Bulletin

KMG CHARTERED FINANCIAL PLANNERS
SERIOUS ABOUT WEALTH

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An economist looks ahead to 2022

By **Julian Jessop, Independent Economist**
www.julianhjessop.com

Julian Jessop is an independent economist who attends meetings of the KMG Investment Committee, speaks at our seminars and is widely reported in the national press

The issues that were at the front of investors' minds at the end of 2021 – including Covid, the cost of living, and the prospect of higher interest rates and taxes – are likely to remain hot topics next year too. Hopefully, though, the news will be better, or at least not as bad.

In the short term the big unknown is, of course, the evolution of the pandemic, and especially the impact of the new Omicron variant. The early signs are that Omicron is more transmissible, but less deadly, which would fit the normal pattern as viruses mutate. Most experts are also confident that the existing vaccines will provide good protection. However, there is little hard evidence yet, and renewed uncertainty is bound to contribute to fresh market volatility.

There are two main risks to the UK economy. One is that the tighter self-isolation rules for those in contact with someone testing positive for Omicron could trigger another 'pingdemic', disrupting schools and businesses in the crucial pre-Christmas period.

The second is that concerns about the new variant could undermine consumer and business confidence, and thus reduce spending, even without an official 'lockdown'. There are already reports of cancelled Christmas parties and of holidays being put on hold again. However, throughout the pandemic the UK economy has shown that it is remarkably adaptable and resilient to shocks. The UK also starts from a better position than many European countries, which were already reimposing lockdowns in response to a surge in cases of the Delta variant.

In the UK, by contrast, more people appear to have acquired a high degree of immunity due to past infections or from the vaccine booster programme, and both hospitalisations and deaths remain mercifully low compared to previous waves. This suggests that Omicron will only be a bump in the economic recovery, rather than something that derails it completely.

Instead, the greater threat may come from supply chain problems and soaring costs, which have raised fears of 'stagflation'. Here it is worth stepping back and reminding ourselves why these are live issues in the first place, and this is mostly a 'good news' story. The overall level of economic activity in the UK is already back close to where it was before the pandemic struck, which is a year or two sooner than many had anticipated. Far fewer jobs and businesses have been lost than feared, reducing the risk of long-term scarring to the economy.

The picture is similar in other major economies, including the US and the euro area, and across Asia. The pick-up in price pressures is therefore at least as much about the strength of demand as a lack of supply. Put another way, if economies were still mired in recession, we would have bigger problems to worry about than inflation.

What's more, the UK is not yet in 'stagflation' territory. This can be defined as a state of 'persistently high inflation combined with high unemployment and stagnant demand'. Breaking this down, consumer price inflation is heading for around 5% in the UK, and has already hit 6% in the US and Germany. But these levels are still much lower than the rates of more than 20% seen in the 1970s.

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An economist looks ahead 2022 continued

There are also good reasons to doubt that inflation will 'persist' at these levels beyond the middle of 2022. The largest upward pressure has come from a rebound in global energy prices, which are now levelling out.

Other big increases typically reflect supply shortages that should resolve themselves over time, such as a lack of semi-conductor chips to make new cars, or drivers and crew for trucks and ships. The latest business and consumer surveys also suggest the UK economy is weathering these problems relatively well, despite the additional headwinds from Brexit.

The 'high unemployment' and 'stagnant demand' parts of the traditional 'stagflation' story are missing. Of course, rising prices could choke off the recovery in consumer spending, but for now at least the strong jobs market appears to be off-setting fears about inflation.

That said, it is too soon to sound the 'all clear'. Inflation is likely to remain higher than many have become used to. Indeed, the 'transitory' price pressures all seem to have been larger and longer lasting than expected. As time goes by they are harder to dismiss and more likely to become embedded in the economy as decision-makers start to take higher prices for granted.

The labour shortages may also persist, as older workers reassess their priorities after Covid and retire early, adding to the pressures from a decline in international migration and an ageing population. In the meantime, there are already signs that underlying wage and price pressures are picking up, even as energy prices drop back. This means we may have to become used to higher interest rates too.

There is not much that central banks can do, or should do, about inflation in the short term. However, they can help to prevent a temporary increase in inflation from becoming permanent. This means ending their policies of 'quantitative easing' (printing money to buy government bonds) and starting to return interest rates towards more normal and sustainable levels which could also contribute to market volatility, but it makes sense to look past this.
Central banks are only likely to take the foot off the accelerator, rather than slam on the brakes. Interest rates and government bond yields can therefore be expected to remain near historic lows – especially 'real' rates, after allowing for inflation.

