budget are definitely a step in the right direction, as long as they do not cause too much upset in their implementation.

It is difficult to make a case for any rise in interest rates in the short term and most forecasters are predicting only the smallest if any hikes before the end of the year. With tax rises and public spending cuts on the horizon – plus deflationary pressures, such as unemployment, still at work and sterling stronger – any interest rate rise could be crippling for the recovery. The Bank of England has indicated rates are likely to remain low for longer than the market appears to expect but, of course, this does mean that income seekers will have to continue to seek alternatives to cash.

For their part, equity markets have more to worry about than the UK election. They are, it seems, more concerned with global growth prospects and the eurozone crisis than they are with the domestic politics of the UK. With two-thirds of the FTSE 100 earnings coming from outside the UK, this is certainly a more appropriate focus. As if to reinforce the point, BP's Mexican Gulf problems have weight on the FTSE 100 Index far more than any political concerns. As the Government settles down to real business, however, what happens next is difficult to predict.



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