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Pointmaker

UH-OH, WE'RE IN TROUBLE

...THE RECESSION'S COME ALONG AND BURST BROWN'S BUBBLE

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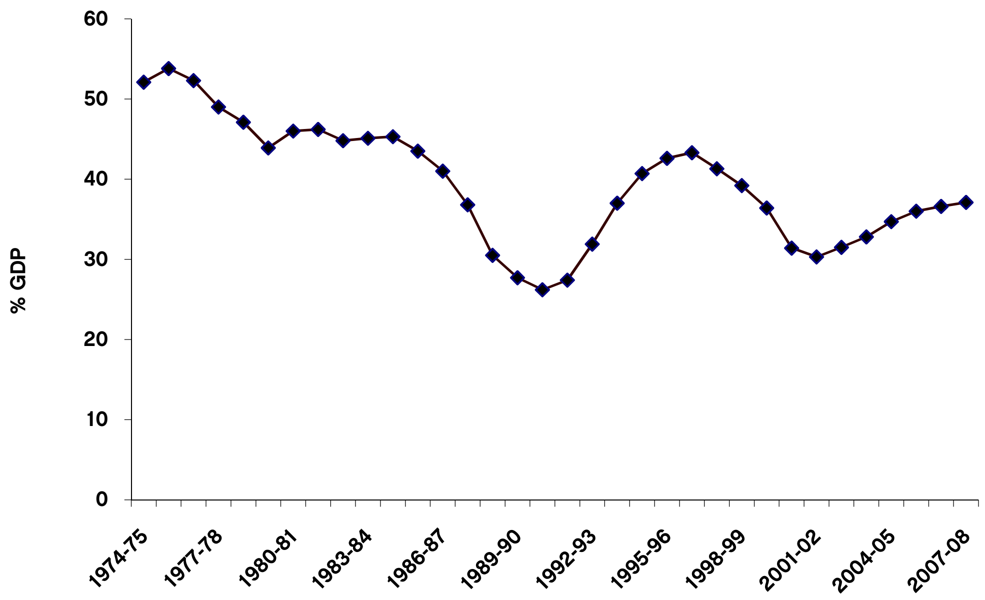
SUMMARY

- Public sector net debt is set to rise to around 50% of GDP, once the costs of the recent bank bail-outs are included.
- Should the full costs of all the government's off-sheet liabilities be included, then government debt would total 127% of GDP.
- At the beginning of the last economic downturn (in the early 1990s), government debt was only 26% of GDP.
- As government debt has increased, so too has consumer debt. Household debt has risen from 60% of GDP ten years ago to 100% of GDP today. Households are highly exposed to any economic downturn.
- While government and personal debt have both increased, real earnings have stagnated for five years. Average household disposable weekly income has risen by £17 in constant prices over the last five years. In contrast, average disposable weekly income rose by £85 in constant prices between 1996/97 and 2001/2.
- Profligacy means that both national and personal finances are in a weak state:
  - excessive government debt restricts the ability to cut taxes responsibly in the attempt to restart the economy;
  - high personal debt, falling house prices and rising unemployment will create great difficulties for millions of households, will harm confidence and will risk aggravating a sharp consumer slowdown.
- The combination of excessive public debt, high personal debt and stagnating earnings is toxic. As a result, the UK could be in serious trouble with the bursting of the Brown bubble.

GROWING PUBLIC DEBT-GDP RATIO



HIGH PUBLIC DEBT

While the financial crisis is indeed global, it is clear that the UK is particularly badly positioned to weather the storm. The Government has borrowed too much in recent years. After the Northern Rock collapse, public sector net debt (PSND) climbed to £645 billion, the equivalent of 26,000 per household or 43% of GDP. After the bank rescue plan, it is expected to be around 50% of GDP.

In comparison, in the 1990s recession, public debt peaked at 43%. In the early 1980s downturn, it peaked at 46%. The last time the public finances were in quite such a desperate state was in 1977-78 when it stood at 49%. So the current situation is most reminiscent of the economic situation of the 1970s.

And it is worse still than it seems at first sight. We are near the beginning of a possible downturn, not at the end. In contrast, before the 1990s downturn, public debt bottomed at 26% in 1990-91. Before the current economic problems began last year, public debt was some 37%.

Public debt is higher still when all the 'off balance sheet' financings undertaken by the Government are included.[1] The debt figures above do not include the full cost of projects financed through the PFI, the unfunded public sector pension liabilities, the debt incurred by Network Rail and the nationalisations of Northern Rock and Bradford and Bingley. If these are included, the real government debt is £1,850 billion – or 127% of GDP, or £75,000 per household.

