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technical news

For professionals working with international clients

London facing new threats

Frankfurt has attracted only a handful of bankers over the last four years. If any firms have relocated to Paris, then they are keeping it a secret. Despite all the money and political capital, Germany and France poured into making sure London was no longer Europe's financial capital in the wake of our departure from the European Union, so far it has had very little impact. Some share trading has shifted, mostly to Amsterdam, and so have some deposits, but that is just numbers stored on a server. Most of the real work is being done in London.

The City may well feel it is time to relax. But perhaps we are looking in the wrong places. London has plenty of competition in Europe – it is just not coming from the cities we expected. Financial centres are booming in two other cities that no one usually pays much attention too: Warsaw and Stockholm. Sweden has more than 1,000 listed companies, more than either Paris or Frankfurt, while Warsaw has 770, only 35 below Paris. Both are some way behind London, which has more than 2,000 listed companies, but they are gaining fast.

Warsaw is building on the strength of the Polish economy. Annualised growth of more than 4% a year is steadily turning Poland into one of the richer countries on the continent (its stock market is one of the world's few remaining bargains, but this is a different story). That is throwing up lots of growing businesses, some of which are ready to float. At least 20 companies are expected to list on the main market this year, and another 16 at least on NewConnect, its version of Aim. But it is also starting to attract global companies as well. Pepco, the owner of discount retailer Poundland, also has a big business in Poland and it decided to list in Warsaw earlier this year, rather than London.

Likewise, Stockholm is thriving on the back of the booming technology industry. Sweden is second only to the UK in Europe in the number of new tech companies it has created, and on a per capita basis it is probably ahead. Nasdaq Stockholm has benefitted hugely from that, as well as from positioning itself at the centre of a vibrant, tech-led Nordic economy that also takes in Denmark, Norway, Finland and Estonia. The trend is not likely to stop any time soon. Klarna, the buy-now-pay-later start-up based in Stockholm, is valued at $45bn, making it the most successful fintech company in Europe. When it lists, it may well choose its home market – there is no reason not to – and that will give Stockholm yet another boost.

Warsaw and Stockholm have four things going for them. Both are outside the single currency, but inside the EU, just as Britain was before we left. That means they have their own central bank which can help the finance sector when it needs to, and they have their own domestic bond market. They can also be a lot more flexible, both in terms of devising regulations and implementing them. They still have to comply with directives from Brussels, but they have more independence than they otherwise would.

Next, they have thriving entrepreneurial economies to tap into. An emerging market such as Poland is always going to have a lot more energy than a mature, developed one. That means a steady stream of companies coming to the market. Thirdly, they have competitive tax systems. Poland has no capital gains tax, and just levies the standard corporate tax rate of 19% on gains, while Sweden is a lot more competitive than it used to be. Finally, both are inside the single market. Brokers and asset managers based in either city have full access to financial markets across the continent whilst preserving some flexibility and independence. The UK has lost that, and there is little chance of getting it now.

London has done well to fend off the assault from Frankfurt and Paris. Warsaw and Stockholm may be more serious challengers. The City can't take its status as Europe's financial hub for granted. Competition is arriving from new centres. It will have to work harder to survive that.

	Within the EU		
London	Stockholm	Warsaw	Paris
2000+	1000+	770+	1005+
Outside single currency			

Pension change hits expats

Thousands of UK nationals planning to move to a European Union country during their retirement could receive lower pensions than expected because of new rules introduced in the wake of Brexit. The changes will potentially impact the state pension of anyone who has spent time during their working lives in Australia, Canada or New Zealand.

To qualify for the UK's state pension, you will usually need to have made at least ten years of national insurance contributions – and paid in for 35 years to qualify for the full amount, worth £179.60 in the current financial year. Assuming you meet these criteria, you can claim the benefit wherever you live in retirement – and anyone moving to an EU country in the future will still be able to claim their UK state pension entitlement.

However, those who work overseas prior to their retirement may struggle to build up a national insurance record. And while the UK has reciprocal arrangements with many countries that allow social security contributions made there to count towards a national insurance record back home, the rules on these have now changed.

From 1st January 2022 onwards, UK nationals who move to an EU country will no longer be able to count periods working in certain countries towards their national insurance records. In particular, time spent in Australia, Canada and New Zealand will no longer boost your UK state pension entitlement if you move to the EU. So, for example, someone with 35 years of national insurance contributions who moves to Spain today can look forward to a full state pension from the UK, even if 20 years of that record came from stints working in Australia.

But the same person moving to Spain from January onwards would only have 15 years' worth of eligible national insurance contributions – their state pension entitlement would therefore be significantly lower.

Importantly, if you already live in an EU country, your entitlement to a UK state pension will not be affected, even if you have yet to begin claiming it.

Nevertheless, many people may be caught out by the new rules, qualifying for smaller pensions than they had expected. Significant numbers of Britons have spent time working in Australia, Canada and New Zealand; and so their state pension is now at risk if they opt to move to the EU later in life.

