Grim forecasts for British economy

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Several reports published in the last few days testify to the increasingly serious impact the financial crisis is having on Britain's financial institutions, the broader economy, public finances and the living conditions of working people. They portend the introduction of sweeping austerity measures, the likes of which have not been seen in the post war era and which the traditional organisations of working people will do nothing to oppose.

Last week, the IMF issued a stark assessment of the UK economy, explicitly criticising the budget and its optimistic assumptions announced by Chancellor of the Exchequer Alistair Darling just last month.

It forecast that the UK economy would shrink by 4.1 percent this year, the biggest peace time contraction since the Great Depression of the 1930s, and 0.4 percent in 2010. It warned that despite the government's "bold and wide ranging" response to the banking crisis, the banks were still exposed to bad debt from the fallout of the financial crisis and insufficiently capitalised, making it difficult for them to lend on the scale required for economic recovery. Figures just out indicate that business investment has fallen by 8.4 percent in the first quarter of this year from that of a year ago.

Consumers, faced with high levels of household debt, falling house prices, a reduction in the value of their occupational and personal plans due to the fall on the world stock markets, rising unemployment and reduced access to cheap credit, are cutting back on spending.

The Council of Mortgage Lenders announced a 60 percent fall in home loan advances for April compared to last year. The Economist Intelligence Unit in its report noted that "This [the lack of household credit] in turn is aggravating a severe downturn in the housing market, which may not reach bottom until 2010 or 2011. Employment has also started to fall, and we expect the rate of unemployment to rise sharply to close at 11 percent by 2011".

The IMF cautioned that the UK remained susceptible to shocks, in particular to the banks and financial institutions, and that the government should prepare contingency plans to bail out the banks again. It said that the authorities should "stand ready to provide further support where needed". But that must lead to a further increase in government borrowing and contingent liabilities—the potential claims on public finances if the banks redeem the government's guarantees. Standard and Poor's, the credit ratings agency, believes that such claims will reach £100 to £145billion (between 7 and 10 percent of GDP).

The IMF noted that it was not just the public debt that was rising, but so were its contingent liabilities arising out of its guarantees to the financial institutions. In addition, there are the explicit and implicit support measures for the government's public private partnerships and bailouts of failed privatisations, all of which are—Enron style—off the balance sheet.

The IMF warned that "the sharp increase in public sector borrowing and contingent government liabilities, together with continued financial sector fragility, are significant vulnerabilities. In these circumstances, a severe shock has the potential to disrupt domestic and external stability".

It insisted that the key to shoring up the banks' financial situation was to restore "fiscal sustainability". Stripped of the bland language of such reports, the IMF was serving notice that the government's projected debt level is unacceptable, and that the bank bailouts must be paid for through attacks on working people. The Brown government and its successors are being called upon to implement public expenditure cuts and reduce borrowing much faster than the chancellor had planned, i.e., in one five-year electoral term, not two or three.

Standard and Poor's report expressed similar concerns last week, downgrading its outlook on British sovereign debt from "stable" to "negative". It said that the UK's triple-A rating was at risk unless government borrowing was cut sooner rather than later. It reaffirmed the UK's actual credit rating, but said the outlook had deteriorated "at a faster rate than Standard and Poor's had previously assumed", because of the massive borrowing to deal with the banking crisis and the recession, which last month cut tax receipts by £2 billion while increasing benefit payouts by £1 billion, compared to a year ago.

The government may miss its own forecast of £175 billion

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in debt for 2009-10, itself a massive increase on last year's £90 billion. Standard and Poor's expects public debt to reach 100 percent of GDP by 2013. The UK's gross debt, already 53 percent this year, is expected to breach the European Union's Stability and Growth Pact limits of 60 percent by next year.

It is the first potential downgrade of UK public debt since the agency began rating government debt in 1978. A credit downgrade could make it more expensive for Britain to borrow. A higher cost of borrowing would increase government expenditure on debt servicing. Bringing down the total level of debt would mean drastic spending curbs and tax rises.

Standard and Poor's warning is significant because it is not based upon new data but is consistent with all the public finance forecasts.

Much to the government's annoyance, the Bank of England also confirmed these reports. The Bank has cut its growth forecast over the next two years and raised its estimate for inflation since February. It appears to be projecting a decline of about 3.9 percent this year and growth of about 1 percent in 2010. The Bank believes that inflation will fall to around 0.5 percent by the end of this year before picking up to around 1.2 percent in two years' time—below the Bank's target rate of 2 percent.

Mervyn King, the Governor of the Bank of England, said that the economy would take time to recover. "There are pretty solid reasons for supposing that there will be a recovery next year, but also pretty solid reasons for questioning if that will be sustained", King said. "But in the light of the state of balance sheets particularly in the financial sector, the committee [the Monetary Policy Committee] judges that the risks are weighted towards a relatively slow and protracted recovery".

Last month, the Bank agreed to expand its programme of "quantitative easing"—in effect printing money—by spending £50 billion of the remaining £75 billion authorised by the government to buy up the banks' worthless toxic assets. This comes on top of £75 billion in March. The committee wanted the chancellor to increase the £150 billion limit "should economic conditions require it". But the Bank said it was "too soon" to know whether the quantitative easing was working.

While the Labour government has bailed out banks and mortgage lenders on the point of collapse due to their own semi-criminal and reckless policies, it has done and will do nothing to assist the millions of working people struggling with mortgages, rising bills and debt. Instead, they face a catastrophic decline in their living standards.

Prime Minister Gordon Brown has made it clear that public sector workers will see their pay rise by no more than 2 percent even as prices rise. He has encouraged private employers to similarly limit their pay increases.

The Institute of Fiscal Studies concluded on the basis of last month's budget that working people would have to face 10 years of austerity measures to bring public debt down to 40 percent of GDP.

A report from the financial services company PWC gives an indication of just what such austerity measures might entail if the government is to bring debt below 50 percent of GDP by 2018. It warns that additional tax hikes or public spending cuts building up to £115 and £133 billion a year by 2017-2018 will be needed, equivalent to £5,000 for every family in the country.

John Hawksworth, head of macroeconomics at PWC, says that the Treasury believes that public finances will come under control by 2017-18. But this is just when the impact of an aging population takes effect. He is calling for tax increases or spending cuts "sooner rather than later" in order to "avoid unduly large increases in the tax burden on future generations of workers to pay for the future pensions and healthcare costs of current generations of workers".

The National Institute of Economic and Social Research estimated that the state pension age would have to be raised to 70 to cut the debt.

Nicholas Timmins, in a *Financial Times* article, looked at where the axe would have to fall in order to balance the books. Selling off the state's assets would not provide the cash it yielded in the 1980s. "More controversially, it involves reducing the role of—and burden on—the state and increasing the role the individuals will play, where politicians believe that will be justified. For example, the introduction of university tuition fees, which look set to rise again after the election; the long term rise in the state pension age; or a reduction in the generosity of public sector pensions".

But as Paul Johnson, a former director of public services at the Treasury, lamented, "Shrinking the state is terribly difficult. [Governments] don't get far in reducing the size of the state without reducing the numbers working for it or reducing the amount they are paid". This is a recipe for a slash and burn programme of job losses and real wage cuts.

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