



**Surviving in a
difficult economic
atmosphere.**



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How to survive a recession

Skirts getting longer? Cigarette butts shorter? Easier to get a cab or a table at that fashionable restaurant? All these are said to be signs of recession – the dreaded R word. The technical definition of a recession is when the economy has shrunk for at least six months – as measured by negative Gross Domestic Product (GDP) figures for two successive quarters. What this means in practice is more businesses are struggling, orders and sales are down, profits are under pressure and jobs are axed. Consumers who are in work worry about unemployment and therefore spend less, so putting further pressure on shops and in turn manufacturing. In a simple league table of economic misery, recession is worse than slowdown but not as bad as depression. The bust in boom-and-bust could mean recession, while a slump normally refers to even deeper and more

protracted economic problems. Or as President Truman of the US once said: it's a recession when your neighbour loses his job, a depression when you lose yours.

There is often debate about when precisely an economy is in recession, which reflects that it is possible for certain business sectors – manufacturing – to effectively be in recession when others aren't. Likewise not everyone suffers in recession. People who keep their jobs and don't have massive debts stand to benefit from potentially lower prices on the high street and elsewhere. It can be a good time to buy property: house prices may fall and should certainly be less buoyant. But even those who feel reasonably secure in their jobs should review their financial situation – they might have to live with no additional overtime pay or salary increase, for example.



Insulating your finances against recession.

Unemployment insurance

Almost certainly the biggest fear for working people in a recession is losing their job and not being able to meet their financial commitments. And the biggest commitment of all for most people is their mortgage.

Government help for the mortgage payments of the unemployed has been scaled back.

If you took out your mortgage since October 1995 – and that includes a remortgage – you get no assistance for the first 39 weeks – 9 months – of unemployment. After that the government will pay your mortgage interest, but even this help is means tested. And the State will not pay your contributions into any repayment vehicle such as an endowment.

The benefit is called ISMI – Income Support for Mortgage Interest.

Even if you took out your mortgage before October 1995, you generally have to wait 6 months before the Government will pay your mortgage interest for you. From week 8 it will pay half your interest. Mortgage Payment Protection Insurance (MPPI) – sometimes called Accident, Sickness and Unemployment (ASU) cover is aimed at plugging this gap. It will pay your mortgage for up to 12 months if you are made redundant or illness leaves you without income. Similarly, Payment Protection Insurance (PPI) covers other loan or credit card payments. Around one in three new mortgages are covered by MPPI. But premiums can vary a lot and the cover it provides needs to be considered carefully. Premiums are typically around £5 for each £100 of monthly mortgage payment covered

but some policies can be three times the price of others. Someone paying £500 a month on their mortgage might be charged premiums amounting to another £25 – or a few hundred pounds a year. Nor should MPPI be seen as a “quick fix” to impending unemployment. Policies have an initial exclusion period of up to 60 days during which time if you become unemployed your claim will be thrown out. This is designed to stop people taking out policies when they get wind of plans for redundancy. Then there is an “excess” or waiting period of up to 60 days during which you get no money – so even if you make a qualifying MPPI claim you may need to fund your mortgage for up to two months out of savings. Taken together these catches mean that you will not be entitled to any payout for perhaps

four months after taking out a policy. You do not need to buy a policy from your lender, nor do you have to buy it when you first take out your mortgage. An IFA will be able to help you find the better value policies.

If you have sufficient health cover elsewhere – perhaps from your employer – you may be able to cut your premiums by restricting the MPPI to unemployment-only. If you have a joint mortgage you can keep premiums down by each of you being insured for say half of the monthly payment. The self-employed and contract workers need to take particular care in finding unemployment cover – conditions can be onerous. Cover for all your debts can also be consolidated in a single PPI policy.

Reducing debt

Over-borrowing is a classic feature of economic booms, and a classic way of getting into trouble in busts. If your earnings fell, would you still be able to manage your debts, particularly if interest rates should rise? Try to pay off debts before you get into difficulties, starting with the most expensive or the most urgent. Some shops charge over 20 per cent APR on their store cards. If you have savings, these are almost certainly earning less than the interest you are paying on debts. And while everyone should aim to have some readily available cash, in financial terms you are likely to be better off overall paying down debts. Paying down some of your mortgage will help protect against negative equity should house prices fall. In the early 90s negative equity – where outstanding loans were greater than the value of properties – was a barrier to homeowners moving.

Transferring plastic card debts to a cheaper credit card will also save interest in the short term, but bear in mind that the lowest rates normally only last for six months or so. And new spending on these cheap cards will often land you with a higher interest bill.

Consolidating personal loans through a debt manager or other credit firm may also appear attractive, but it is important to consider any penalties for switching and the overall cost of the new deal. Just because the new monthly payments are lower does not make it better – you could be paying more in the long term including high admin charges.

If your debts are getting out of control and you cannot meet repayments, talk to your lenders – missing payments is only likely to lead to penalties and additional costs. Or approach a free debt adviser such as the Consumer Credit Counselling Service on 0800 138 1111.