More broadly, however, Britons moving to the EU are in a stronger position than those retiring elsewhere. Even after Brexit, EU-based Britons will continue to be entitled to the same annual increase in their state pension as pensioners living in the UK. By contrast, ministers continue to refuse to change the rules governing Britons retiring to countries including Australia, Canada and New Zealand, where your UK state pension entitlement is frozen at the rate payable in the year you begin claiming.

Dividend drought ends

In investment terms, dividend pay-outs were among the biggest casualties of the Covid-19 pandemic. Companies slashed their pay-outs back to 2017 levels on a global basis, with the UK market being hit particularly hard. And yet what could have been a nightmare for dividend-dependent investors has turned out to be far less damaging than feared with dividends recovering to their pre-Covid-19 highs within a year.

Unheard-of government support for businesses and employees, combined with a surge in demand as restrictions eased, meant that companies found they had been overly pessimistic. Banks reversed bad debt provisions, while firms across the board found that their main problem was meeting customer demand rather than managing a decline.

Yet there are a few useful lessons that dividend-focused investors should learn from this near-miss. Firstly, UK investors should note that while pay-outs are recovering fast, UK dividends may not get back to 2019 levels before 2025. Companies have taken the opportunity to reset payments at more sustainable levels, as payout ratios were stretched in several sectors even before Covid-19 struck. Shell's Chief Executive, Ben van Beurden, was upfront about it: "We felt that our dividend needed to be reset... the gap between our dividend payout and free cash flow was simply too large."

This is good news – it implies that if you're buying UK stocks just now, then dividend payouts should be on a more sustainable footing than they have been in some time. On the other hand, it shows the importance of diversifying. The FTSE 100 index is a high-yield index, but there is more to dividends than yields. Growth matters too. So it's even worth looking at regions that may seem to have less recovery potential. Japanese stocks barely cut dividends in 2020 yet saw strong underlying growth of 11.9% in the past year.

But the most important lesson is this: don't get too hung up on dividend income. Whilst dividends are great – they remind managers of who they're working for (shareholders) and they're a transparent way to return cash. However, if you are at the stage of investment life where you are relying on your portfolio for regular income rather than building a nest-egg, then dividends should only form one part of that strategy. Other income-generating assets such as property and bonds are key, while ensuring you always have a cash cushion of one or two years' living expenses will help to ensure you aren't forced into cashing in investments at exactly the wrong moment.

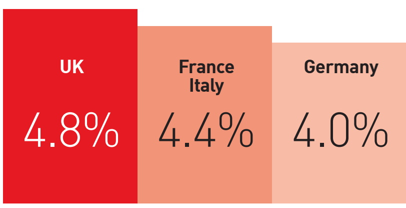
Britain leads G7

Britain's economy is on course to outpace every other nation in the G7 in 2022 for the second consecutive year, roaring back to life after a deeper recession than most rivals. The UK's relatively fast booster vaccine programme is one factor behind the strong growth forecast. Economists at Goldman Sachs predict the UK will grow by 4.8% in the coming 12 months, well above the 3.5% predicted for the US, 4% for Germany and 4.4% for both France and Italy. Canada and Japan's GDP is also set to grow significantly slower.

The UK's output expanded by almost 7% in 2021, as the country rebounded from a particularly deep Covid-19 recession which shrank GDP by close to 10% in 2020. The IMF also expects Britain to outgrow the rest of the G7 club in the coming year.

The economy should keep recovering as activity is supported by very strong household finances from savings, paying down debt and higher house prices, combined with traditional British consumer appetite to spend.

Measurement of public sector output cast the UK in a bad light during lockdowns but will be a plus as things get back to normal. The Euro-zone will also be held back by Covid-19, particularly since the currency area was already struggling with a new wave of the pandemic even before the latest variant came along.



Central Banks falling behind the curve

In November, the Bank of England failed to raise interest rates despite market bets that it would. In December, it pulled the reverse trick, becoming the first big central bank to raise the cost of borrowing. The 0.15% rise to 0.25% came despite market bets that Omicron-related uncertainty would cause the Bank to keep policy steady. With inflation at an annual rate of 5.1% and predicted to hit 6% next April, the Bank decided it didn't have the luxury of waiting for more clarity about Omicron.

The interest rate hike is so marginal that it is unlikely to make much of a difference, It is, however, an important signal of intent. After a year spent making increasingly unconvincing excuses for soaring inflation, the Bank needed to head off speculation that its real objective is to keep government borrowing costs low. It has now shown that it won't back excessive spending forever.

Even those of us who have long supported tighter policy must admit that this was not a great time to start raising rates. UK growth was stagnating even before Omicron and inflation had surged, suggesting a touch of stagflation. The service sector had a nightmare before Christmas. By raising rates at a difficult time, the Bank has at least won back some of its lost credibility as a central bank that takes inflation seriously.

