

Britain on the brink of an economic depression, say experts

Britain is heading for economic depression for the first time since the 1930s, economists have warned.

By Edmund Conway, Economics Editor
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Families must brace themselves for a slump of far greater severity and longevity than the recessions of the 1980s and 1990s, they warned. They said the current crisis will be of a scale to rival the biggest peace-time crisis in modern history — the Great Depression.

The warning was delivered by economists and politicians after the Office for National Statistics revealed that the economy shrank by 1.5 per cent in the final three months of 2008 alone.

The contraction follows a 0.6 per cent fall in gross domestic product (GDP) — the most comprehensive measure of Britain's wealth generation — during the previous three months. This means Britain fulfils the criteria for a technical recession — two successive quarters of negative output.

The news sent the pound sliding to its lowest level since 1985. Sterling dropped more than three quarters of a cent to \$1.3688 as investors speculated that the Bank of England may be forced to cut interest rates towards zero in response to the recession.

John McFall, the Labour chairman of the Treasury select committee, sounded a more optimistic note. He said: "We know that 2009 is going to be really tough for many people. There is a determination in Britain and across Europe to keep people in work, to avoid unemployment, so people's contribution will not be lost."

Confirmation that the economy has entered recession capped a week in which Gordon Brown was forced to announce a new £350-billion bank rescue plan. Unemployment has almost reached two million. President Barack Obama discussed the financial crisis with the Prime Minister on the telephone yesterday, his first call to a European leader.

The fall in GDP is the sharpest since 1980, when Britain was mired in its most severe post-war recession. The news is an embarrassment for Mr Brown, who pledged as Chancellor not to return Britain to "boom and bust".

Britain is likely to suffer more than other economies due to its heavy reliance on the financial services sector, which has all but imploded in the wake of the economic crisis, experts said.

Others raised the spectre of an outright economic depression, often defined by experts as a peak-to-trough economic contraction of 10 per cent. Aside from the demobilisation periods following the First and Second World Wars, this kind of contraction has never taken place — not even in the 1930s' Great Depression.

Roger Bootle, the managing director of Capital Economics, said: "I think there's a very good chance this recession will be the worst since the 1930s. I suspect the economy could shrink by 6 per cent from last year to the end of next year — and that might not be the end.

The plight facing Britain is uncannily similar to the 1930s, since prices of many assets — from shares to house prices — are falling at record rates, but the value of the debt against which they are held remains unchanged.

This "debt deflation" is among the most painful of all economic phenomena, since it means the amount families owe increases each year even if they borrow no more.

Albert Edwards, a strategist at Société Générale, likened the British economy to a Ponzi scheme — a fraudulent debt mountain like that allegedly used by the New York hedge fund manager Bernard Madoff.

"What I find amazing is that people aren't really nailing Gordon Brown and [Bank of England Governor] Mervyn King for this," he said. "At least in the US they had the excuse of the arrival of sub-prime — a new sector of the market. We didn't really have anything similar but we ended up with a bigger national Ponzi scheme than the US."

