

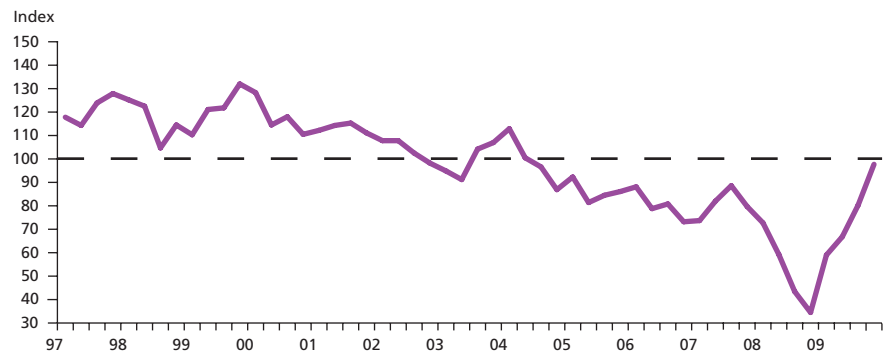
# UK Financial Reality Index – Q4 2009

January 2010



The latest research from the Alliance Trust Research Centre shows that, at the end of 2009, the overall financial situation facing UK households improved for the fourth successive quarter. Economic activity is still subdued and the labour market remains under pressure, but the relatively low level of inflation recorded in recent months has helped to boost real disposable income and household wealth has benefited from the sharp improvement in the equity market over the last year. As a result of these moves our UK Financial Reality Index has risen from 80.3 to 97.7, moving close to the critical level of 100 for the first time since Q2 2004. Our results suggest that the recent boosts to both wealth and real incomes could help to improve consumer confidence, at least over the next few months, and that we could see some slight improvement in consumer spending as a result. However, much of the gain in the index has been due to recent low levels of inflation, which are already reversing, and so we expect any improvement in spending levels to be temporary.

## UK Financial Reality Index



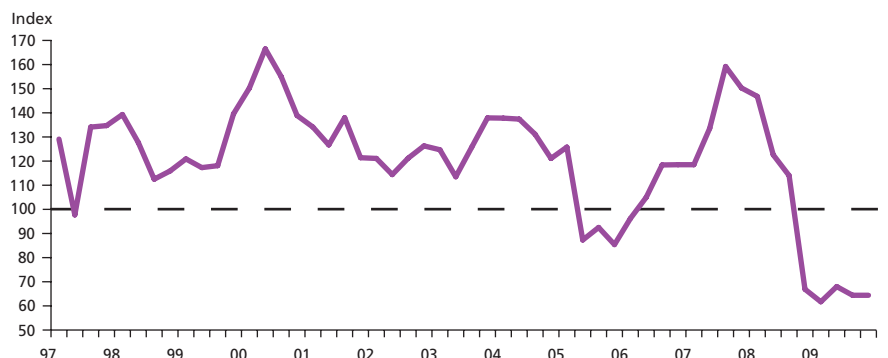
## Financial Reality Index

The Alliance Trust Financial Reality Index improved from 80.3 in Q3 (09) to 97.7 in Q4 (09). This further improvement in the index brings it close to the critical level of 100, for the first time since 2004.

## Economic Background – Remains unchanged at 64.4

The economic background component of the Alliance Trust Financial Reality Index remains unchanged at a level of 64.4, and has now been in negative territory for five successive quarters. Economic activity is still under pressure and the

## Economic Background



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## UK Financial Reality Index

labour market remains relatively weak, even though unemployment has not risen by as much as most people expected. The ILO unemployment rate has risen to 7.9% and is expected to move above 8% over the next few months. Although the low level of interest rates continues to help many households avoid insolvency, the positive impact of this continues to be outweighed by the generally weak level of economic activity and softness in the labour market, and the economic background remains the weakest of all three components.

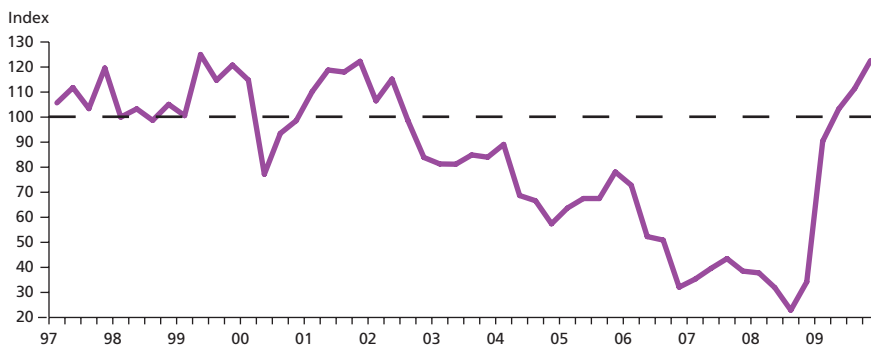
### Household Budget – Improved from 111.4 to 122.6