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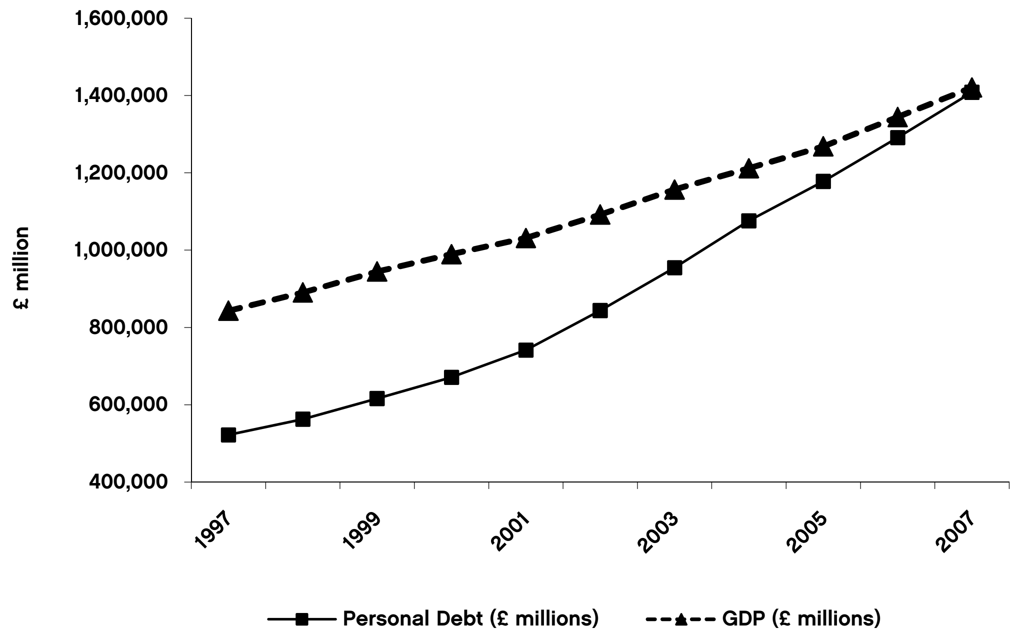
1 See Brooks Newmark MP, *The Price of Irresponsibility,* CPS, 2008 for more details.

GROWING PRIVATE DEBT



HIGH PRIVATE DEBT

Personal debt (mortgages, loans and credit cards) is also now at an alarming level. This now stands at £1,408 billion – the equivalent of £58,000 per household.

UK personal debt is now equal to the entire GDP of the UK. Ten years ago, personal debt was only 60% of GDP.

This increase in personal debt is largely the result of the excessive growth in UK money supply (itself the result of lax government regulation and inappropriately low interest rates over the last decade).[2]

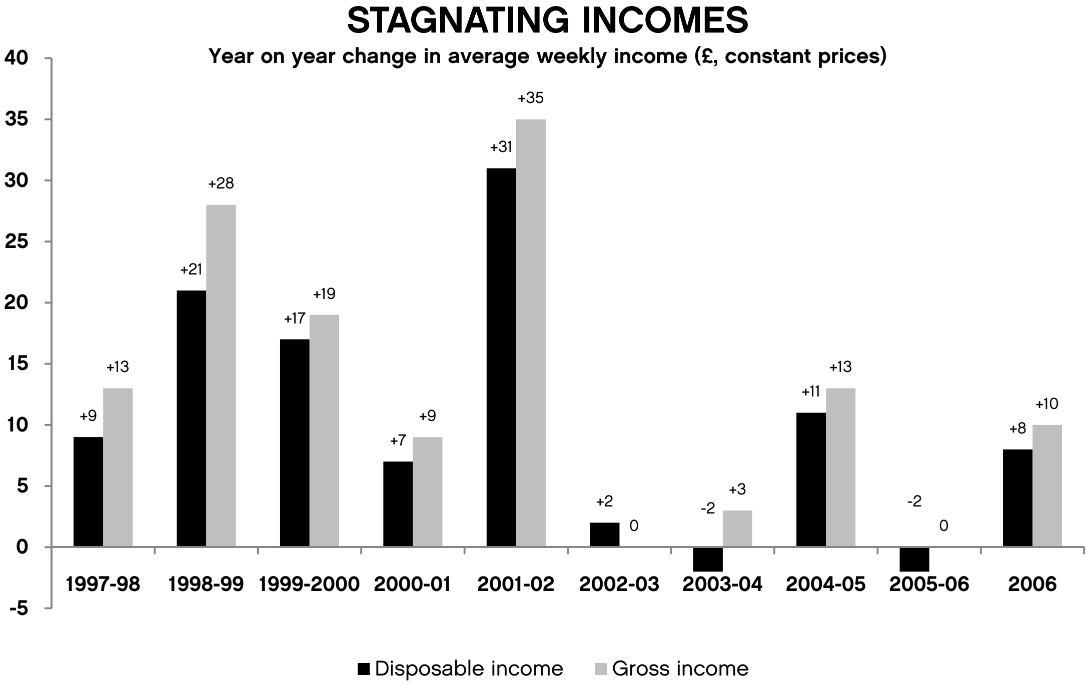
So it is not just the public finances that are overstretched. Our personal finances are as broken as the public finances. Households, as well as the government, are badly placed for economic shocks.

