

# Economic Context

Dr. William Thomson,  
Director of Economics

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## “These are unprecedented times ...”

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*Many Britons seem to believe that their recession is the worst since the 1930s.*

*The slump (in America) has been billed as the “mother of all recessions.”*

*Consumers have had much to worry about ...: they are overburdened with debt; house prices, their main store of wealth, are falling; and many feel their governments are mismanaging the economy.*

*The main imbalance still requiring correction in America and Britain today is the private sector’s heavy debt burden. ... If yesterday’s big spenders become tomorrow’s penny-pinchers, so the prospects of any consumer-led recovery could shrivel.*

**Source: *The Economist* 16th March 1991 & 18th April 1992**

# Will the game change forever?

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## 1990s – End of ...

- Escalating household debt
- Public finance imbalances
- Housing boom(s)
- London's dominance
- The North-South Divide

## 2008 – End of ...

- Escalating household debt
- Public finance imbalances
- Housing boom(s)
- London's dominance
- Financial Services
- Globalisation
- Capitalism
- The world as we know it ...

# Summary

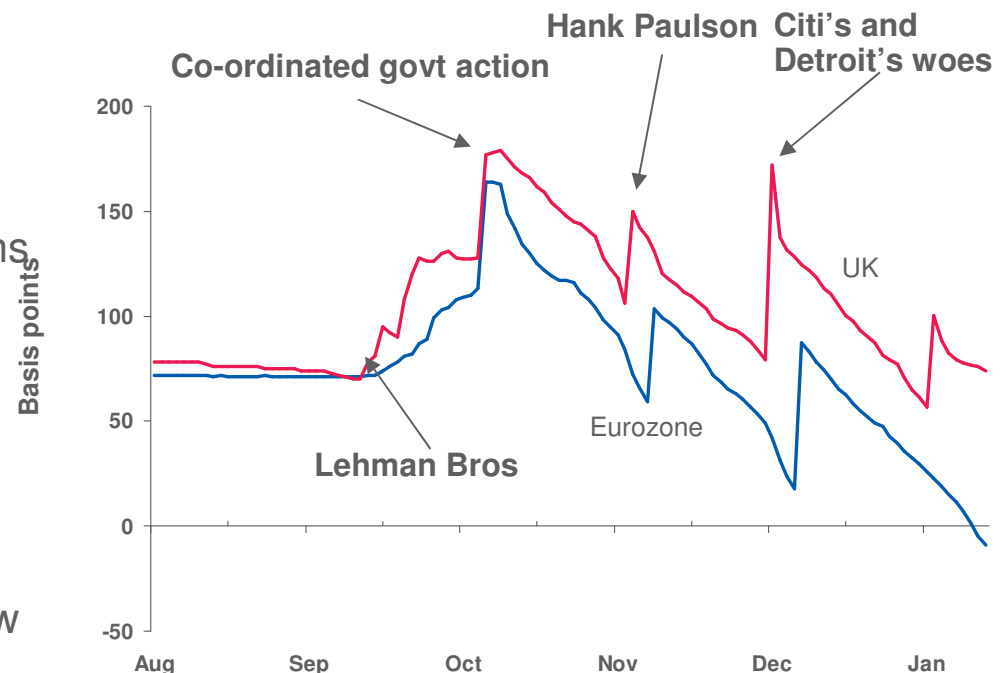
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- **All major economies have or will fall into recession; while emerging economies are slowing markedly or look vulnerable (Eastern Europe)**
  - Asset market bubbles burst
  - Resulting credit crunch
  - Lehman Brothers fallout
- **Great Depression 2.0 has been avoided so far**
  - Interest rates slashed and a raft of unprecedented liquidity measures
  - Capital injections
  - Fiscal stimulus
- **But deep and widespread recession**
  - Households deleveraging
  - Slow thaw of money markets
  - Major trade partners are also in recession
- **Risk:** slower permanent 'speed-limits' in the future
- **Worst-case scenario:** 'lost decade' like Japan in the 1990s

