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MONEY BOX

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LEWIS: Hello and welcome to this Christmas Eve Money Box special. We'll be looking forward, and occasionally back, on the key financial topics: inflation, house prices, mortgages, pensions, interest rates, investing, saving. But before we come to any of those, it's almost 10 years since the first crisp Euro notes came out of cash machines on 1st January 2002 across the countries then in the Eurozone, and Money Box was there.

LAUNCH OF EURO 1ST JANUARY 2002: (*Fx: Fireworks*) With the fireworks still going off in the square in Florence, we're now going to take our Euro out of the machine and try and buy a drink. Okay, so I'm buying a cappuccino in Euro. He's tested the note in a little machine to check it's genuine and he's going to give me my change. I'm getting the change in lira. (*laughs*) That's your first transaction in Euro, but I've got to have lira!

SALESMAN: I am sorry.

LEWIS: You have no change?

SALESMAN: No.

LEWIS: Grazie.

Well 10 years on we might see the Euros converted back to lira, you never know. The only thing deep and crisp and even is the mess the new currency's in. So let's start today's discussion with Justin Urquhart Stewart who's a Director of Seven Investment Management and a Euro watcher for many years. Justin, will the Euro outlive 2012?

URQUHART STEWART: Paul, I think there's a very good chance it probably will, but probably not in the same form. This has been a disaster waiting to happen for the past decade, in fact probably two decades if you go back to its origination. Why? Well because you've got 17 different economies rammed into one currency, and unless you actually run that with a discipline that, say, we had with the pound throughout the whole of the United Kingdom, it isn't going to work. So I'm afraid when you've got economies as disparate as Greece, Portugal and Germany, I'm afraid there's going to have to be some change. So the Euro will be there, but not as we know it today.

LEWIS: People did say that though, didn't they, from the start, but they were completely overwhelmed - and I have to confess I was very excited getting those notes out 10 years ago - they were overwhelmed by the whole of Europe saying no, it will work, it doesn't matter.

URQUHART STEWART: There was a great euphoria to it, it was very exciting - a brand new currency right from scratch - without necessarily looking at actually the underlying rules, a lot of which were laid out in treaty, in the Treaty of Maastricht. But one by one every single country - apart from Luxembourg - decided to break the rules, and no-one decided to impose them until well finally now when Mrs Merkel is now trying to actually get them to actually fall into line.

LEWIS: So what will happen? You say a different Euro. Will we see them using drachma in Greece or pesetas in Spain or even lira in Italy?

URQUHART STEWART: Well I wonder if you hung onto those lira from 10 years ago. They may come in useful. No, I suspect actually the likes of Italy may still be there in the Euro; but, no, when you look at maybe Portugal and Greece there's a

reasonable chance that what you end up is a sort of Neuro, a sort of Northern Euro of the core members. And the others probably default to a form of Euro Lite, as it were - a sort of Euro with an olive pip on it or something like that. A bit like the Totnes pound.

LEWIS: Malcolm McLean from Barnett Waddingham, an actuaries - you're a consultant there - what do you see the future of the Euro? Is it going to really disappear?

McLEAN: I'm struck by the notion that I heard somebody say the other day that good intentions don't always result in good practice, and that's certainly the case here. I'm sure the people who set up the Euro thought it was a good idea at the time, but in practice, as Justin says, it just hasn't worked, and it does require the strong countries such as Germany to support the weak ones such as Greece and I don't see any inclination really that Germany's prepared to do that. So I think, for the foreseeable future anyway, there needs to be something dramatic happen to save the Euro.

LEWIS: The other big story of the year, which threatens 2012 as well, is of course inflation. It's been pretty much 5% - whichever of the two official measures you use. At that rate, the value of money halves in about 13½ years, so if you've got £1,000 in the bank now, by June 2024 it'll buy what £500 will buy today. The Bank of England of course says the rate will fall. We'll see. As ever, the bank's long-term forecast and that of the Independent Office of Budget Responsibility is that the consumer prices index will fall to 2%, though the forecast for the retail prices index - inflation in the more old-fashioned way we used to measure it - is that it will fall and then drift up to around 4% by the end of 2017. RPI inflation, as I said, has been around 5% for well over 18 months. So how has a year of high inflation affected people?

MALE 1: Gas, electric, etcetera, food, transport. Now I'm going to have to really start cutting back.

MALE 2: It's been very much more noticeable with fuel. But when going out

shopping as well, supermarket shopping, the prices have been a little bit more expensive than they were last year, definitely. I'm trying to use my car as little as possible. We've probably down branded on the things we get, so where we'd usually get the branded names, we're now going for more like the supermarkets' own brand.