Omicron or no Omicron, the Bank had no choice but to hike. Inflation is more than two times the 2% target. November's delay had raised serious questions about its willingness to both raise the Treasury's borrowing costs and to upset market traders, who love easy money. Credibility is a must-have for any effective central bank: if businesses and consumers come to believe that authorities will never act against inflation then it will become a self-fulfilling prophecy.

The US Federal Reserve (the Fed) is also in tightening mode. It says it will reduce its monthly asset purchases twice as fast as previously planned. That leaves the Fed on course to wind up its quantitative-easing programme (whereby it buys bonds with printed money) and start raising US interest rates in the spring. The Fed's latest projections show it plans to hike interest rates up to three times during 2022.

For all the fanfare about its newfound hawkishness, the Fed has effectively committed not to raise rates above 1% in 2022. Yet annual US inflation is 6.8%. Policymakers are stuck between the rock of raising rates sharply, which will cause a market crash, and the hard place of doing nothing, which will let inflation rip. The Fed's solution? Magically assuming in their projections that inflation will disappear by itself.

UK house prices soar

Markets might be a bit nervous now, but one asset class is proving as impervious as always. The UK housing market is as robust as ever. In fact, according to the latest Halifax data, prices are now rising at the fastest rate in 15 years.

House prices in the UK were up by 8.2% year-on-year in November. And up 3.4% on the quarter (the fastest such growth since 2016). The stamp duty changes and a 'will-we, won't-we' approach to returning to the office has failed to put even a whiff of a dent in the housing market. This is a bad thing.

Forcing young and not-so-young people to borrow to the hilt - whether it's sensible or not - simply to put a (often badly built) roof over their heads is politically, financially, socially and economically toxic. Housing bubbles cripple an economy when they burst, and unlike every other investment bubble, they leave no legacy of cheap infrastructure on which to build a future boom. They just leave indebted, possibly homeless individuals; bankrupt housebuilders; and a devastated financial system which then wreaks havoc on every other sector.

But it's not just the eventual bust that's a problem. The boom is a challenge too. A lack of cheap housing makes it harder for people to move for work. It makes it harder to start a family. And it adds to the feeling that we live in an unfair society.

This is almost entirely about cheap credit and, contrary to the impression you may sometimes get, this is no longer a uniquely British disease as recent price rises have been global in nature.

Santa's Rally

In a landmark moment for London's blue-chip shares, the FTSE-100 index gained 0.7% on its return from the Christmas break as it belatedly joined the so-called Santa rally boosting global markets. Stocks have been lifted by hopes of a milder Covid-19 variant preventing more economic carnage in 2022 despite record infections across the UK, US and Europe in recent days.

The FTSE 100 has finally risen above where it stood in late February 2020 just before the pandemic and lockdowns sent markets tumbling. The index plunged by a third in just a month when Covid-19 panic first struck markets before beginning a rollercoaster recovery that saw stocks soar on vaccine optimism and set back by new variants.

The FTSE 100 plunged 14% in 2020 but closed on its best year in more than a decade after rebounding 15% in 2021. The index is on track for its strongest performance since 2009 when shares bounced back from the financial crisis.

For now, markets are overwhelmingly pricing in the latest variant as a milder incarnation, despite its easier contractibility. Despite wider market optimism over Omicron, travel stocks, such as British Airways owner IAG, were among the biggest laggards on London's leader board.

Global shares have enjoyed a blistering rally as the Omicron continues to rage and fails to register on this market, supported by investors' optimism that the economy can cope with Omicron-related risks and tighter central bank policies.

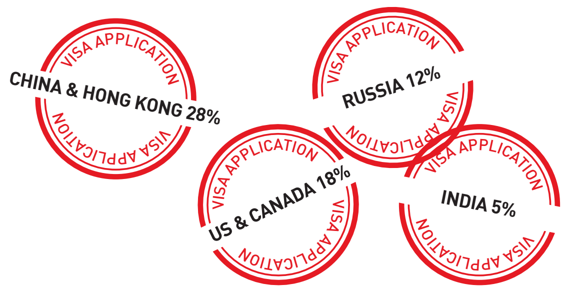
Markets will, however, be volatile for some time to come. While an improving outlook on the virus is helping to lift stock prices, investors will still have to navigate the threat of rising interest rates in 2022 as central banks seek to stamp out inflation.

UK Investor Visas return to pre-pandemic levels

The UK issued 100 investor visas (previously Tier 1) to main applicants in the quarter ending September 2021. China and Hong Kong remain the top nationality of origin, but only accounted for 28% of the total, which is around half of normal levels. 12% of applications came from Russia, 18% from the US and Canada and 5% from India.

This brings the total number of visas issued so far this year to just five short of the number issued in the whole of last year, marking a return to pre-pandemic levels of applications. Since EU Nationals wanting the right of residency in the UK need to apply now on a specific category, we are now seeing applicants from countries like France and Switzerland.

One of the main reasons for wishing to secure the right of residence in the UK is because of the high quality of schools in London and throughout the UK. Knightsbridge Wealth has just published a guide to UK Education which may be of interest to your clients. Let us know if you would like a copy.



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