# Credit crunch continued

- **Spreads elevated**
  - Renewed meltdown (Lehman Bros)
  - Well above pre-Sept levels
- **Easing?**
  - Further rate cuts & liquidity injections
  - Other unorthodox measures
- **'Normalisation' by end 2009?**
  - Risk premia shifting up
  - Could last well into 2010/11
  - Feedback loops: Real economy now hitting financial markets

Spreads between 3m money markets and policy rates



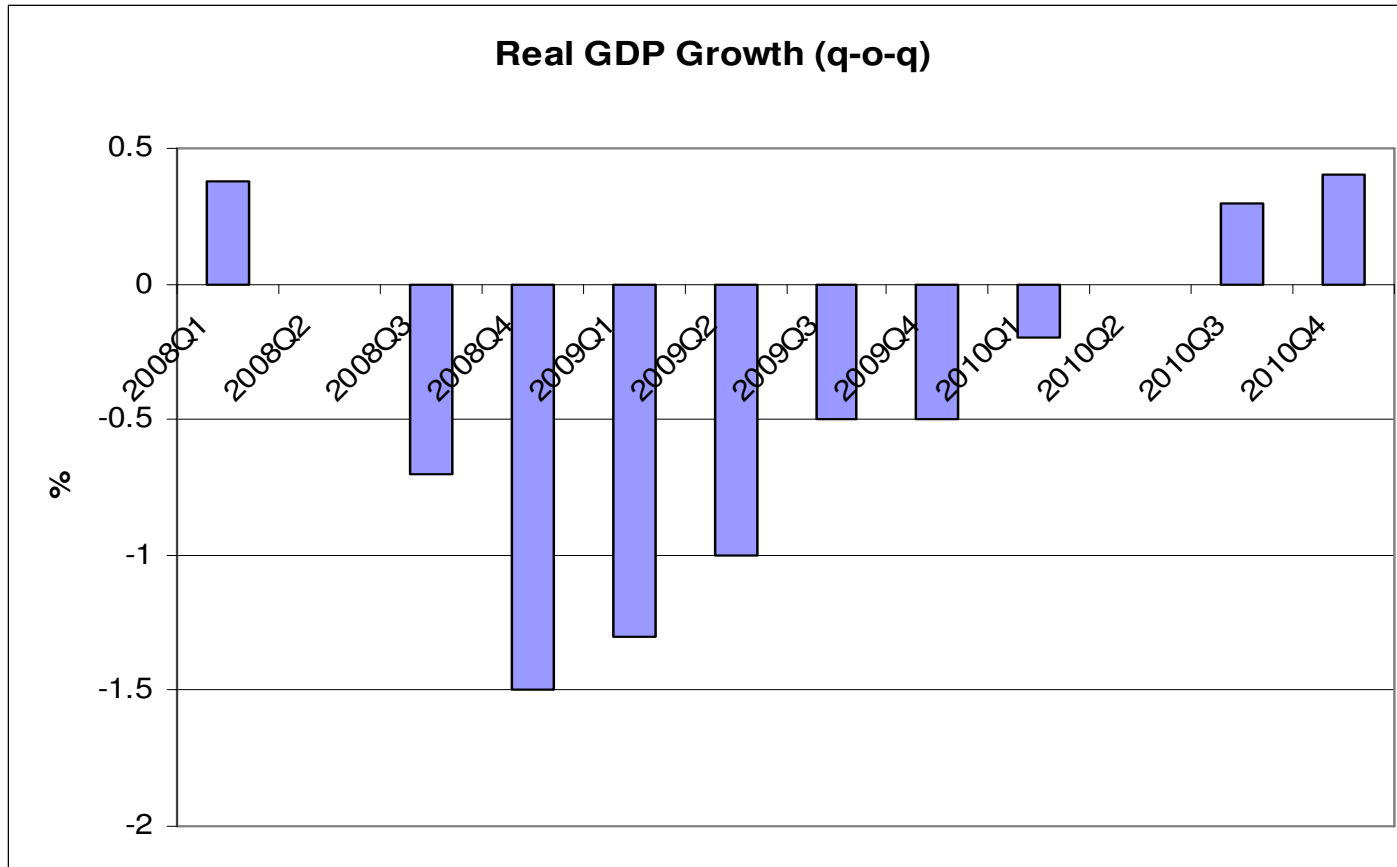
Source: Bank of England; European Central Bank

