After the crisis: How Britain has and has not adjusted?
Lecture - David Smith, economics editor of The Sunday Times

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In 2008, the world faced what many economists considered to be the worst financial crisis since the Great Depression, or possibly a hundred years. Originating in the American housing market, it quickly spread to the Eurozone and affected its member countries. In the summer of 2007 it began to affect the British economy, and in particular the banking system – resulting in the first run on a British bank – Northern Rock – since the 19th century, including Britain.

It has now been 7 years, yet it is still not clear to many whether Britain and other countries have adjusted to the effects of the crisis. Mr. David Smith, economics editor of The Sunday Times, expertly answers this question.

Post crisis, many of the world's economies went into large public sector deficit and rising government debt, with the Eurozone not being an exception. Additionally, the banking system was also heavily affected, requiring a large number of world governments to undergo the lengthy process of capital injection and/or full or partial bank nationalisation. This time lag is evident in the fact that many British banks are currently still living on state support, and will continue to take time to recover.

In regards to how Britain has or has not adjusted to the crisis will be considered on the basis of the following five aspects: Growth, the labour market, fiscal adjustment, rebalancing and normalization.

Growth post-crisis has been a stop-start recovery. The recession in 2008 led to a 6% fall of GDP, after previously experiencing 66 consecutive quarters of growth. Current recovery rates remain weak compared to past standards, despite a period of normal recovery within the last 18 to 24 months. Recently, in spite of weak productivity growth, the UK recovery looks better by international standards. Weak productivity growth appears to have been the result of the substitution of cheap labour for capital and growth of jobs in lower-productivity service industries.

The British labour market continues to experience falling unemployment, currently at an unemployment rate of 6%, which is significantly better than the European average. Employment is at its highest level ever, and employment growth has been stronger recently, with an estimate

of 2 million more people in work than at the lowest point of the recession. In face of reduction of jobs in the public sector, employment continues to grow, however wages are still relatively weak. This is because working on minimum wage has become the norm for many workers, dragging the average of wages down. Despite all this, falling inflation rates has helped ease the pressure on consumers but a puzzling pay breakdown remains.

Another aspect to consider is fiscal adjustment, which is comparably slower than after past recessions. As a result of slow fiscal adjustments, borrowing in the public sector reached very high levels. Targets for reducing spending in the public sector have mainly been achieved. The difficulty is on the revenue side. This is partly caused by certain tax revenue problems, such as loss of revenue from the City and also weak income tax receipts: the result of weak growth in wages. The elimination of the current budget deficit was targeted to be achieved by May 2015, but slow growth in tax receipts has hindered this. By the end of this parliament, it is estimated that only about half of the overall deficit reduction intended by the coalition government will be completed.

In terms of rebalancing, all sectors of the UK are currently growing and contribute to a portion of GDP. However, only the services industry is currently above pre-crisis levels. Business investment has been recovering well, but exports have been disappointing. Since the crisis, world trade has grown by less than world GDP, which is underwhelming when compared to pre-crisis growth, which was typically twice as fast as that for world GDP. This has contributed to the record current account deficit. Due to these factors, rebalancing is considered the biggest failure in any assessment of post-crisis readjustment.

The monetary policy implemented by the Bank of England has had some success but remains relatively loose, with interest rates value at virtually zero. This in turn has ushered in the longest period of unchanged Bank Rate since shortly after the Second World War, at the lowest ever official rates in history. The unconventional policy of £375 billion of quantitative easing has not been reversed, nor is there any sign of that on the near horizon. It is predicted that rates will eventually rise, with the Bank of England and Federal Reserve expected to hike in 2015, but will

only do so gradually and to a significantly lower level than in the past (with 2.5% or 3% being the new norm for rates).

Briefly, the answer to Britain's adjustment is that there is a long way to go, and on most measures the country is no more than halfway through the process. Recovery from a crisis of such a major scale may take 10-15 years of adjustment and will not be completed any time soon.