

Britain's Economy: Going, Going . . .

by Mary Burdman

Like the rotten old house in Charles Dickens's *Little Dorrit*, the British economy is teetering. Last year's speculative frenzy in the housing market was apparently squashed in 2005, so now some are talking of housing prices going on "crabwise"—but this cannot last for long. In reality, the situation is like that unreal morning in Dickens's book, after the great speculator Mr. Merdle's famous bank had already crashed, but none of the victims knew it yet. Now, the housing inflation bubble, the "basis" of the whole crazy structure, is ready to go.

In 2004, U.K. housing prices shot up some 20-22%; this year, prices have just kept with inflation, or fallen outright—depending upon whom you ask. Consumer spending is stagnating, industry is evaporating, and the whole shaky New Labour public spending policy is imploding.

Since 2003, skyrocketing inflation of housing prices and consumer credit spending has generated a £1.1 trillion (\$1.87 trillion) personal debt bubble in Britain, the largest in the European Union. Even the self-adulating Labour government is gloomy. On Dec. 6, Chancellor of the Exchequer Gordon Brown had to admit to the "toughest and most challenging year for the economy" in his eight years at the Treasury. He announced £5 billion in tax increases over the next three years, while having to cut in half his wildly over-optimistic 2005 growth forecast.

The vast majority is mortgage debt, but some 20% is unsecured consumer debt. Consumer spending counts for two-thirds of the British "economy," the whole thing based on illusions about ever-rising property prices. But the property price inflation rate peaked in Summer 2004; since February 2005, it has been sinking. According to the broad-based *Financial Times* index Dec. 9, house price inflation is rising at the slowest rate since June 1996. The index said that November prices were up just 2.1% year on year—just about the current official rate of inflation in Britain.

But that is the best of it. The housing market analyst Hometrack reported, on Dec. 21, the first annual *fall* in housing prices in 10 years, with prices down 1.29% this year, and down 4.17% since mid-2004. Earlier, on Dec. 6, Britain's largest building society, Nationwide, predicted house prices stagnating at 0-3% growth in 2006, but warned that if there is no "economic recovery," prices could fall up to 2%. There was an unusual year-end uptick in mortgage lending—the first such rise in over a year—but at least half of this was

due to high levels of remortgaging, the Council of Mortgage Lenders said Dec. 20.

Prices have a long way to fall. The Office of the Deputy Prime Minister reported Dec. 13 that the cost of the average property is £186,103, which is more than *eight times* the average salary. Traditionally, mortgage lenders granted loans for houses up to 3.5 times a buyer's annual salary. Warnings are out that, even in the current stagnating market, the average price in some areas of the U.K. could break through the £200,000 barrier in 2006—if the whole house of cards does not tumble first.

This year-end, some hints of the extent of the trouble are coming from leading institutions in the City of London, one of the three largest financial centers in the world. In the Bank of England's "Financial Stability Review," released Dec. 16, Bank deputy governor Sir Andrew Large warned of "significant downside risks" for the financial system. *The Economist* Intelligence Unit used the same phrase on Dec. 19, talking about "the threat of falling house prices." Two days later, in its article "Miraculous Recovery or Last Gasp?" *The Economist* cautioned those who want to believe in the "surprisingly strong" figures now being published about house prices: "Housing markets may be the canaries that signal the fate of the broader economy. And, as any miner will tell you, canaries don't live all that long."

Meanwhile, the "buy-to-let" market is in trouble; big lenders, including the Portman Building Society, are now refusing to accept new applications for buy-to-rent mortgages on new properties, because of fears about the stability of the market. The buy-to-let market had been sustaining the housing bubble, since house prices are so high that new buyers just cannot get in the market. On Nov. 25, the British Property Federation warned that some lenders were offering new types of mortgages which do not require rental income to be more than the monthly mortgage *interest* repayments, while previously, they had required rental income to be at least 130% of interest, allowing for other costs—such as rental vacancies, arrears, and so on. British Property Federation officer for rentals, Ian Fletcher, warned that "at this point in the rental cycle . . . things [are] not as buoyant as they have been. . . . We would be worried if these types of deals became prevalent." The arrears on buy-to-let loans have doubled in the past 18 months, to 0.7%, almost as high as 0.88% for conventional mortgages.

The Debt Bomb

The British population is drowning in debt. As economics journalist Liam Halligan wrote in the *New Statesman* Oct. 24, two-thirds of outstanding credit card debt in the European Union is British. The average household has unsecured loans of £7,650, almost \$13,400, rivalling the situation in the United States. The *Daily Mail* reported Dec. 7 that an estimated 3 million people in the U.K. owe more than

£10,000 unsecured debt, out of a population of almost 60 million. Of these, some 2.5 million have unsecured debts of more than £50,000. In London, 9% of the population owe more than £10,000.

The weight of the debt is having an impact: Britain saw the biggest fall in consumer spending in 22 years, the Confederation of British Industry (CBI) reported at the end of September. Sales have fallen for seven months. Stores are closing down at a record rate, with those related to the housing market worst hit.

Consumers took advantage of the Bank of England's August interest rate cut to dump their debt onto their mortgages. There was a net reduction in credit card debt in August, but an 8% rise in home loans. This is hardly a safety net. In the third quarter, the Department for Constitutional Affairs reported a 66% year-on-year increase in mortgage repossession orders in England and Wales, to nearly 20,000, while the total number of homeowners being taken to court by lenders rose 55% to nearly 30,000. The Council for Mortgage Lenders has predicted that more than 10,000 homes will be repossessed by the year end. These numbers are low compared to those of the 1990s housing crash, when some 70,000 houses a year were repossessed, but they have been rising steadily. In the 1990s, the critical factor was high interest rates; now it is high personal debt.