# View from the UK

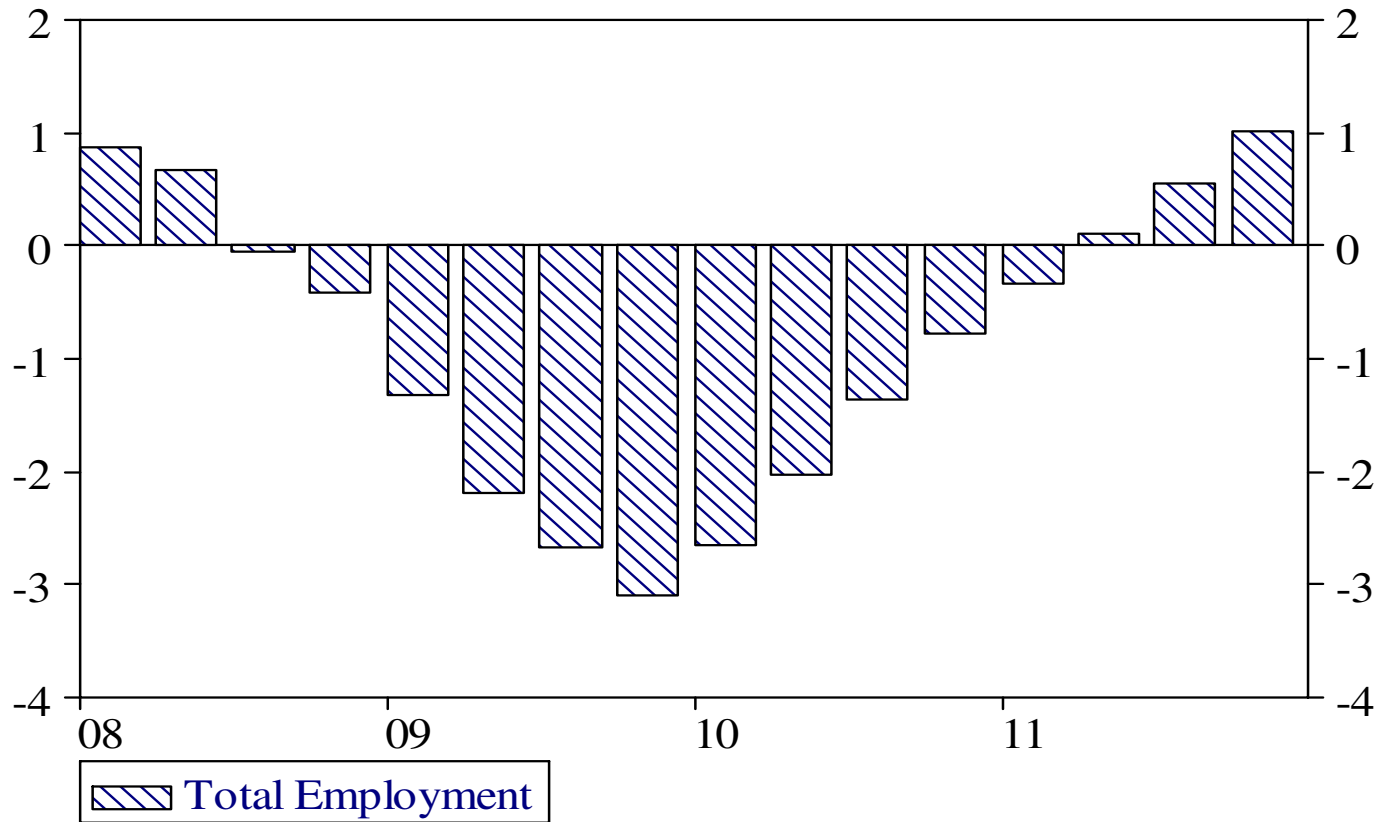
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- Recession as bad as the early 1980s
  - ◆ Economy to contract by 2.6% in 2009
  - ◆ Unemployment to rise above 3 million
  - ◆ Interest rates to fall below 1% and more house price falls ahead
  