FEMALE 1: Buy cheaper. (*laughs*) I go to cheaper shops.

FEMALE 2: I've noticed that inflation has gone up, but it hasn't affected me that much personally because interest rates and stuff has come down, so the cost of living is a bit cheaper for me personally.

LEWIS: Well that was some thoughts of shoppers in West London this week about inflation. It's supposed to be controlled by the Bank of England who raise interest rates when inflation's high, damps down demand, and that cuts prices. Or of course when inflation's low, it's supposed to cut interest rates. But Justin Urquhart Stewart, with interest rates at half of 1%, there's not much further they can go, is there?

URQUHART STEWART: Not really. People have been talking about more cuts, but frankly it doesn't make any difference at those levels. When you talk about the rates that people are paying on their loans, they're nowhere near that. They're much higher because the cost of loans has been rising. No, overall prices have been going up and pay in real terms has been going down as people find themselves being squeezed. But of course politicians quite like inflation for the reasons you said earlier. Effectively the money is devalued over a period of time, and with our level of debt that's quite useful.

LEWIS: And Jane King's here. She's a consultant with Ash Ridge Asset Management. Jane King, somebody there was saying though that inflation was okay because interest rates were low and they've got more money because their mortgage is cheaper.

KING: Well as part of what I do, I sit down with borrowers and we have to go

through their affordability quite carefully, and it would appear to me that people are now actually very seriously considering what they're spending their money on. They are reducing their fuel consumption, they are taking the car out less and less, and so I think if that happens countrywide, UK wide, inflation has got to fall back. Supermarkets will continue to cut prices and I think inflation will start to fall back next year.

LEWIS: You think it will seriously fall because the Bank of England seems to be saying it'll be way down by the end of next year?

KING: I think it will fall back. I think people have realised now that they actually have to do something about what they're spending their money on.

LEWIS: Malcolm McLean?

McLEAN: I think inflation is a major problem for pensioners actually. I don't know any pensioner who thinks that they're adequately covered by the increases they get on their pensions by the consumer prices index - if that's the index that applies, as it is doing at the moment. And also it's a problem for those pensioners who rely on interest from their savings to top up their pensions and other forms of income, which again at traditionally very low rates like this, it just means that the value of their savings is going down all the time. And obviously this is not something that they counted on when they first planned their retirement and decided to invest their money with a view to getting this extra income to top up what they had coming in from their pension and elsewhere.

LEWIS: Yes and indeed that's the perfect time to talk about savings. Inflation is the death of savings. Throughout 2011 savers were hit with the double whammy of high inflation with low interest rates. And here are some more thoughts from our London correspondents.

MALE 1: I think that the low interest rate regime is a great mistake. I think there's a

lot of people like myself who've retired who obviously suffer from very low returns.

MALE 2: My bank account, I actually have I think it's about 3% interest if you keep the balance over a certain amount. That is quite good compared with you know quite a lot of building societies.

MALE 3: Anybody who has to have a loan out unfortunately pays high rates. Anybody got money in the bank gets nothing. So it's bankers winning again, isn't it?

FEMALE 1: I'm broke. No savings. I'm broke.

LEWIS: *(laughs)* Well that was some thoughts from a local shopping centre earlier this week. Time to bring in Rachel Thrussell who's Head of Savings at the price comparison site Moneyfacts. Rachel, we heard some people getting good returns; others of course getting very low ones. How low have saving returns gone this year?

THRUSSELL: Well the average rate last week when inflation came out, we looked at an instant access account and it was 0.93, but there's an awful lot of accounts out there paying sort of 0.01 or 0.1.

LEWIS: Yes, you might as well say nought really at that level, mightn't you?

THRUSSELL: Well yeah. There are even a couple paying nought, so you give them your money and they don't give you any interest.

LEWIS: Yes, not quite as bad as putting it in a Swiss bank, which I think was paying negative interest rates at one stage this year. Has that got worse during the year as interest rates have stayed pretty flat?

THRUSSELL: Well there has been a lot of competition obviously from the banks needing to boost their balance books, so with a low interest rate you would expect to see rates quite low, but they are artificially high at the moment with all the big

bonuses that are on account. So I mean we've got bonuses up to sort of 2.7% for a year, so they artificially increase the rate, so it looks like there are some good rates out there but in a year's time obviously they'll fall back to about 0.5%.

LEWIS: So that's the familiar rule that we've talked about very often with you, isn't it?

THRUSSELL: Yeah.

LEWIS: That you have to move your money every year and not be loyal and then you get a rate that isn't as high as inflation but at least it can be 3% now, can't it?

