Dr. Vincent Cable on the Banking Crisis

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We have 'Punch and Judy' politics, Cameron blaming Brown's domestic policy, Brown claiming global crisis. Vince Cable casts both sides as foolish then artfully concedes both have a point.

What the government has done has been right. Dr Cable confessed he initially advocated a strictly classical approach, that is, to let Northern Rock fail. But once intervention was planned he advocated "going all the way" and taking it into public ownership. Letting a small bank fail sends a message to the others but Lehman Bros was not big and its fall had repercussions on every bank in the world. HBOS is one of the biggest. You couldn't let that go without rattling the whole system. For the shareholders to lose everything is part of the deal but you risk destabilising bond markets. Government moved quickly, Mr Cable said, that the UK came within 24 hours of complete collapse of the banking system.

10 year crisis

Forget Recession, 18 to 24 months, this is a banking crisis and they are a ten year phenomenon. Depending on how it is addressed. The Scandinavians did all the right things. They moved swiftly to nationalise the banks, separated out all the bad loans. Re-established confidence and when the crisis was through they refloated the banks and even made a profit. Whereas the Japanese banking crisis has lasted 15 years. There were elements of corruption. Throughout a lost decade no one would admit the problems. 'Zombie firms' that should have been let fail were propped up by banks. Zero interest rates failed to halt the decline. From the bust in 1990 Japan did not come off the bottom until 2003, remaining vulnerable as the current crisis hit. Japan is still in trouble 3.3% fall in output Q4 of 2008 compared with 1.5% falls in Europe and America You should go further not just cut VAT but engage directly in public works. Asked if too many people employed by the state sector was a problem, Vince Cable gives an unequivocal 'NO' but also talked up the private sector. There is more of a shipbuilding industry in the UK than people realise he says. Beating metal is done abroad but the high value activities of design and marketing still thrive here.

UK government debt

The government's budget deficit is high at 10% of GDP. What used to be called the Public Sector Borrowing Requirement (PSBR) now Public Sector Net Cash Requirement is this year's overspend. or government debt. In a recession PSNCR at 10% of GDP should be regarded as 'normal', according to Dr Cable the Tory opposition is simply ideological anti-Keynesianism but in their early 90's recession it was 8-9%. It may be worth noting that in his 1998 budget report[1] Gordon Brown regarded 7% peak 90's PSBR as an expensive mistake to be prevented from recurring by his new cautious and prudent forecasting of the business cycle and by two policy 'rules'. The 'Golden Rule' that public debt to national income will be stable over the business cycle. Brown explained that revenue surpluses in 1993/4 which were simply part of a business cycle had been misconstrued to be the results of real structural improvements effected by Lawson/Thatcher's supply side policies. Ironic. So the Tories gave back a cyclical surplus in tax reductions, Labour spent it on public services. Traditional really. The accumulated debt is now £800bn 55% of GDP. It exceeded the 'sustainable investment' rule of 40% in July 2008 when the purchase of Northern Rock took it to 43% of GDP (46% with PFIs).

Money supply

Monetary reformers argue that while private banks are allowed to create money they cannot be allowed to fail without a disastrous hiccough in the money supply. Money broadly defined, M4, has grown every year from 1963 peaking in 2007 at £1.7tr (compared to GDP of £1.3tr). Cable agrees in principle the Bank of England could by-pass the banks if they are blocking the flow of credit to business. But in practice that flow may be more simply achieved through pressure exerted as the majority shareholder in HBOS, Lloyds TSB and Northern Rock.

Quantitative easing

QE to the tune of £150bn has been made available by the Bank of England with the consent of H M Treasury. This is new central bank reserves rather than issuance of Treasury Bills. Of the £150bn, to date we have seen a £75bn purchase of gilts and corporate debt. Is it 'printing money'? In the most important sense, yes, it is creation of new money. Albeit digital, not paper money. But although as cash (M0) it is 'new', it is being used to 'buy' (one might equally say 'extinguish') stuff that is itself almost money (M4) and was as liquid as cash two years ago.

Devaluation

Vince was upbeat on the beneficial effects of Sterling falling in a floating currency market. No doubt the fall represents a truer evaluation of the strength of the UK

[1]http://archive.treasury.gov.uk/pub/html/docs/fpp/lesson/main.html

The Gladstone Club
1 Whitehall Place London SW1A 2HD

economy displacing the chimera of a new paradigm of endogenous growth, an end to boom and bust. The perpetual motion myth has been debunked, again. Families and firms will 'buy British' as imports become more expensive for our weaker pounds and indeed there has been a sharp 6% fall in imports. However no sign yet of the green shoots of growing. Exports are down begging a question whether both phenomena are representative of a global contraction or the arrival of protectionism.

Dr Cable commended Gordon Brown and other leaders' efforts to head off a return of protectionism. The calls for 'beggar-thy-neighbour' policies, to protect national interests, to prop up failing native industries, or to tax imports inevitably grow louder in a downturn. He pointed to such noises in Obama's recent statements.

Consumer indebtedness

Cable expresses concern that UK has the highest level of consumer indebtedness and Brown cannot avoid responsibility. At £1.4tr consumer debt is 10x PSNCR. Should we be reassured that we are joined there by Netherlands and Sweden? According to Experian[2] we have irresponsible borrowers who 'can and occasionally do extend their unsecured debts well into six figures' then others previously responsible who run into illness, divorce or job loss. But 84% of the 1.4tr is secured home loans for which there are supposedly matching assets. Housing assets stand at £4.1bn. BERR[3] notes the ratio of Debt-to-Assets at 17% is unchanged over several years but hides a huge increase in the ratio Debt-to-Income from <50% in the 70s to 158% in 2008.

Lending on assets was self reinforcing. Cable says the Bank of England should specifically watch asset values as well as inflation in goods. While Chinese imports deflated the price of goods, the Consumer Price Index CPI failed to reveal 6% annual inflation in assets including house prices. The price of a house in London would buy five similar ones in Berlin.

[2]http://press.experian.com/documents/CRI%20indebtedness%2003-04%20GPO%20version.pdf

[3] Dept for Business Enterprise & Regulatory Reform 07 to 09, formerly DTI, now Business Innovation & Skills. 'Household Debt Monitoring Paper Feb 2009'