

# Unemployment data highlight Government's challenge

By Tom Stevenson, 16 June 2010

## Slashing the deficit in the face of a weak jobs market poses great risks to the UK economy

The Government is walking a tightrope ahead of next week's Emergency Budget. On the one hand it faces pressure from the international financial markets to reduce the size of the deficit. On the other hand, as today's unemployment figures confirm, the economy remains in the sick bay and overdoing the speed and scale of the fiscal consolidation threatens to push it back into intensive care.



Today's rise in unemployment to 2.47m in the three months to April, up by 23,000 for an unemployment rate of 7.9%, won't be the end of it either. The 7,000 reduction in public sector employment after a long expansion is just the beginning if the mood music from Whitehall is to be relied upon.

With more than 6m people employed in the public sector, some might say that there is plenty of scope for reducing jobs in this part of the economy, but whatever your views in this contentious debate the outcome is going to be painful for all concerned.

John Philpott, at the Chartered Institute of Personnel and Development, said recently that he expected the squeeze on the public sector to push unemployment back above 3m by 2012. That's a lot worse than many other economists predict but if he is right then it would represent the longest jobless queue in Britain since the early 1990s.

Within the figures, there are some particularly depressing statistics. The number of unemployed youngsters, for example, is worryingly high. Around one in five of those aged between 16 and 24 are out of work. This is a dreadful start to many working lives and is one for which many will pay the price for years to come.

The impact on wages is elementary economics. Average weekly earnings, excluding bonuses, rose by just 1.9% in the same three month period compared with a year earlier, with few workers feeling confident enough about their job to attempt to recoup the roughly 5% rise in the retail prices index.

It is against this gloomy backdrop that George Osborne will next week spell out the

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spending cuts and tax rises package for which we have been so carefully softened up. His challenge, which few will envy, is to set the public finances back on an even keel while avoiding tipping the economy back into recession.

What does this mean for investors? On the face of it, an investment in UK plc looks a lot less attractive than in some other faster-growing parts of the world. High unemployment, rising taxes and probably a soggy housing market too do not argue for buoyant profits from companies exposed to the domestic economy.

In this context I was interested to hear the comments of Harry Nimmo, an award winning UK smaller companies portfolio manager from Standard Life Investments, who was one of a panel of investors who kindly agreed to speak at a Fidelity investment round table I chaired earlier this week.

Mr Nimmo made the point that whatever is going on in the wider economy there are always growth opportunities at the individual company level. I think this is even more the case with smaller companies which are much less a reflection of the wider economy. As the old investment adage says, elephants don't gallop and the performance of smaller companies is determined by a wide range of factors from management strength to new products. In any market conditions, winners can be found if you are prepared to look hard enough.

Another point, which is more usually made about the larger companies in the FTSE 100, is the fact that a good proportion of company profits are made outside the UK. According to Mr Nimmo, around 40% of earnings for the companies he looks at are struck overseas. That's less than the two thirds or so of the biggest companies' profits but it still reduces their exposure to the UK economy considerably.

It is hard to put much of a gloss on unemployment figures which demonstrate clearly the long hard slog we face to recover from the financial crisis and the recession it triggered. Against such a difficult backdrop, however, the case for active stock-picking - digging out the corporate gems that can thrive in all market conditions, looking for the companies that retain higher than average pricing power, the businesses with the most resilient balance sheets - remains a strong one.

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