Any policy shifts are also likely to be gradual and signalled in advance, allowing markets to take them in their stride. The sanguine response to the US Central Bank's announcement in November that it will start tapering its asset purchases is reassuring here.

Context is crucial as well. Central banks will be responding to a combination of stronger economic activity and higher inflation (which for some companies at least means more pricing power). Improvements in these fundamentals will matter more for the valuations of most assets, especially equities, than small changes in monetary policy.

A premature tightening of fiscal policy could actually be a bigger risk. The significant increases in personal and corporate taxes in the pipeline could yet undermine the recovery in the UK economy. However, faster economic growth should go a long way towards repairing public finances and reducing the pressure for further tax hikes.

In conclusion, we may already have reached 'peak fear' over stagflation. Nonetheless, investment strategies need to account for the prospect of higher inflation and higher interest rates, particularly in the UK and US. In the meantime, new Covid variants will continue to create volatility, but the success of the vaccination programmes is reassuring. Investors should therefore continue to take a longer and more strategic view, rather than try to second guess every market move.

Important reminder about Trusts .....

Please be aware there is a new requirement for all Trusts to be registered by 1st September 2022 to ensure as Trustees you comply with new anti-money laundering regulations. Information was contained in our last publication. The link to register can be found here :-

https://www.gov.uk/guidance/register-a-trust-as-a-trustee

If you have any queries we will be happy to help you so please do not hesitate to contact us.