THRUSSELL: I mean if you want a rate over 3%, you're either looking at a long-term fixed or an account with an introductory bonus. If you don't want to keep moving your money around, then you're looking at under 3%. Sort of 2.8 is about the highest rate we've got.

LEWIS: And there are some savings plans of course that protect you against inflation. They actually guarantee they'll go up in line with the retail price index, sometimes a bit more. Are they worth thinking about?

THRUSSELL: They are worth thinking about. But obviously although inflation's high now, these are usually 5 year products and if they're talking about trying to get inflation down you don't know what it's going to be in 5 years, so you may have been better off in a normal fixed rate bond. But we don't actually have any. They were all withdrawn. I mean National Savings withdrew theirs in September and the last inflation linked products offered by BM Savings were withdrawn last week.

LEWIS: So that option's gone ...

THRUSSELL: Yeah.

LEWIS: ... and of course, as you say, it was risky anyway because you're gambling on the future of rates, which none of us knows where they're going. In fact maybe a moment for me to ask Justin Urquhart Stewart whether he thinks interest rates will rise.

URQUHART STEWART: Base right I think is highly unlikely to rise in the near future unless we're going to see some significant inflation coming through. But we can't see that for the time being, so flat for the moment, I think.

LEWIS: Flat for the moment. You think for the whole year it'll stay at 0.5%?

URQUHART STEWART: I think very unlikely they're going to move it because they really want to try and get the economy moving at all. But of course, as we were saying earlier, what you're actually seeing in terms of the base rates bears no resemblance to the cost of borrowing that most people are getting to see, which is significantly higher.

LEWIS: No, that is very high, isn't it? Let me just ask Jane King about this because you deal with the housing market. Mortgages are lower than they have been, but they're still significantly above half of one per cent?

KING: Oh yes, significantly. I agree with Justin that I think rates will stay low. I do think we may have a quarter point rise half-way through the year. If it doesn't happen half-way through the year, then I think it will stay at 0.5%. However, I do wonder whether building societies and banks will hike their own internal standard variable rates. It will give them the perfect excuse and they may not put them back down again.

LEWIS: Yes. And what are the best sort of deals? I mean what should people be looking for if they are looking for a reasonable mortgage?

KING: Well at the moment the gap between the fixed and the variable rates is quite

small. However, I see this widening next year. I think fixed rates will become slightly more expensive next year, which will make tracker rates look more attractive. So I would say if you can get a fix now, fix it now.

LEWIS: Justin, we were talking about savings there. We're often told if you want to beat inflation, you have to invest. I sometimes think that's a way of tempting people into risking their own money for the profit of the people who invest it for them, but can you really beat inflation with any investment over the next 12 months?

URQUHART STEWART: I think there's a reasonable chance that you might be able to, but of course, as you say, investment is riskier, but equally leaving your money under the mattress or even in a bank account if it's in real terms is being eroded away. So yes if you actually take a 5 year view on a range of investments, you should be able to look at something like 7% a year over that time.

LEWIS: (*over*) I think you told us ... you told us that a year ago. Was that true? I mean could you really make people 7% over 2011?

URQUHART STEWART: If you had gone into government gilts and taken that risk, then the answer is yes.

LEWIS: But you're looking back now, aren't you? You didn't tell us that at the time.

URQUHART STEWART: No, no. This year I would have actually said if you had a blend of those, no you wouldn't have done. And certainly we didn't. We found ourselves down about 3.7%. But on a 3 year, 5 year basis, that is exactly what you would expect.

LEWIS: So you really think investing is better than saving. And Rachel Thrussell, do you find people are moving money out of savings from what you know and putting it into investment just to try and chase that rate?

THRUSSELL: I think those who are sort of happy and who don't mind a bit of risk. But a lot of elderly people who are looking to supplement their income, they want to know their money is safe because they're relying on an income, so they want to know that they're not going to lose part of their capital over the years. And I mean my parents, for example, they don't think they're going to be around for long, so they don't want to tie their money up long-term.

LEWIS: No and I suppose that's a point, Jane King, isn't it? If you are elderly, you don't want to put it in investments as such because you can't ride the ups and the downs. Cash savings are much more attractive to older people.

KING: Yes, absolutely. We've had quite a few inquiries this year for offsetting whereby people have used any savings that they do have to offset their mortgage borrowing. It's normally placed with their lender, which gives them the safety of having it with a lender and also the option of removing it later on if rates increase.

LEWIS: Yes and just explain what offsetting is for people who don't know.

KING: It's for anybody that has a mortgage and savings. If you place your savings in a linked account to your mortgage, then you get no interest on your savings. However, you do get that amount deducted from your mortgage and your monthly repayments are reflected on the lower amount. So for some people, this is a good way of getting their lump sum being used until rates improve.