STAGNATING HOUSEHOLD INCOME

Even before the current turn of events, household income had been stagnating for some time. The latest available edition of *Family Spending* (ONS, 2007) shows that:

- Average weekly *gross income* per household has grown by just £26 in real terms, rising from £616 in 2001/02 to £642 in 2006, at 2006 prices.
- This is a compound growth rate of 0.7% a year. Households in the UK are hardly any better off than they were five years ago.
- Similarly, real weekly *disposable income* per household has gone up by just £17 a week over the same period, rising from £504 to £521. This is a compound growth rate of 0.6% a year.

[2] For more details, see Howard Flight, *From Boom to Bust: a plain guide to the banking crisis*, CPS, 2008.



- This contrasts with the higher growth rates in Labour's first term in office. Average *gross income* per household rose by £114 from £512 a week in 1996/97 to £616 a week in 2001/02 (at 2006 prices) – an average compound growth rate of 3.7% a year.

- Real *disposable income* per household increased from an average of £419 a week in 1996/97 to £504 in 2001/02. This was also a compound growth rate of 3.8% a year.

The Family Spending data is confirmed by the DWP's *Households Below Average Income* latest report (2008). Taking household income after taxes and benefits (a similar measure to disposable income in Family Spending yet before housing costs), the evidence shows that:

- Average weekly income grew by just £18 between 2001/2 and 2006/7, rising from £445 to £463 in 2006-07 prices.

- This is a compound growth rate of around 0.7% a year. Households in the UK are not significantly better off than they were five years ago.

- This contrasts with the higher growth rates in Labour's first term in office. Income rose by £68 from £377 a week in 1996/97 to £445 a week in 2001/02 (at 2006-07 prices). This was an average compound growth rate of 3.4% a year.

CONCLUSION

The combined effect of high levels of government and personal debt will exacerbate the depth of the recession.

High government debt means that significant debt-funded tax cuts are unlikely to be viable for long. With interest rates already being cut to new lows, the Government's ability to stimulate the economy further will be severely restricted.

For individuals, a "triple whammy" of rising unemployment, high personal debt and stagnating incomes will also restrict their ability to weather the impending downturn. For recent home buyers, falling house prices will compound these problems.

With the bursting of Brown's bubble, in the words of the pop group Shampoo, we're in trouble.

TABLES

GROWING NATIONAL AND GOVERNMENT DEBT

	GDP (£000s)	Government Debt (£000s)	Government Debt as a % of GDP	Personal Debt (£000s)	Personal Debt as a % of GDP (%)
1997	843,145	348,218	41.3	521,973	61.9
1998	890,272	348,986	39.2	562,464	63.2
1999	944,630	343,845	36.4	615,835	65.2
2000	989,552	310,719	31.4	671,105	67.8
2001	1,031,458	312,531	30.3	741,422	71.9
2002	1,092,056	343,997	31.5	843,574	77.2
2003	1,156,815	379,435	32.8	954,791	82.5
2004	1,211,978	420,556	34.7	1,075,966	88.8
2005	1,268,395	456,622	36	1,177,752	92.9
2006	1,344,308	492,016	36.6	1,291,476	96.1
2007	1,421,000	527,191	37.1	1,408,317	99.1

Sources: GDP data from HM Treasury figures (www.hm-treasury.gov.uk/data_gdp_fig.htm); debt from Budget Red Book 2008, Table C14; and personal debt data from ONS data series AMWT and VZRI. Note that these data exclude costs of all bank bail-outs (including Northern Rock).

STAGNATING INCOMES

Average weekly household income, constant prices (£)

	Disposable income	Gross income	Year on year change in disposable income	Year on year change in gross income
1996-97	419	512		
1997-98	428	525	+9	+13
1998-99	449	553	+21	+28
1999-2000	466	572	+17	+19
2000-01	473	581	+7	+9
2001-02	504	616	+31	+35
2002-03	506	616	+2	0
2003-04	504	619	–2	+3
2004-05	515	632	+11	+13
2005-06	513	632	–2	0
2006	521	642	+8	+10

Source: ONS, *Family Spending 2007*, 2008, Table A47. Note that this report has moved to a calendar year basis.

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