Fertility and Childbirth

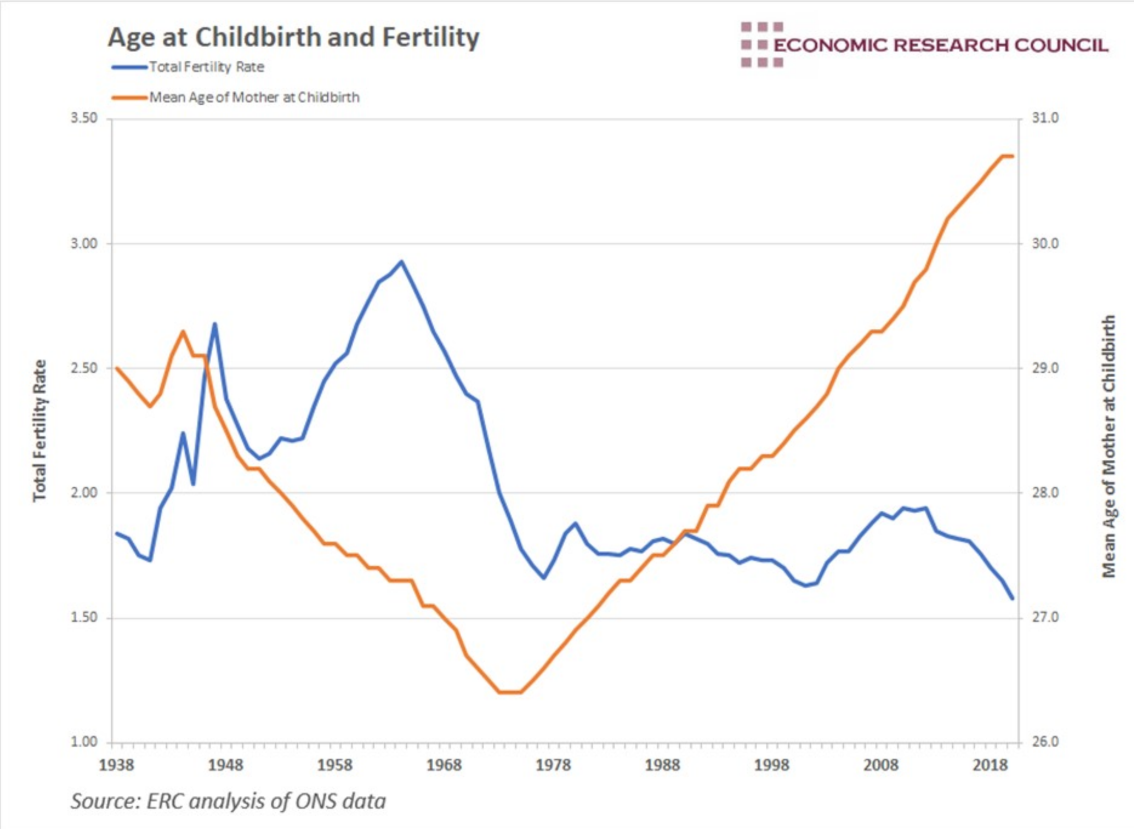
By **Nick Matthews**
nick@kmg.co.uk

Amongst the many hours and days that our Investment Team spend interpreting and identifying ideas or notions about what the future might hold, we periodically find some really helpful work by others that helps to illustrate our own thoughts. We thought it would be worth sharing this one with you, put together by the Economic Research Council. We have been talking about the trends in global demographics as being a fundamental change for humanity for some time now. This is something that can be seen decades in advance, and which has now been exacerbated by Covid; not just through the dreadful death toll, but in the behaviour that seems to have resulted. In other words, people across much of the World are having fewer babies.

Although the mere fact that fewer babies are being born is important, it is the effect of this socially and specifically on investment and economic growth that is relevant here and on how we look to put your money to work.

Summary:

Fertility rates are at historic lows whilst the average age of childbirth has been on the rise since the 1970s. This chart assesses the likely effect of this on individuals and society.



What does the chart show?

The blue line denotes the total fertility rate. This is the average number of children women would bear if they experienced the age-specific fertility rate each year throughout their childbearing life. This is read from the left-hand axis. The orange line displays the mean age of women at the point of childbirth and is read from the axis to the right.

Why is the chart interesting?

The chart shows total fertility rates at a record low in 2020, with women on average bearing 1.58 children. This continues the declining trend of fertility rates, falling for 5 years in a row in England and Wales. Interestingly, the total fertility rate has been below the replacement rate since the end of the baby boom in the early 1970s.

Several factors have been put forward for the decline in fertility rates. Firstly, access to contraception has become more widespread over time. Secondly, infant mortality rates have significantly reduced in England and Wales, falling from around 18 infant deaths per 1,000 live births in 1970, to under 4 per live birth in 2019. In addition to this, the orange line suggests postponing childbirth has also potentially led to lower levels of fertility.

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Fertility and Childbirth continued ...

This trend is set to continue. The Centre for Population Change has predicted a "decline over the next three years leading to significantly fewer births annually".

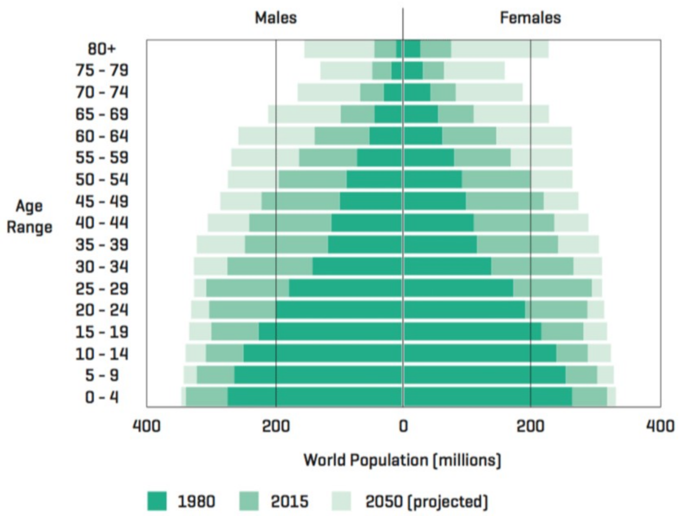
The orange line displays the incredibly sustained trend of rising average childbirth age, at 30.7 in 2019, up from 26.4 in 1975. A major factor in this is the growing financial consideration surrounding childbirth. The Child Poverty Action group has suggested a cost of £71,500 to raise a child to the age of 18. In addition to this, the average cost of nursery for 25 hours per week stands at £6,800 annually. This is all in the context of childcare costs rising 4 times faster than earnings in the UK, and 7 times faster in London between 2008 and 2016. Coupling this with rapidly rising house prices makes it easy to understand why people are waiting longer to have children.

These ideas have been shown to create further effects. As discussed above, a higher mean age of childbirth is likely to impact fertility rates, and potentially impact future population growth. Despite this, other effects occur at an individual level. Women who give birth later tend to have higher lifetime earnings than those who give birth earlier. They also tend to have accrued more experience and can rely more on in-work entitlements than women who have given birth earlier.

