Britain still in recession

Julie Hyland
24 December 2009

The UK economy remains in recession, according to figures released Tuesday. The economy shrank by 0.2 percent between July and September, making an overall contraction of 6 percent since April 2008.

The longest and deepest recession since the Second World War has confounded analysts, who expected the latest figures to show that the UK had finally turned the corner. It means that Britain is alone amongst the G20 countries in remaining in recession. This is despite the fact that the Labour government has committed proportionally the largest amount amongst Western nations to bailing out the banks.

The Bank of England's Financial Stability Report confirmed that some £1 trillion of public monies has been handed over by the Brown government in various fiscal stimulus packages—including cash injections into banks and state underwriting of their debts. This is equivalent to almost 75 percent of national income, the BoE reported. Bank bailouts accounted for 50 percent of Gross Domestic Product in the United States and 30 percent in the Eurozone.

The BoE states that the massive subvention of public funds was necessary to rescue the world economy from collapse at the end of 2008. Total losses in financial wealth towards the end of the first quarter of 2009 "were equivalent to around 50 percent of world GDP," it states.

Unemployment rose sharply as a consequence, especially in the United States and Britain. This had a knock-on effect on property prices, which fell sharply. By March 2009, house prices in the US had fallen by 30 percent, "the largest nominal fall on record. In the United Kingdom, property prices had fallen further than in the early 1990s recession, with residential and commercial property prices down 20 percent and 41 percent respectively from their 2007 peaks," the BoE reports.

At the same time, "personal insolvencies and bankruptcies rose to historic highs," while total corporate insolvencies in the UK increased by more than 50 percent in the first quarter of 2009 compared to the previous year.

The various fiscal stimulus packages saw "central bank lending to the financial system and beyond expanded, leading to a more than doubling in central bank balance sheets to around 15 percent of GDP in the United States and United Kingdom. Almost half the world's largest 20 banks received direct government investment."

The BoE report confirms that while government intervention has proven a lucrative bonanza for the City of London and the super-rich, it has by no means resolved the underlying economic problems and has left a huge financial burden for working families.

Far from the fiscal stimulus packages being seen as a temporary, one-off measure, it has fuelled a new feeding frenzy on the stock markets. "Risk appetite appears to have returned," the BoE report states, and "market sentiment has improved in recent months. Equity markets have risen by 25 percent—35 percent from low points in March, recouping around US$8 trillion of mark-to-market losses."

The situation remains precarious: "Notwithstanding these positive developments, balance sheets of banks internationally remain weak…. As long as these balance sheet vulnerabilities persist, there is a risk to the banking system from further adverse economic or financial sector developments, which could in turn affect lending and economic recovery."

Writing in the *Times* of London, John Waples noted that not only must the banks refinance their debts over the next years, but they "also have to wean themselves off the financial support package provided by the Bank by 2012. That includes £178 billion provided by the BoE's special liquidity scheme and a further £134 billion of guarantees issued under the Bank's credit guarantee scheme. Put a further €180 billion of European leveraged loans into the mix that have to be refinanced between 2013 and 2016, and you start to get a flavour of the gargantuan challenges still faced by our British banks."

In addition, the BoE noted that "Governments have also taken on very sizable contingent claims, for example through debt guarantees. The cost or utilisation of these

© World Socialist Web Site

contingent claims will not be known for some time."

Referring to Ireland and Greece, which have suffered cuts in their credit ratings amidst demands by the financial markets for massive austerity measures, the BoE warned of further downgrades if action was not taken decisively to cut state deficits. Although the UK is not referred to directly by the BoE in this context, with its public sector net borrowing at a record £20.3 billion in November some economic and political commentators have warned of a Greek-style scenario unless drastic measures are taken.

According to the Office for National Statistics, public sector net debt is at £844.5 billion, or 60.2 percent of UK economic output. Chancellor Alistair Darling has been attacked for concealing the fact that annual interest payment on this debt is forecast to reach £60 billion within four years—approximately double current interest charges. This would mean that interest repayments on the national debt would be the second largest single outlay for the government after the National Health Service.

The BoE does state, "Because of the projected UK government debt position, investors might have become more concerned about the UK's credit standing and demanded additional compensation to hold gilts"—one of the principal means through which government bridges the gap between public spending and tax revenue. It points out that already there has been a marked increase in the cost of insuring the UK against the risk of default.

So far, the major ratings agencies have delayed acting on the UK's credit ratings until after the general election due by June 2010. Responding to the latest figures showing Britain remained in recession, rating agency Fitch reiterated its demand that the UK must "articulate more credible and stronger fiscal consolidation during the course of 2010 to underpin confidence in the sustainability of public finances." The absence of such measures, it warned, made the risk of downgrade more likely.

The BoE report underscored that, so far, many families have only been able to weather the economic storm thanks to extremely low interest rates. Should rates start to rise, as expected, it would have major impact—especially under conditions where, the Bank notes, arrears on unsecured loans such as credit cards and overdrafts "remain high" and many borrowers will be hit by "payment shocks" due to the increase in mortgage repayments.

With regards to the long-term course of action, the BoE stated that the objective must be to build a "more resilient financial system," "without the expectation of large-scale official support." Reiterating its concerns over institutions regarded as too "big to fail," it warned that "the current size and structure of financial systems may be incompatible with maintaining financial stability." Urging that "market discipline…be strengthened significantly," it recommended that in order to "control risk-taking, financial institutions need to face a credible threat of closure."

While it may be necessary for government to step in "sometimes" as a "backstop to the financial system," such "interventions should be guided by explicit principles to ensure that they do not encourage imprudent behaviour by financial institutions and that they minimise risks to the public finances," the report urged. If annual payouts in bonuses and shareholders dividends had been just 20 percent lower in each of the years between 2000 and 2008, the BoE noted, the banks would have stored up £75 billion of additional capital, and would not have required state assistance.

"Work is needed to gain acceptance for such principles," the BoE report stated. This is a major understatement. Even its minimal proposals have been fiercely contested by the City of London and the super-rich.

Only at the start of the month, directors at the Royal Bank of Scotland threatened to resign en masse if the government tried to prevent them paying out bonuses of £1.5 billion. RBS has been the recipient of the largest state bailout paid anywhere in the world to a single bank. Some £53.5 billion has been handed over to shore up RBS, which has been effectively nationalised.

In response to government proposals for a one-off "windfall" tax on discretionary bank bonuses, Goldman Sachs has become the latest financial institution to threaten a pullout from the City of London. According to reports, the investment bank has threatened to move up to 20 percent of its London-based staff to Spain. The threat is seen as a bargaining ploy by the bank, which is in negotiations over the bonus tax. Only at the weekend, HM Revenue & Customs agreed that stockbrokers, asset managers and insurance companies will be exempt from the tax after protests.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site