The government is also introducing new measures which make it easier for lenders—banks, credit companies, and stores—to collect debt, including any profit on the forced sale of a debtor's house. Debt counsellors are warning that these measures are effectively abolishing the distinction between a secured and an unsecured loan.

At the end of October, it was reported that British corporate insolvencies are up more than 20% over the past year. According to Consultants Experian, 4,787 firms went under during July-September, up from 3,954 in the third quarter of 2004. The sectors that are doing the worst are those most exposed to the housing market and consumer purchasing.

Personal bankruptcies are now twice as common as when Labour took office. Personal insolvencies have been rising for seven months to hit a record in the third quarter. Department of Trade & Industry figures showed 17,562 personal insolvency cases, up 46% from a year ago; these include more lenient "voluntary" insolvencies and 12,043 bankruptcies. This rise brings the total number of individual insolvencies during the past 12 months to 60,102, which could break the 1992 record.

Losing Work

In December, Britain saw the tenth monthly increase in the number of people claiming unemployment benefits, to 902,000—the longest monthly rise in more than 13 years. The U.K. government says it has very low unemployment, but this

is deceptive. If those unemployed not claiming benefits are added, the numbers are more like 1.5 million. On top of this are some 2.7 million people on incapacity (disability) benefits, mostly former industrial workers, of whom two-thirds could actually work.

In eight years, under Blair's New Labour, Britain has lost 1 million manufacturing jobs, far more than under the last Conservative Prime Minister, John Major, when 500,000 jobs were lost in 6.5 years. Overall, manufacturing employment has fallen 60% since its height in the early 1970s.

Blair's "employment miracle" is in the public sector, which is now jeopardized by growing public debt. Some 930,000 new public sector jobs have been created since 1997, almost *half* the 1.97 million total rise in employment, according to *Sunday Times* economics editor David Smith. These are service jobs: national industries used to employ more than 2 million people, but since the era of Margaret Thatcher, that has dropped to only 400,000.

Energy Crunch

What is left of British manufacturing could be finished off this Winter, if predictions of the coldest weather in years are borne out. At the end of October, CBI deputy director general John Cridland warned that rising energy costs and falling consumption had hit U.K. factories, whose output was at the lowest level for two years. Cridland said that 21,000 manufacturing jobs had been lost since August, and warned that another 24,000 would go by year-end. Despite sharply rising energy costs, firms were cutting prices just to keep going.

In November, things became more dire. Gas prices shot up almost 45% in Britain, Europe's largest consumer and the one with the highest prices. North Sea sources are drying up, but nothing has been done to deal with the problem. On Nov. 1, the chemicals firm INeos told the Parliamentary Trade and Industry Select Committee that a very cold winter would cause a "devastating energy crunch," leading to "massive" rises in the price of gas, which "is very likely to put many manufacturers out of business for good. We expect the U.K. to be short of gas leading to a gas deficit emergency. This will have consequences such as 'three day weeks,' wide-scale power cuts, loss of essential services such as water and sewerage, and further business closure. We are faced with the nightmare scenario that, in the event of very cold winter weather conditions, the U.K. will essentially be 'closed for business.' Much of this business will not recover and is unlikely to operate again."

The head of the Energy Intensive Users Group, of steel, glass, and paper makers, was quoted in *The Times* Nov. 23: "We are in uncharted territory. If prices stay at these levels it is difficult to see how industry can continue without closing some plants. It is no longer economical for many industries to run at full production." The high fuel costs sent overall raw

materials prices up by 12.7% in November. But product prices charged were down 0.2%, according to the Office for National Statistics.

Trade and Industry Secretary Alan Johnson had to announce Nov. 22 that lights would not go out in Britain "under any scenario whatsoever" this winter. But the situation was bad enough for Downing Street to publicly order an inquiry, after a secret meeting Nov. 10 of government ministers and industry representatives. The Department of Trade and Industry has commissioned reports on how large industrial users and power stations could cut their gas consumption to safeguard domestic supplies, and the effects these cuts would have on the economy.

Nuclear Makes a Comeback

At least some good may come from this debacle: nuclear energy is back on the agenda. The Labour government has been anti-nuclear, but now things are changing. In his speech Nov. 29 to the CBI, Blair said that Energy Minister Malcolm Wicks will publish a policy statement on energy in early Summer 2006, which "will include specifically the issue of whether we facilitate the development of a new generation of nuclear power stations." In the next 15 years, Britain will have to decommission coal and nuclear plants which generate some 30% of the current electricity supply; this cannot be replaced by "renewables," so therefore, nuclear must be under consideration, he said. Ironically, Blair's rash promises to cut carbon emissions when he signed the Kyoto Protocol, is forcing his hand on the matter of "clean energy"—nuclear is the only one which will meet those standards and keep the lights on in Britain.

Blair is also under pressure on transport. On Nov. 27, CBI head Sir Digby Jones said that the CBI is calling for the government to spend an extra £1 billion over the next two years on road and rail projects, and overall an injection of £60 billion to increase spending in the coming decade to £300 billion. Jones told the BBC: "Although transport spending has risen in recent years, there are decades of under-investment to deal with, and it is clear that business still finds it far too difficult to get its goods to market and its people to work. . . . The government must not bury its head in the sand. We have to do something about it, and quickly.

He said that "Germany built two high-speed railway lines and three airport terminals in the time it took us to have a planning inquiry to build Terminal 5 at Heathrow. This is no way for the fourth biggest economy on earth to operate." Jones earlier had said that there soon had to be a decision on the future of nuclear power, which he called a "reliable, low-carbon energy source."

There are, after all, a few reasonable voices in the wreckage in Britain. If the United States can pull itself out of industrial collapse, there are chances for economic sanity even there.