

Financial Reality Index – Q2 2008

July 2008



The latest research from the Alliance Trust Research Centre shows that the financial situation facing UK households has deteriorated. Food and energy prices have risen, debt levels have increased, house price growth has slowed sharply and equity markets are in decline. Our Financial Reality Index has fallen to a record low level, indicating that the outlook for household spending is under significant stress. Growth in household expenditure accelerated slightly in Q1 2008, but these results suggest that spending growth will slow back to a level reflecting the financial reality consumers are facing. The three sub-components of our index, which reflect the current economic background, household budget conditions and household net wealth, all decreased over the quarter.

Financial Reality Index



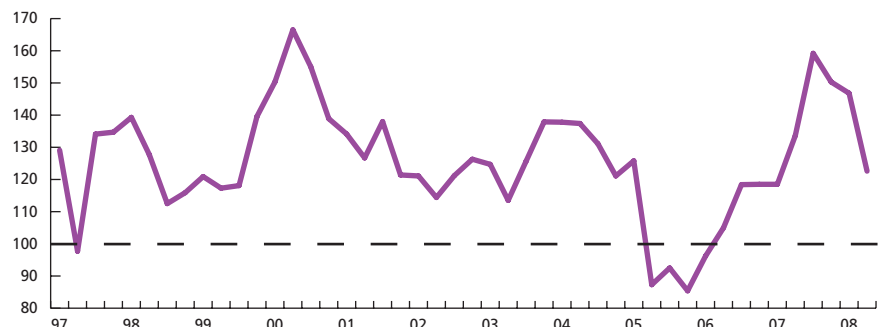
The Alliance Trust Financial Reality Index plunged from 72.7 in Q1 (08) to just 59.2 in Q2 (08). This is the lowest reading recorded during the course of our 11 year study.

closer to the long term average of 100. Latest estimates indicate that GDP growth has slowed considerably but the labour market has held up relatively well so far, with little change in the rate of unemployment during Q2. These factors, together with an increase in insolvencies, produced a fall in the index of 24.2 points over the quarter.

Economic Background – Slipped from 146.8 to 122.6

The economic background remains the strongest component of the Alliance Trust Financial Reality Index, even though it recorded a decline in Q2, taking it

Economic Background



Contact

Shona Dobbie

Head of Research Centre

Alliance Trust PLC, Meadow House,
64 Reform Street, Dundee DD1 1TJ

Tel +44 (0)1382 201700

Fax +44 (0)1382 225133

Email contact@alliancetrust.co.uk

Web www.alliancetrust.co.uk

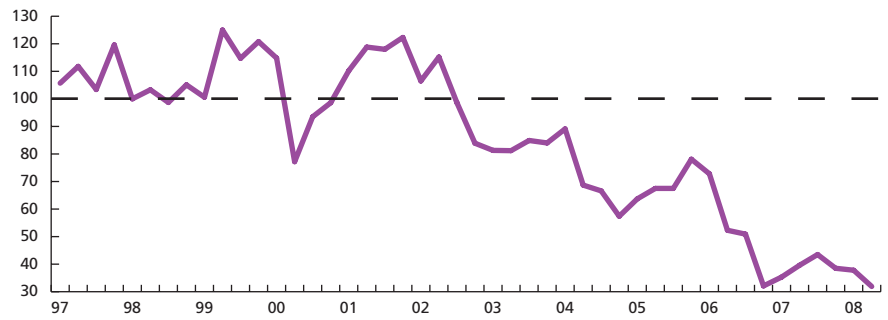
Alliance Trust PLC is the largest generalist investment trust company listed on the London Stock Exchange. The Research Centre is part of Alliance Trust and was formed to carry out economic and social analysis to deepen our understanding of economies, markets and socio-economic issues.

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Household Budget – Dropped from 37.8 to a record low 31.9

The household budget remains the weakest component of the Alliance Trust Financial Reality Index and has fallen to a new record low during Q2. This index has been consistently below the critical level of 100 since Q3 2002, as consumers have had to struggle with higher mortgage costs, high council tax and falling real earnings. In addition to this the recent pick up in inflation, particularly in basic goods and services, has hit real disposable incomes hard, leaving consumers with much less money to spend on discretionary goods. Higher food and energy prices are weighing heavily on household budgets.

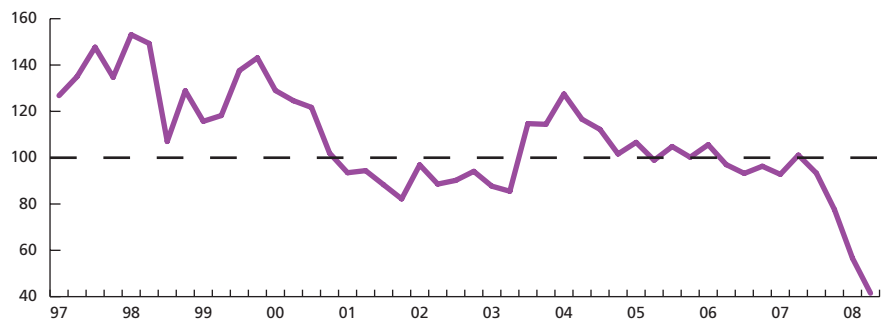
Household Budget



Net Wealth – Dropped to a new record low in Q1, falling from 56.6 to 41.5

After dropping heavily in Q1 (08), this component has continued to weaken during Q2, and has fallen to a new record low of just 41.5. As in the previous quarter, this downward move was largely due to the decline in the stock market. However, house price growth has also cooled sharply and the high levels of debt have become an even greater burden on household net wealth.

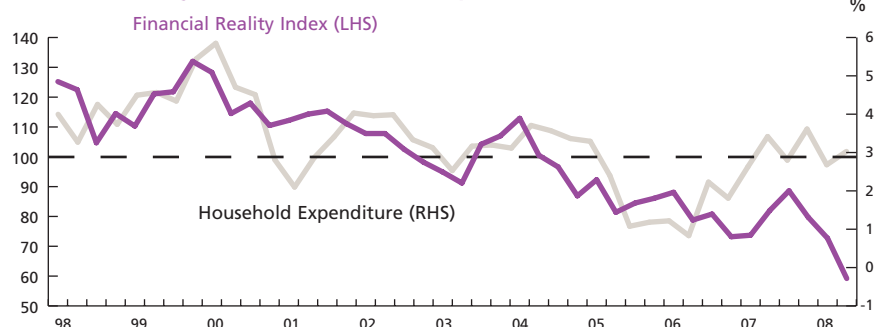
Net Wealth



Summary and conclusions

Our Financial Reality Index fell to a new record low level in Q2, increasing significantly our concerns about the outlook for consumer spending in the UK. Over the first 8 years of our study there was a very close relationship between our measure of financial conditions and actual consumer spending growth. This relationship broke down over the past few years as consumers continued spending, despite a worsening financial reality, resulting in ever higher levels of debt. During Q1, household consumption growth accelerated slightly, in spite of growing signs that the financial reality was worsening sharply. These latest results support our view that household consumption growth will have to slow over the rest of the year, coming back into line with the financial reality facing UK households.

Financial Reality Index vs Household Expenditure



Sources: ONS, DCLG, CML, EcoWin and Inhouse Analysis.