Britain in recession: Mervyn King’s moment of clarity

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There is some truth in the old saying, "Don't shoot the messenger". Though his admission was certainly damaging, Bank of England governor Mervyn King's statement Tuesday before businessmen in Leeds that, "It now seems likely the UK economy is entering a recession", was not responsible for the precipitous fall of the pound that followed.

If anything, King's was a deliberate understatement of the real position facing the UK economy. What was in reality most significant in his statement was his frank admission that on October 6 and 7 Britain's banking system had been closer to collapse than at any time since the start of World War I.

King told his well-heeled audience that it is "difficult to exaggerate the severity and importance of those events. Not since the beginning of the First World War has our banking system been so close to collapse".

Bank funds had started to dry up and it required the radical action of the £500 billion bank bailout to ensure the survival of the financial system. Even so, King insisted that the provision of liquidity by central banks was only "a sticking plaster" and not a substitute for proper treatment of the problems afflicting the banking sector.

King went on to speak of how "the plan to recapitalise our banking system, both here and abroad" meant we had "turned the corner" and begun "a long, slow haul to restore lending to the real economy, and hence growth of our economy, to more normal conditions."

But this proved to be less convincing than his admission, as summarized by the BBC, that "this was one of the worst banking crises ever. He does not say in so many words, but the Bank of England, along with counterparts at the Treasury and the Financial Services Authority, seem to have found themselves looking over into an abyss with unthinkable consequences if they fell."

The next day, the pound plunged almost five cents against the dollar and fell against the euro. The 3.4 percent fall to its lowest level since September 2003 was the biggest decline since September 1992, when investor George Soros drove sterling out of Europe's Exchange Rate Mechanism.

However, King's remarks could only have an impact if what he was admitting was what the markets already believed—that sterling is overvalued because of the dire state of the UK economy. In reality the UK is already in recession, something that Prime Minister Gordon Brown was also forced to accept in a speech to parliament the next day when he warned of a "sharp and prolonged slowdown".

Moreover, the pound's fall took place against a background of sharp falls on European and Asian stock-markets due to fears of a deep global recession with the United States at its epicentre.

The International Monetary Fund's six-monthly study has warned that euro zone economic growth will almost grind to a halt next year, with zero growth in Germany, Europe's most powerful economy. With Sweden only the latest European government to announce a $205 billion bank rescue, the IMF also warned Wednesday that more European banks might still fail. Private funding is "virtually unavailable" the IMF said, and banks will have to rely on public intervention, asset sales and consolidation. Europe's banks have already been forced to borrow $72 billion in short-term loans from the European Central Bank, as other credit sources have dried up.

UK will be worst hit by recession

Even so, it is becoming clear is that the UK economy is perhaps the most exposed to the global downturn. The National Institute of Economic and Social Research has said the UK is on the brink of its first *full year* of recession since 1991 and that the economy will shrink by 0.9 percent in 2009, with consumer spending falling by 3.4 percent, business investment down by 3.8 percent and private housing investment by 17.1 percent.

The NIESR has warned that "The British economy will

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suffer next year as it experiences the worst setback among the G7 countries." And if the government's £50 billion banking bail-out did not succeed, the recession could be even deeper and longer. The NIESR said its forecasts assumed that the Bank of England would cut interest rates to 4 percent early in 2009.

The Ernst and Young Item Club predict that the UK economy will decline more dramatically still next year--by one percent--and that it has "deteriorated dramatically" in the past three months. The credit crunch would hit the economy "very hard", it warned. Consumption will fall by 1.2 percent next year, with credit continuing to be hard to obtain and unemployment expected to rise.

It also predicts house prices will fall 14 percent by the end of this year, and drop a further 10 percent next year. Mortgage lending fell to its lowest level for more than three and a half years during September, according to the Council of Mortgage Lenders, ten percent less than during August and fully 42 percent below the level for September last year. Housing sales have fallen by more than half, down 53 percent in September compared with the same month in 2007. Andrew Clare, head of asset management at Cass Business School, told the *Sunday Herald* that housing prices could slide by a further 40 percent, "taking UK house prices to 2023 before they matched the level reached in 2007."

The Confederation of British Industry has reported falling demand for UK made goods and a drop in output leading to the sharpest single-quarter fall in manufacturing confidence in 28 years, with 46 percent of firms reporting falling orders—the fastest decline since 1999. Many firms are planning to reduce spending on machinery and buildings, the largest cut back since the early 1980s. UK retail sales fell 1.5 percent below their September 2007 level, with Homebase, Currys and Argos reporting falling sales. "Christmas will be painful for much of the sector as consumers continue to batten down the hatches," reported Ernst and Young.

Mass unemployment

This will lead to a massive rise in unemployment.

The CBI predicts that 23,000 manufacturing jobs will be shed in the third quarter and that this number will increase to 42,000 in the fourth quarter—a total of 65,000 redundancies. Such job losses in manufacturing will add to the hundreds of thousands in the financial, retail and service sectors.

The number of people out of work in the UK has soared by 164,000 compared to the previous quarter, the biggest rise for 17 years. Now at 1.79 million, or 5.7 percent, unemployment is widely predicted to stand at two million by December possibly rising to three million by December 2010—or nine percent.

The Chartered Institute of Personnel and Development said that recruitment is slowing and redundancies rising. "We'll see hundreds of thousands of jobs being lost, and unemployment is likely to rise, certainly above two million. The question is how much further than that," said the organisation's chief economist, John Philpott.

The *Sunday Herald*, in a survey entitled "Capitalism isn't working" noted that unemployment would rise across all sectors of the economy, all age groups and all regions.

It reported, "In the last turn-down in the 1980s some areas of Britain escaped, especially London and south east England. This time round, unemployment in London is already estimated to be 300,000 and rising daily as the City's financial institutions re-evaluate their needs in a shrinking market. The latest unemployment figures appear to show increases across Britain and there is no evidence to suggest that the rise towards three million won't be uniformly felt."

This is politically significant in that both the Conservatives under Margaret Thatcher and John Major and Labour under Tony Blair and Gordon Brown depended on relatively better-off social layers predominantly located in the south east to provide a degree of social support for their pro-business agenda. Now even that is breaking up, threatening ever-sharper political and social convulsions.

The efforts by government to bail out the super-rich also herald massive attacks on working people. UK government borrowing soared to a 60 year record high of £8.1 billion in September and is projected to reach £64 billion this year or over 40 percent of GDP. With £500 billion already committed to supporting the banks it is inconceivable that increased levels of borrowing can be sustained without tax hikes and deep cuts in public spending and welfare programmes.

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