- Recovery will be slow
  - ◆ Growth below 0.4% in 2010, close to 2% medium term
  - ◆ Consumer deleveraging, fiscal consolidation and higher risk premia
  
- Downside risks:
  - ◆ House price correction has further to run
  - ◆ 'Normalisation' of money markets is delayed until 2010-11
  - ◆ Second-round effects: another wave of bank failures

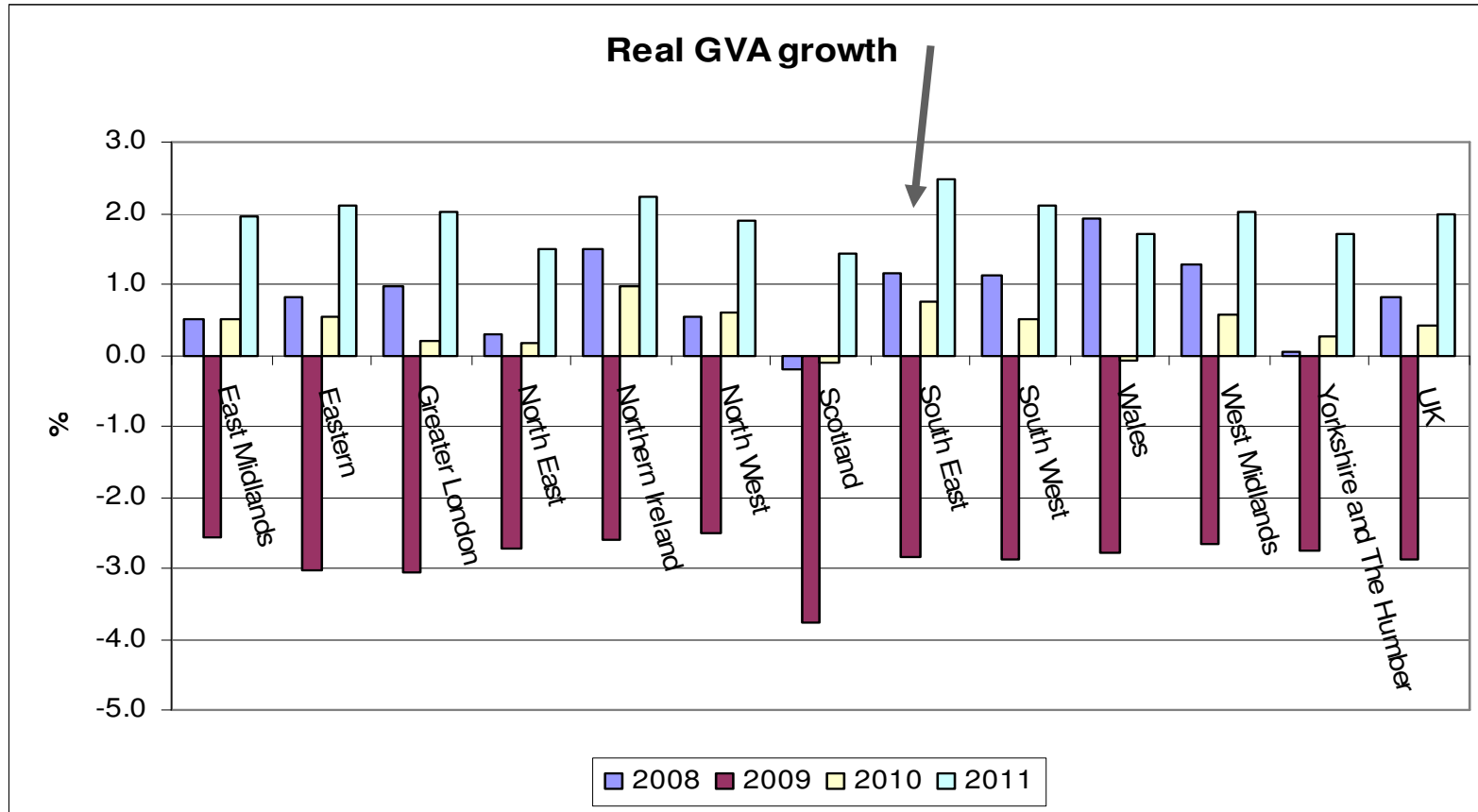