LEWIS: Yes. And you can also offset a current account as well if you're someone who keeps money in there, revolving in there.

KING: You can, absolutely. It's been incredibly popular.

LEWIS: Now we talked about housing and mortgages a few moments ago and we're talking about offset mortgages now, so let's get onto that British obsession: house prices. Whether you have a home and worry about its falling value - though as I often

say it's still worth one home - or you want to buy one and fear that prices are not falling fast enough, buying a home is the only way to get security. That's the way housing is organised in the UK. Now house prices have well probably fallen in 2011, though different surveys produce different results, I have to say, and the change is certainly different across the UK, but whatever the fall may have been, it's not been enough for many who aspire to buy.

FEMALE 1: We moved back home a couple of months ago to try and save, but it just wasn't working out. Like we couldn't afford to even buy, so we've just moved back into a flat and rented because it's just easier for us.

FEMALE 2: I can't even afford my rent right now, let alone a mortgage.

MALE 1: Interest rates we pay to the banks is still quite high considering that it's, what, 2%, 3% more than the basic interest rate. And it's just if it goes up anymore, I think everyone's going to start struggling.

MALE 2: You try and get onto the property ladder. I mean I'm 25 and I can't see myself buying a property for probably another 10 years, maybe even longer.

LEWIS: Yes, well that's a common theme of people who contact the programme, I must say. And Jane King, just let's try and sort out first what happened to house prices. The Land Registry, which I tend to trust more because it is real sales right across England and Wales, they've fallen 3.2% in the last year. Others though are reporting rises. Nationwide says house prices have risen by 1.6%.

KING: I think the situation is very regional, as I said before. I think London, Edinburgh and the major cities in the UK, the prices are stable or even rising slightly. Buy-to-let landlords are always looking to purchase in these sort of areas. They're perfect for investments. Again I've had clients looking to buy buy-to-let property as an alternative to pensions as a form of long-term investment. So I think it's very, very regional across the country.

LEWIS: And that was last year I was talking about, but if we look at the fall since their peak, then the Land Registry says they've fallen 14%, Halifax says 19%. Is that a crash?

KING: I tend to tell my clients to look at their property as a home first and an investment second.

LEWIS: A woman after my own heart.

KING: Unless you need to sell, it's just a paper loss. And so for those that do need to sell, I agree it's a heartbreakening situation. I know the Government has recently asked lenders that purchasers can take their negative equity with them. Hopefully that will ease the situation. But if you look at it as a home and not an investment, then I think you've just got to look at it as a paper loss.

LEWIS: Yes, I mean that's alright if you don't ... because some people have to move and then if they've got negative equity, they've got a bigger loan than the value of the property. That means they're stuck, they can't move, they're trapped. And there's many, many ... a million people maybe in that situation.

KING: Well the Government have asked lenders to be sympathetic and allow some owners to take their negative equity with them as long as they can fit the affordability for a new property.

LEWIS: Now we heard some young people there wanting to get on the housing ladder, as they call it. Is it a dangerous time to buy because if you're borrowing 90, sometimes 95% of the value, you can be in negative equity very quickly if house prices carry on falling?

KING: You can. I think now is a good time to buy because we have low interest rates. However, we do have to be very careful about future affordability. People do have to understand exactly what they're taking on and the likely costs of any increase

in interest rates in the future, but as long as they take that on board there are various government schemes available to first time buyers and I think first time buyers should take advantage of those.

LEWIS: Justin Urquhart Stewart, do you think it's sensible to invest in property, or is that just a recipe for losing money over the next few years?

URQUHART STEWART: It's a perfectly valid asset class, but the property market (if it's on the commercial side) has not provided good returns domestically or, come to that, in Europe over the past few years; and if it comes to the household, domestic side of it, it has - as Jane was saying - been incredibly regional. Some areas have actually stood up quite well. But the buy-to-lets certainly have been more popular.

LEWIS: Yes and of course we are being sold them quite heavily at the moment by companies that either they want to sell property or they want to sell you mortgages for them.

URQUHART STEWART: The problem is we're not just building enough at the moment. There's a very distinct shortage. We need to actually get some reform here to probably encourage longer term leases with assurance.

LEWIS: Yes so if we built more of course, that would increase supply and perhaps bring prices down, which is what those young people really need.

