Signs of post-Brexit financial crisis mount

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Three more property funds in Britain shut the door on redemptions Wednesday following the earlier decision by three major funds on Monday and Tuesday to halt withdrawals of cash.

A total of more than £15 billion in the commercial property market is now frozen, threatening to snowball into the biggest seizing up of financial markets since the 2008 financial crisis.

The six funds were forced to close the door on withdrawals after growing numbers of investors sought to pull their cash on fears of a collapse in the British commercial property market in the wake of the June 23 Brexit vote.

The freezing of the market began when M&G Investments, Aviva Investors and Standard Life Investments suspended withdrawals on Monday and Tuesday. They were followed by Henderson Global Investors, Colombia Threadneedle and Canada Life on Wednesday. According to a statement by Canada Life, the freeze could last for up to six months.

In a note to clients, Laith Khalaf, a senior analyst at the investment firm Hargreaves Lansdown, said that "over half of the property fund sector is now on ice" and would remain so until managers could raise enough cash to meet redemptions. The funds would likely be closed for weeks or months rather than days, she added.

There is a significant risk that as the funds are forced to sell commercial real estate to meet cash demands, they will further depress real estate prices, spurring more withdrawal orders and triggering a chain reaction leading to disaster.

A spokesman for Britain's Financial Ombudsman Service said that although the decision to suspend redemptions had been expected, the extent of the suspensions so far had been "quite troubling."

The commercial property market has proven to be particularly vulnerable to the shock waves from the Brexit vote because of the previous inflow of cash into London and southeastern England fuelled by the cheap money policies of the Bank of England and other central banks since 2008. The funds lend long-term for the financing of property development projects but borrow short-term, offering investors the prospect of being able to withdraw their cash on short notice. This is the same business model that led to the collapse of Britain's Northern Rock bank in 2007.

The Brexit decision had an immediate impact on the inflated commercial property market because of fears that financial and investment firms would chose to relocate their European headquarters to the continent so as to retain access to the European Union market. The *Financial Times* reported that at least £650 million worth of large-scale commercial property ventures had been shelved within a week of the Brexit vote.

The turbulence could rapidly extend beyond commercial property into the financial system as a whole. According to Keenan Vyas, a director at the financial advisory firm Duff & Phelps, the consequences could be profound. "If there continues to be a tremendous pressure in a short period of time, this could result in a large number of sales transacting below book value and an eventual overall correction in property asset pricing across the UK market," he said.

Sales below book value will mean that firms that borrowed money on the assumption that property prices would continue to rise will be unable to pay off their debts, extending the crisis into the banking system.

Lloyds Banking Group and the Royal Bank of Scotland could be badly affected. According to Sandy Chen, analyst at the UK securities firm Cenkos, "both have large commercial property loan portfolios, and the coming falls in commercial property indices will translate into higher required impairment provisions against them." In other words, they will have to make greater provisions for bad loans, impacting their balance sheets.

Overall, the large UK banks have lent £69 billion to the £800 billion British commercial property market.

The sell-off goes beyond property and is a key factor in the stability of the financial position of the UK. In its latest financial stability report, released Tuesday, the

Bank of England (BoE) noted that the financing of Britain's "large current account deficit" relied on continuing capital inflows.

Commercial property has been a key source of foreign cash, but, as the BoE reported, foreign flows into UK commercial real estate sank nearly 50 percent in the first quarter. Moreover, "valuations in some segments of the market had become stretched." This is a euphemism pointing to an asset bubble in commercial real estate, fuelled by speculation.

The BoE report pointed to high levels of UK household indebtedness and the vulnerability of such households to increased unemployment, "fragilities in financial market functioning, which could be tested in a period of elevated market activity and volatility," and "subdued growth in the global economy, including the euro area, which could be exacerbated by a prolonged period of heightened uncertainty."

The growing financial turbulence has seen the British pound continue its fall. From a level of $1.50 before the Brexit vote, it has touched levels below $1.30, with predictions that it could go to as low as $1.15.

The global bond market is characterised by a manic flight to safety, which has pushed up bond prices and dramatically lowered yields (the two move in an inverse relationship).

On Tuesday, the yield on US 10-year government bonds reached a record low of 1.375 percent, with yields on German and Japanese long-term bonds in negative territory. Australian government bonds, while still positive, have also hit record lows. The total value of bonds with negative yields has soared, rising by more than $1 trillion over the past month. It is now heading towards $12 trillion.

The Brexit fallout is not confined to Britain. In the immediate sell-off that followed the June 23 referendum, Italian banks, which have about €360 billion worth of bad loans on their books, were among the hardest hit. The largest Italian lender, UniCredit SpA, has lost 60 percent of its share value so far this year.

In an interview with Bloomberg Television on Wednesday, the chairman of the French financial firm Société Générale and former member of the executive board of the European Central Bank, Bini Smaghi, warned that the country's banking crisis could extend to the rest of Europe. He called for rules preventing direct state aid to banks to be reconsidered to prevent that taking place.

"The whole banking market is under pressure," he said. "We adopted rules on public money; these rules must be assessed in a market that has a potential crisis to decide whether some suspension needs to be applied."

Under EU regulations, national governments cannot directly use public funds to prop up their banking systems. But this has been challenged by Italian Prime Minister Matteo Renzi, who has said he is prepared to intervene if necessary with a 40 billion euro taxpayer bailout of the country's major banks. The main opponent of such action is Germany. Finance Minister Wolfgang Schäuble underscored this by insisting at a news conference that his Italian counterpart intended sticking to banking union rules.

But Smaghi said there was the possibility of a system-wide crisis unless the government stepped in. He said there were too many banks in both Italy and Germany, and the Italian government had to take politically unpopular measures, including mergers, leading to job cuts.

He also warned that proposals by Britain to further cut corporate tax rates, in order to attract investment, would lead to tax rate competition across Europe.

New bank bailouts and competitive cuts in corporate taxes will mean further attacks on the working class, including deeper cuts to social services to pay for them.

Whatever the immediate developments flowing from the Brexit turbulence, two things are clear in light of the bitter experiences of the crisis of 2008 and everything that has followed.

First, the ruling elites not only have no solution to the crisis—their actions over the past eight years have only created the conditions for a new and bigger financial meltdown—and second, any measures they do adopt will bring ever-worsening conditions for the working class in Britain and across Europe.