# UK: Contraction and stagnation



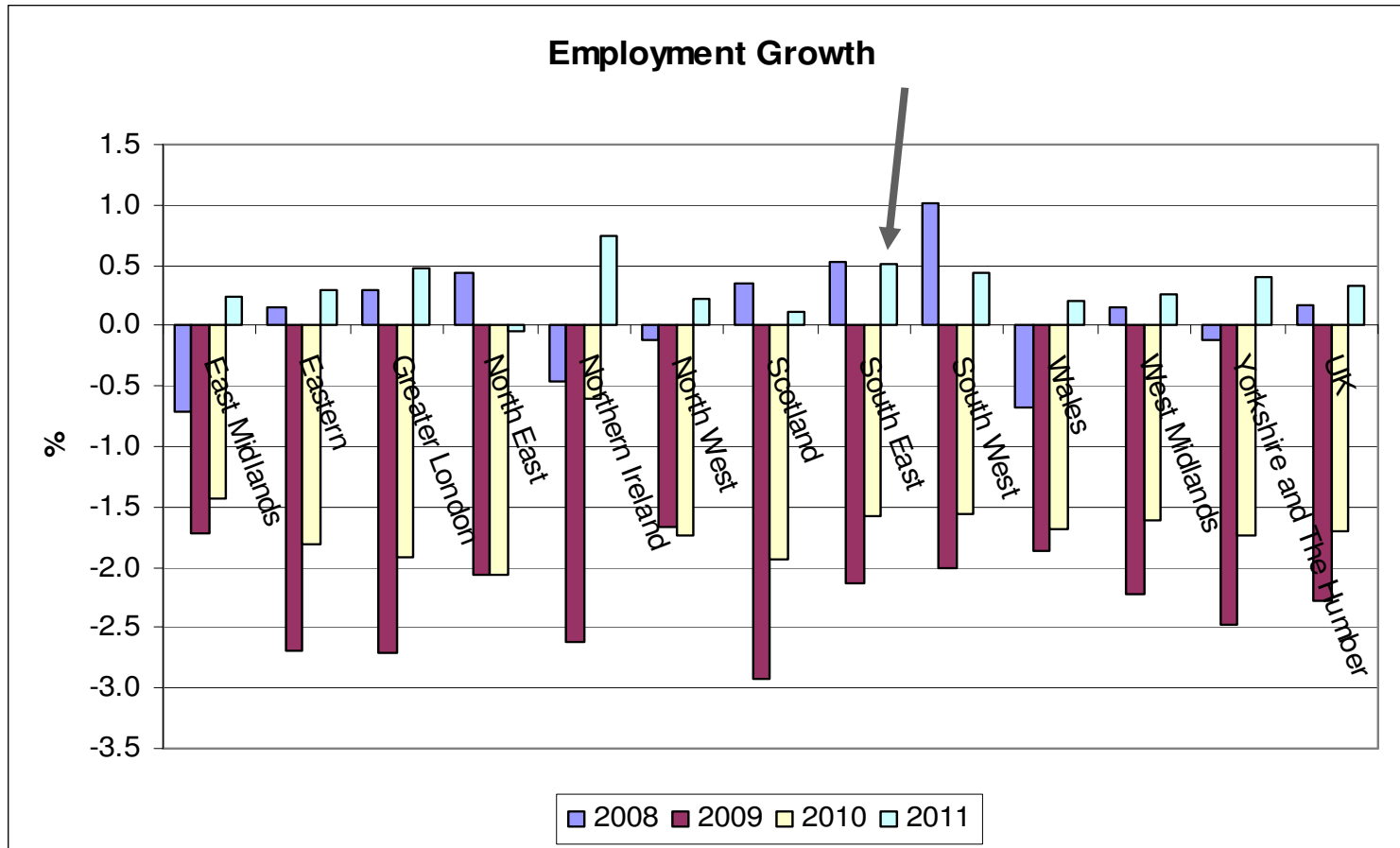
# Labour market collapses



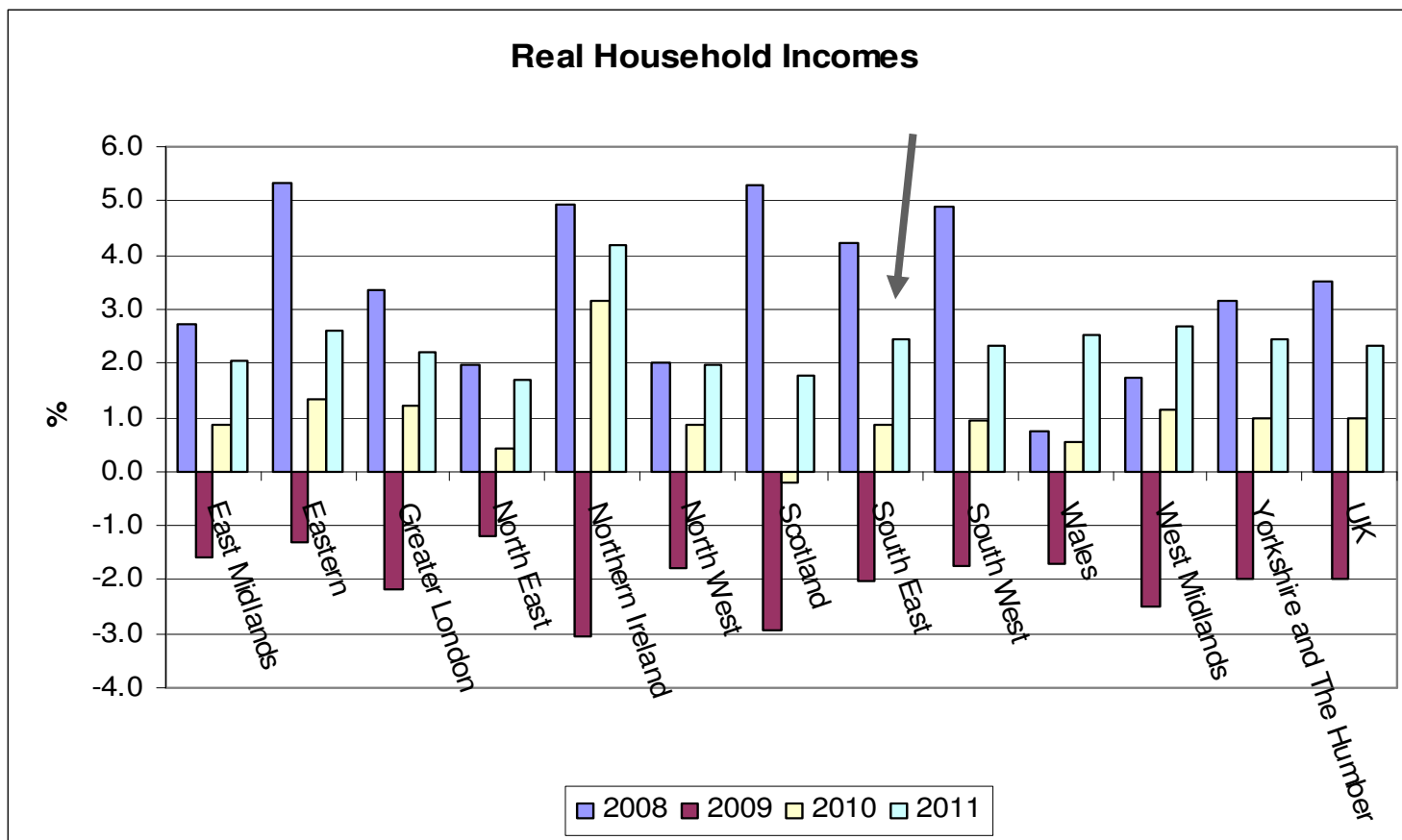
# South East recovers fastest (2011)