The household budget index improved once again during Q4, achieving its fifth successive quarterly gain and remaining above the critical level of 100 for the third successive quarter. This index has now reached its highest level since Q2 (99). The recent decline in the rate of inflation to relatively low levels has caused a major improvement in real earnings and the cost of basic goods and services also declined a little bit further, leaving consumers with slightly more income available to spend on discretionary items. For the third successive quarter, the household budget is the only component of our index which is giving a truly positive signal. However, this latest gain is clearly due to the recent low level of inflation. This trend is currently reversing and there is a danger that the household budget component could start to deteriorate once more.

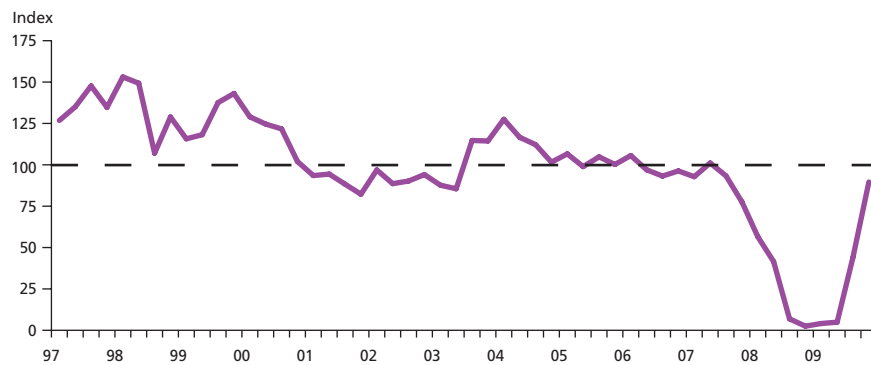
### Net Wealth – Sharp improvement from 44.2 to 89.6

The net wealth index has recorded another fairly sharp improvement during Q4, rising from 44.2 to 89.6 and is no longer the weakest component in our Financial Reality Index. However, although the reading achieved in Q4 (09) is the highest since Q3 (07) it still lies below the critical level of 100, suggesting that conditions are considerably weaker than the long run average and that there is still scope for further improvement. During Q4 there was a modest improvement in house prices, due predominantly to a lack of available supply, and the ratio of debt to disposable income was reduced very slightly, although the level of debt clearly remains a significant burden. The biggest driver of

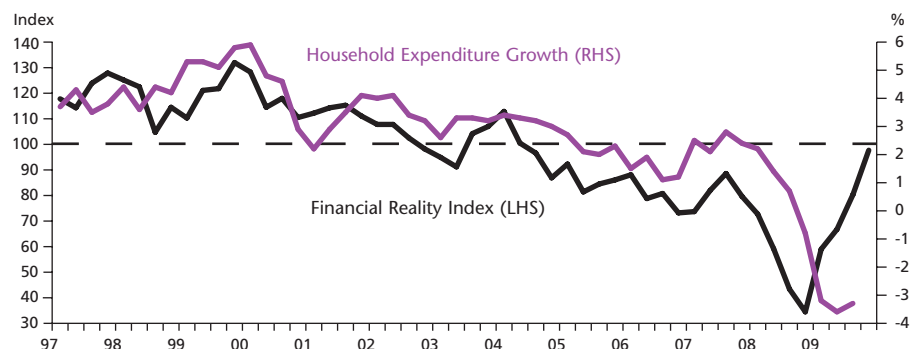
### Household Budget



### Net Wealth



### Financial Reality Index v Household Expenditure



the improvement in the wealth component during Q4 was the stock market, reflecting the fact that the FTSE All-Share gained 25% over the year as a whole.

### Summary and conclusions

Our Financial Reality Index has improved for the fourth successive quarter as the financial pressures facing households continue to ease. This ongoing improvement in the headline index has brought it closer to the critical level of 100, which reflects the long term average. However, much of the improvement recorded in this particular quarter has been due to the recent dip in headline inflation, which is currently being reversed, and there is a risk that the index will start to deteriorate once more in 2010.

Over the course of our 12 year study there has been a very close relationship between our Financial Reality Index and actual consumer spending growth as can be seen in the chart above. Over the last year we saw a sharp drop in consumer spending as households came to terms with their weak financial situation. The most recent improvement in our index is clearly welcome, but the fact that the headline index still lies below the critical level of 100, and the fact that inflation is expected to increase, suggests that even though consumer spending improves from recent low levels, it will still remain generally weak over the next few months.

Sources: ONS, DCLG, BoE, ECOWIN and Inhouse Analysis