Remortgaging

Millions of homeowners could reduce the cost of their single biggest debt by remortgaging. They could also guard against the risk of rising repayments by locking into a fixed or capped rate deal. Lenders continue to offer discount deals with no penalties for switching at the end of the special rate period, so offering no-risk savings for a borrower paying standard variable rate.

Flexible mortgages allow borrowers to make overpayments when they can – reducing their overall debt and interest bill – as well as take payment holidays if they need to. A borrower who lost their job could put their mortgage “on ice” or draw down a lump sum to help them out until they find new work. But even if a lender allows a payment holiday, borrowers should remember

that the unpaid interest will still be rolling up, increasing the overall debt.

With hundreds of mortgages to choose between at any one time, a good mortgage broker or IFA can help select the right loan for you. However it is important to switch loans while you are still in work – you are highly unlikely to be offered as good a deal and lenders may well not want to touch you at all if you have just lost a job.

If you do get into problems with your mortgage payments, talk to your lender as soon as possible. And don't simply cash in your endowment policy – an IFA may be able to help you get as much as a third more money by going to the traded endowment market.

Build up a cash buffer

If you lost your job tomorrow you would still have bills and expenses but your previous income would come to an end. Even if you are entitled to benefits these might take some time to come through. Having some readily accessible cash savings will help tide you over until you get a new job or can attempt to adjust your lifestyle to meet a reduced income. Experts recommend having the equivalent of at least a couple of months salary in an easy-access account paying as much interest as possible.

Worryingly, it is estimated that average household savings in the UK are just £750. Likewise, whatever the arguments for investing in a recession (see page 9), if you think your job may be vulnerable you should be looking to your potential cash requirements before committing money to longer-term investments.



Cut costs

Drawing up a list of your outstanding commitments and your spending is a good way to identify potential savings. Can you achieve the same by spending less? For example, try paying utilities by direct debit or switching companies, find a better value mobile phone tariff or network, or simply try to use your mobile less at peak rate times. Get into text messaging – it could work out cheaper. Experts say that when money gets tight, life insurance premiums and pension contributions are often early economies. It may be possible to stop paying into a pension plan without penalty, but check. Keeping up life insurance may be more vital: if times are hard now, think how much worse they would be for your family if you were to die. Life insurance premiums have fallen in recent years and an IFA may be able to find you a cheaper deal – and even advise

you on that pension. Equally, beware of cashing in endowment and other savings plans early – you may be heavily penalised. Other money saving tips worth considering include:

- Getting rid of a second car, not changing your existing car so often, buying secondhand, or if you're buying new, try the Internet.
- Cycle instead of using a car or public transport.
- Eat out less and learn to cook with a book from a celebrity chef instead.
- Buy fewer new clothes – even go to charity shops.
- Give up smoking – a recession could be just the discipline you need.

Traditionally, luxuries like gym memberships have been cancelled when times got tough – though some might argue that gyms are now necessities in a stressful modern world. Don't be too hard on yourself...

Making money out of recession

If your finances are already looking shaky, piling into the stockmarket may be the last thing on your mind. Once you have a sufficient cash buffer, government gilts are another lower risk option. Unlike with corporate bonds, there is no risk of the government not meeting its liabilities, and low interest rates and inflation are also generally good for gilt prices. With shares, the classic advice is to stick to businesses that are relatively immune to recession, such as supermarkets and utilities that consumers will continue to buy from no matter what. Other so-called defensive stocks include tobacco and drinks companies. But if you like the idea of switching into these businesses, beware that investor demand hasn't already driven share prices up. Furthermore, the stockmarket is something of a leading indicator for the real economy, looking ahead by as much as 18 months, according to experts. So it can fall ahead of recession while the economy is still booming, and

then jump again while jobs are still being shed and the business news is bad.

Catching this recovery can be profitable – and a good reason for not selling when the economy is at its bleakest. For investors who do not feel confident picking individual shares or gilts themselves, an IFA should be able to recommend a well-managed investment fund. If you are concerned that the stockmarket might fall further – or you don't want to put aside too much money at a time – saving monthly is worth considering. Unit trusts OEICs, investment trusts and tax-efficient ISAs will accept £50 or less a month. If the market does fall you will be better off than if you had invested everything at the outset.

The cautious could also consider lower-risk investments like guaranteed stockmarket bonds or with-profits bonds, both of which protect you from market falls. Arguably however, you would get better value investing in guaranteed products that are at a high, not after they have already fallen.

Notes

For further information on the subject contained in this guide, please contact your IFA.

If you do not already have an IFA and are looking for advice on personal finances call the **IFA Promotion Consumer Hotline** on **0800 085 3250**.

If you do not already have an IFA and are looking for financial advice for your business call the **IFA Promotion Corporate Hotline** on **0800 085 3251**.

Alternatively, visit our website at www.unbiased.co.uk



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The above brochures are available in the following alternative formats: large print, braille and audio tape. Please call our Hotline on **0800 085 3250** if you wish to order an alternative format.

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