Well finally, let's move on from that obsession to another one that we've often had over the last few years, and perhaps appropriately our last topic is pensions. It's been a difficult year. People who wanted to convert their hard saved pension pot into a pension for life have found the amount they can get, even if they have £100,000, is smaller than it's ever been. For £100,000 you'd get around £6,000 a year for life at 65. Barely half that though if you want your income to rise with inflation, which might be a sensible thing to do nowadays. Malcolm McLean, why have those rates - the annuity rates, the pension you get from your hard earned savings - gone down so

much?

McLEAN: Well they've been on a downward slide for a number of years and it comes back to this issue of the fact that people are on average living longer and, therefore, pensions in the form of annuities have to be paid for longer periods of time. That affects the amount that insurance companies are prepared to offer. So that's one reason and that's a sort of sliding scale as it were, that it's going down. But there's been other factors over the last 12 months which have influenced the level of annuity rates. One other problem in connection with that, of course, is that many people have found because of volatility in the stock market, that the value of the pension pots itself has dropped, which in turn means they get a smaller annuity because of that. And other things have come along as well. Strange as it may sound, the Bank of England's policy in relation to increasing the money supply by quantitative easing actually has an adverse effect on annuity rates because it affects the gilt market, which in turn bounces across to the level of annuity rates. So every time the Bank of England embarks on a quantitative easing exercise, that actually is bad news for annuity rates.

LEWIS: The other thing that's going to affect us starting in 2012 of course, Malcolm, is auto-enrolment. Everybody is going to be expected to put money into a pension at work - big employers from this October and all employers from 2017 - and of course those pensions will be exactly the ones that you have to use to buy an annuity later in life.

McLEAN: Yes indeed. Auto-enrolment is the Government's big idea really and it stems from the fact that, as I think we all know, that many, many people are just not providing for themselves in their later years. Many people are effectively sleepwalking into a financially uncertain old age. And the Government, I suppose any responsible government has got to be concerned about that given the impact that will have long-term in relation to the number of pensioners that are going to require support from the state and in terms of the number of workers who will have to pay extra by way of tax and national insurance to support them. So the idea is to try and persuade people to invest in a private pension arrangement. So from October next year, we will have automatic enrolment, which means that you will be as an employee

(providing you are within age 22 and pension age) will be automatically enrolled into a pension scheme and the employer will have to contribute towards that pension scheme.

LEWIS: Well thanks for those thoughts. Well you've all been pretty gloomy, I have to say, and I'm going to ask all of you now as a last thought: are you going to feel as gloomy, do you think, this time next year? Let me ask you first, Rachel Thrussell.

THRUSSELL: I'm positive that things can't get any worse. Things are going to get better and we'll come out smiling this time next year.

LEWIS: Well that's a cheery thought. Malcolm McLean, are you cheery or still gloomy about the end of next year?

McLEAN: Well I actually think that 2012 could be a watershed year for pensioners. There are many good ideas bubbling under the surface. A lot will depend how the economy performs, a lot will depend how things like auto-enrolment applies, so we'll have to wait and see. But I think there are more positives than negatives.

LEWIS: Right. I was going to say I'm not going to let you wait and see. Gloomy or cheery this time next year?

McLEAN: Cheery.

LEWIS: *(laughs)* Thanks Malcolm. Jane King, gloomy or cheery?

KING: Cheery.

LEWIS: Cheery. Going to say more than that?

KING: I'm going to feel quite cheery because I'm hoping they'll have sorted the Eurozone out and I'm hoping that all these government schemes for first-time buyers

will come into effect, which will get the property market moving again.

LEWIS: Let's hope that happens. Justin Urquhart Stewart?

URQUHART STEWART: I'll be feeling a lot more chipper. Why? Because the global economy's still growing. Lower and slower, but still growing. And also a lot of the issues that have held investments back in the past year have been a lack of credible political policy and leadership, which we can really believe in. That I believe is going to change. We'll get the US election out of the way and I think they'll finally get round to sorting out the Euro.

LEWIS: And I am going to ask you now. The FTSE 100 at the end of next year? It's about 5500 as we speak.

URQUHART STEWART: I think we could probably get up to about 6000, but you never know where it's going to end.

LEWIS: A small rise. Thanks very much for that. Well thanks to all of you. Thanks to Justin Urquhart Stewart from Seven Investment Management; Jane King from Ash Ridge Asset Management; Malcolm McLean from Barnett Waddingham; Rachel Thrussell from Moneyfacts. That is it for today and for this year. No Money Box on New Year's Eve. We are back fresh for 2012 on Saturday 7th January. And I'm back this Wednesday with Money Box Live taking your questions on consumer rights like maybe taking presents back or who's liable if something doesn't work or doesn't arrive. Meanwhile from producer Ben Carter, from the whole Money Box team and from me, Paul Lewis, have a wonderful Christmas.