Evidence grows that UK is entering a sharp recession

Julie Hyland
31 October 2008

"In recent weeks, the global banking system has arguably undergone its biggest episode of instability since the start of the first world war," the Bank of England's bi-annual Financial Stability Report released this week states.

Total losses as a result of the global financial crisis will reach some £1.8 trillion ($2.8 trillion), the Bank forecast. This is three times the UK's annual public spending bill, 36 times the amount spent on aid to the developing countries and enough to provide for all the basic requirements—health, food, education and basic infrastructure—for 3 billion of the world's poor.

According to the bank, losses in the US have reached £1 trillion ($1.58 trillion). Losses among UK financial institutions total £122.6 billion so far, while losses in the euro zone area have risen to €784.6 billion (£625 billion).

Commenting on the report, which he said was not for "those of a nervous disposition", the BBC's Robert Peston noted the Bank's estimate "that £5,000 billion has implicitly or explicitly been made available by central banks and governments since April 2008 to support wholesale funding by banks," which is "equivalent to about a sixth of the total annual economic output of the whole world".

Even so, the Bank warned that measures such as the UK's £500 billion bailout were only a temporary palliative.

Britain's six largest financial institutions could lose up to £130 billion over the next five years, with the Bank stating that "even after accounting for recently announced capital-raisings which the UK government will help underwrite, the largest UK banks would need to shed around one-sixth of total assets to reduce leverage back to, say, 2003 levels."

"Risks remain in the financial system," it stated, noting fears over the stability of emerging economies, the balance sheets of insurance companies, and the fragility of the commercial property markets.

The financial crisis was "rooted in weaknesses within the financial system that developed during an extended global credit boom: rapid balance sheet expansion; the creation of assets whose liquidity and credit quality were uncertain in less benign conditions; and fragilities in funding structures," the report continues.

The Bank's own figures bear this out. In 2001, the level of lending by UK banks to customers was equal to deposits but by 2008, they had lent out £700 billion more than they held. The value of lending to UK households rose from approximately 60 percent of GDP in 1998, to some 90 percent in 2007. Mortgage loans at 3.5 times income grew from 10 percent of homebuyers in 2004 to 35 percent four years later.

The result is that the ratio of household debt to annual disposable income is 170 percent in the UK, compared to around 140 percent in the US, and an average of approximately 100 percent in Western Europe. Total mortgage, loan and credit debt stood at £1.44 billion in June 2008, outstripping the UK's GDP.

Yet the Bank goes on to claim that "few predicted" these "weaknesses" would cause "such dislocation in the global financial system."

If the Bank, and the government, were unprepared for events it was in part because they were completely taken in by their own propaganda eulogising the triumph of the "free market". Only last year Brown proclaimed that a "new Golden Age" had begun, thanks to the "high value-added, talent-driven" City of London. But more fundamentally, a tiny layer of the super-rich were doing extremely well out of the huge profits generated by collateralized debt obligations, credit default swaps and the like, despite their being based on a mountain of debt backed by virtually no real value.

It is the interests of this layer that have determined social and economic policy over the last two decades. And despite this having created what Charles Bean, the Bank's deputy governor, has said is "possibly the largest financial crisis of its kind in human history" the concerns of this financial oligarchy continue to determine official policy.

The last week saw £90 billion wiped off the FTSE 100 index, and the pound suffering a 10 percent fall against the dollar, to $1.53. Nick Parsons, from National Australia Bank, forecast that the pound could be as low as $1.40 by early 2009. "We will go down further because the problems the UK faces are worse than other countries. We are uniquely exposed because of the sheer amount of debt we've got," he said.

Official figures also showed a sharp contraction in GDP—down by 0.5 percent in the July to September period—the first fall in 16 years. The decline is particularly significant as it concerns the period prior to the onset of the financial meltdown of the last weeks. "It's a big shock that the decline is so large. It is truly dire," said Philip Shaw, chief economist at Investec.

Peter Mandelson, the business secretary, was just as blunt during a trade visit to Russia. The UK faced an "unparalleled financial crisis," he said. "I don't think people have realised what the impact is going to be on our real economy, on businesses and jobs back home."

The scale of the crisis has caused an apparent volte-face in ruling circles. After more than a decade in which it has denounced any "interference" in the free market, and championed "light-touch" regulation, the Labour government is now involved in one of the largest state interventions anywhere in Europe.

In addition to the £500 billion bailout, which does not include some £100 billion extended to Northern Rock, the government is to bring forward capital spending programmes in an effort to "kick-start" the economy. This week the government signalled that it would tear up its so-called 40 percent "golden rule" on public sector borrowing, introduced by Gordon Brown as chancellor in 1997 as proof of New Labour's break with its reformist past.

Without a trace of embarrassment, Alistair Darling, chancellor of the exchequer, told an audience at the Cass Business School on Wednesday, "Just as markets change, so should policy. Today, governments all over the world are using approaches that had until recently been consigned to policymaking history, but it is natural that the conduct of policy should evolve."

"Flexible" rules could enable government to borrow up to £3,225 for every person in the country; with some predicting government borrowing could reach £110 billion by 2011.

The plan caused ardent New Labour supporter, the *Guardian's* Polly Toynbee, to excitedly exclaim that an "epic ideological battle has begun."

It was "Keynesian versus neo-conomist in the battle for Britain's future", she claimed, referring to Conservative criticism of the plan and opposition to the government's abandonment of "laissez-faire" from a group of 16 economists in a letter to the *Sunday Telegraph*.

"This is Labour's great chance to show what good government can do to save people in time of need," she said, while warning that "Labour would be rash to think pro-Keynesianism was a done deal."

In reality, the proposal bares no resemblance even to the limited reforms of the New Deal introduced by Franklin Roosevelt in 1933. Little concrete detail is currently available as to what will constitute the speeded-up public sector projects, which at any rate are heavily dependent on private finance. And both Brown and Darling have made clear that they will ensure any borrowing is swiftly reduced as soon as economic conditions allow.

Moreover, the move has the backing of significant sections of big business, which recognise it as an extension of the government's efforts to place the burden of the financial crisis onto working people. The *Financial Times* editorialised that while it was "galling" to see the rules on public sector borrowing relaxed, "Mr. Brown and Mr. Darling are doing the right thing," noting "the private sector's appetite to lend money to governments has never been bigger... As Adam Smith once remarked, there is a great deal of ruin in a nation."

The government's "stimulus" plan in fact involves no help for the millions facing joblessness and home repossession.

The Bank warned that 1.2 million UK homeowners are at risk of negative equity if house prices continue to fall sharply. Already house repossessions have climbed by 71 percent over the year, amidst warnings that some 25 percent of homeowners are under threat as house prices are expected to fall by 30 percent. With hundreds of thousands facing the loss of their jobs, Brown categorically ruled out any aid stating, "I can't promise people that we will keep them in their last job if it becomes economically redundant. But we can promise people that we will help them into their next job."