Low fertility levels may not be at the forefront of policymakers' minds for now, but it does have the potential to pose serious economic issues. Falling fertility rates coupled with an ageing population will eventually put considerable strain on public finances, reducing tax receipts whilst increasing spending on social security. These issues have already started to impact countries like Japan, where over a third of the population will be over 65 years old in 2030.

Why are we so interested?
As the final statement above explains and because this trend is not just in the UK. Even India, which has been one of the population growth centres, recently announced a birth rate of 2 (children per women) which is below the rate to keep the population stable. This leaves just Africa where the population continues to expand.

Many of the reasons are the results of fantastic advances – in nutrition, medicine, public health, education, rising wealth etc – but it does mean that the future economy is going to be very different to the past. An ever-growing work force supported a smaller retired population but we now can expect just the opposite: an ever smaller number of working people on the planet compared to those retired and ageing. See the chart below showing current trend but we expect the 1980 triangle to invert.



In 1960, the vast majority of the World's population was under 65. By 2050, the predicted numbers are drastically different. The numbers are all bigger as population swells (before falling later in the century), but as a ratio it is that there are a lot more people not working compared to those who are.

Pre Covid we were watching a significant increase of over 65s staying in the workplace (perhaps as the state pension was raised) and yet it would seem that this is no longer the case, with many older people deciding they can get a better balance in their life by forgoing the extra holiday and avoiding health issues. It has exaggerated workforce problems at a time when travel and work restrictions were already making life difficult.

As the trend advances just how does the Government collect the tax to meet the ever-growing demand we make for the services we have come to expect from the State. Relatively too few people working makes this challenging to say the least.

So, the risk is that we simply run out of money and active people. The economy will change as a result. It will, along with climate change, be just about the most important trend in the generations ahead. It will create opportunities as it does.

Companies that become more productive and that adapt to the zeitgeist of the moment (something Tesla and Apple have done so successfully) will shine. Those that don't will have their Kodak moment (a company that did not adapt and disappeared). That is the challenge moving forward, and why we are moving your money in the direction that we are.

The confused state of the state pension

By **Christine Norcross**
christine@kmg.co.uk

There are many challenges when thinking about later life and retirement but preparing the landscape for an enjoyable retirement is both necessary and challenging. The conversations need to happen before the event to be of any use!

This bulletin piece will focus on the state pension because more people need to be aware of the benefits of this and how to maximise them. In polls it appears that fewer than 20% of people actually know how valuable a benefit the state pension is and understand that they would need to have an investment of between £250,000 - £300,000 to fund a similar pension income! Not only that but the state pension is a guaranteed and rising income by a **minimum** of 2.5% a year.

The current maximum pension amount is a payment of £179.60 a week, £780.94 a month, £9,371.27 per year. (There are however, some people lucky enough to have earned higher benefits in the past, which could see them receive an amount higher than this.) It is paid weekly from the Government when you reach state pension age. Current state pension age is 66 for both men and women. This will gradually be phased to age 67 and then 68 as time goes on, so you can understand that there is confusion as, of course, the state pension is subject to Government review.

In our office we were shocked to learn that a study conducted in 2019 by the Department of Work and Pensions showed only 44% of pensioners received the full amount payable. That is a huge number of people missing out!

It is important to note that the state pension is based on National Insurance contributions and qualifying years are built up over your lifetime, largely by working but also credits can be applied in relation to certain criteria. **Some credits are not applied automatically and need to be claimed.** It is our recommendation that everyone below state pension age checks their pension forecast, challenges any gaps in contributions and considers the option to top-up missing years' credits. 35 years of full contributions are required to gain the maximum pension. If you are not quite there when you reach state pension age you will qualify for a proportion of the pension payment. I.e, if you have 20 years of contributions your pension will be 20/35ths of the payment, and so on.

You can go online for a forecast, and you should be warned that in all things Government Gateway, you should exercise a degree of patience(!) It is possible to go from registering for a Government Gateway to receiving your pension forecast within 10 -15 minutes if you have the right documents to hand to speed things up. I recommend having to hand a device to log in with, a mobile phone, one copy of a current photo ID such as passport or driving licence and a payslip or similar, plus a hot cup of tea - essential.

Please go online using the following details and let us know if it raises any questions for you.

https://www.gov.uk/check-state-pension

Seasons Greetings and warm wishes for the New Year from the KMG Team