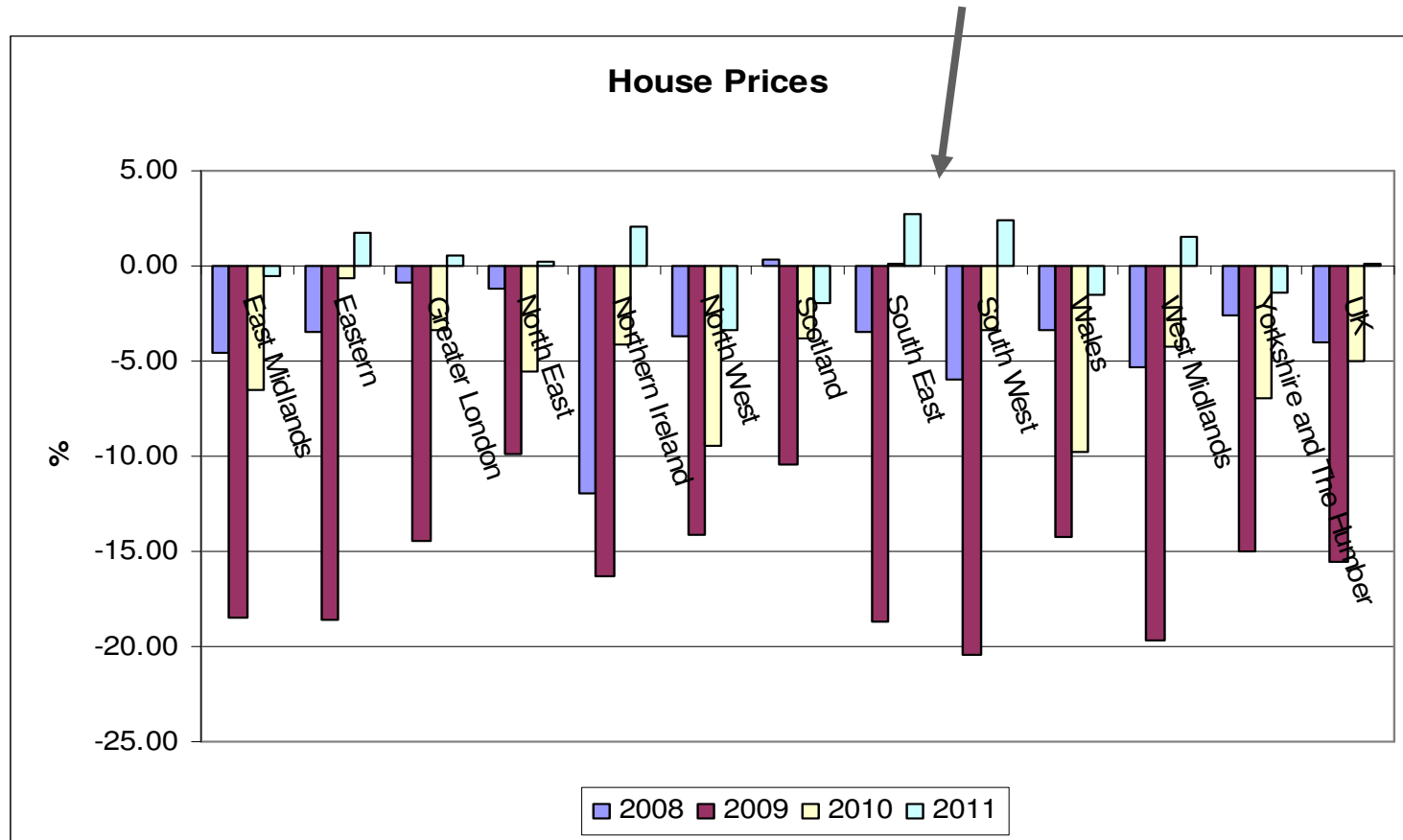
# Labour market recovers faster



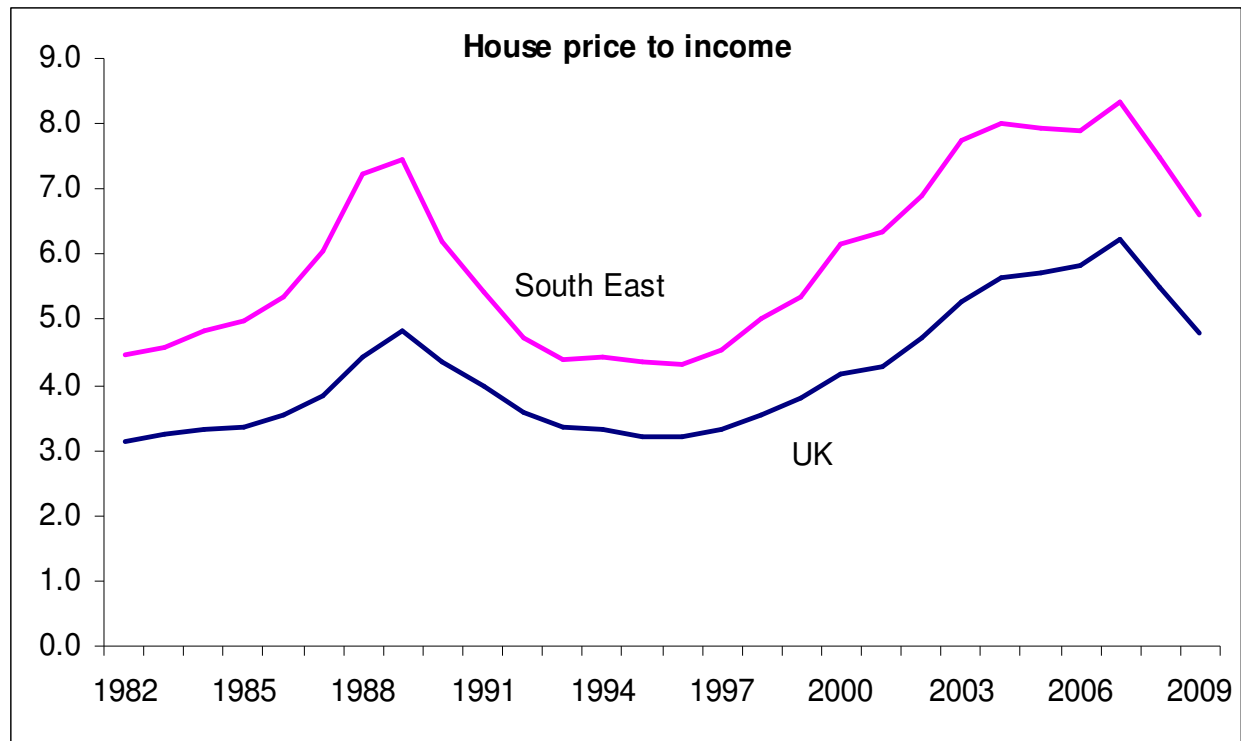
# Real disposable incomes move in line with UK average



# House price adjustment strongest in South East



# House prices – a long way to fall yet



## Downside risks: Game over!

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- Downturn longer and deeper
- Bank losses even worse than feared
- Credit spreads remain wider for longer
- Long term interest rates rise rapidly
- House prices undershoot
- Deflation and more deflation
- Unemployment moves towards 4 million not 3 million
- Consumers retrench further
- Sterling collapses

