The financial crisis in the uk essay example

Countries, England

There have been a lot of crises throughout the history: South Sea Bubble (1720), Cuban missile crisis in 1960s, OPEC oil price shock in 1990s, Asian financial crisis of 1997, Economic crisis in Mexico (1994) and many others. However, the financial crisis of the 2007-2008 is said to be the worst crisis since the Great Depression of the 1930s. First victims were the countries, which are the biggest financial centers in the world. Later, in a year or half, the rest of the developing countries started to suffer from the financial crisis that became global.

The term of the housing bubble is usually used to describe the cause of the crisis. This means, that the prices of houses became so high that almost no one can afford them, and then the prices suddenly fall down. That is how the bubble burst.

Like all crises, this one affected the economy of all countries, but what is worse is that the consequences 2007-2008 are still cannot be resolved even using new fiscal, monetary of other policies.

Ben Dyson (2013) created an understandable chain how financial crises happen. The same chain can be applied to the financial crisis of 2007-2008. Firstly, banks created too much money. This means that “ every time a bank makes a loan, new money is created” (Dyson, 2013). At the beginning of the 21th century, bank created large sums of the new money by making a lot of loans. In 7 years, “ they doubled the amount of money and debt in the economy” (Dyson, 2013).

Secondly, banks use this new money “ to push up house prices and speculate on financial markets” (Dyson, 2013). Dyson notes, that a little part of the trillion pounds that banks created between 2000-2007 went to business that is outside the financial sector. He calculated, and it can be seen from the fig. 1 that nearly 31 percent of the money went to residential property, “ which pushed up house prices faster than wages” (Dyson, 2013). Other 20 percent was in the commercial real estate, for instance, office buildings and other business property. About 32% went to the financial sector, “ and the same financial markets that eventually imploded during the financial crisis” (Dyson, 2013). Next 8 percent went into different credit cards and personal loans. Finally, the last 8 percent went to the business outside the financial sector.

Source: Office for National Statistics 2012 cited in Dyson, 2013.

According to Dyson (2013), next link in the chain after the speculation in the financial markets, to be exactly, a huge amount of mortgages is the debts that became unpayable.

People started to lend large amounts of money to buy houses, and as a result, this made the prices of houses rise in the property market and the level of personal debt as well.

Having taken credits, people had to pay interests. But, the problem, as Dyson mentioned (2013), was the fact that he debt rising quicker than incomes. Sooner or later, “ some people become unable to keep up with repayments” (Dyson, 2013) and they stop repaying their loans. Furthermore, banks find themselves in danger of going bankrupt.

This caused the global financial crisis. As the former chairman of the UK’s Financial Services Authority, Lord (Adair) Turner stated in February 2013: “ The financial crisis of 2007 to 2008 occurred because we failed to constrain the financial system's creation of private credit and money" (cited in Dyson, 2013).

One of the ways how the government can tackle this issue is by pursuing a right fiscal policy. It was written in the Economy Watch (2010) that the British government took several expansionary fiscal steps in order to protect the major banks from bankruptcy.

When Northern Rock faced problems with interest repayments, that is from 17th September 2007, " the government guaranteed 100% deposits return for depositors' in Northern Rock up to 35, 000 pounds" (Economy Watch, 2010). This approach was applied to all banks on the 1th October 2007. Later, it was claimed that the limit was increased up to 50, 000 GBP. However, it does not help to stop the crisis. The British government spent a huge amount of its money to nationalize major financial institutions, which were at the edge of the bankruptcy.

The main feature of the UK fiscal is that " there was a combination of increased public spending and reduced taxation. Nanto (2009, p. 141) lists that on 8th October 2008, the British government unveiled a nearly 850 billion USD programme to save its banking sector." Meaning, the government decided to cut taxes to ease pressure on society.

There was a cut in the value added tax (VAT) to 2. 5% for 13 month. Besides, there was a postponement of corporate tax increases, and government guarantees for loans to small and midsize businesses (Economy Watch, 2010). Regarding corporation tax rates, they were also reduced in 2009 from 30% to 28% and there was increased expenditure on accounts of Job Seekers Allowances as people lost jobs amid the contracting economy (Nanto, 2009).

Saving the financial institutions, increase in expenditure on social and unemployment benefits and tax cuts increased the public deficit.

Although impacts of the financial policy can be seen at once, results of the UK fiscal policy can be estimated in a year, at least. One of the criteria of its effectiveness is National output (GDP), which can be seen from the fig. 3. This was posted in the Telegraph that The Office for National Statistics estimated that “ the British economy contracted by 6. 4pc between the second quarter of 2008 and the third quarter of 2009” (2010). During the third quarter of 2009 and the first one of 2010, the GDP rose significantly from 5 to 0 percent, respectively.

Source: Public Spending in the United Kingdom, 2014.

However, after 2010 the speed of the GDP’s growth remains stable. Duncan Weldon, Senior Policy Officer in the Economic and Social Affairs Department, called the reasons for this: the impact of the Eurocrisis on exports and the global commodity prices on inflation and incomes (2013). As for not global impacts, then it can be called the influence of fiscal policy.

Source: Office for National Statistics 2012 cited in UK GDP growth, The Telegraph, 2010.

He created a fig. 4, based on data from the Bank of England, which shows, very clearly, the extent of the fiscal tightening over the last few years. According to Duncan Weldon (2013), the stable growth of the GDP was caused by fiscal tightening in 2011/12 and 2012/13, as “ fiscal loosening accompanied stronger growth in 2009/10.”

“ Everyone has been hearing a lot recently about how the ‘ economy is healing' but is was healing a lot faster in 2009/10 when fiscal policy was supporting rather than subtracting from growth" (Weldon, 2013).

Source: The UK's two stage ' recovery' & fiscal policy, Weldon, 2013.

No matter how successful the fiscal policy was, the financial crisis in any way affected all spheres of the UK's life.

When the global financial crisis hit, the unemployment rate was gently more than 5. 6% (1. 6 million people) (see fig. 5).

Source: Office for National Statistics, 2014.

Global financial crisis made huge impacts not only on the UK's economy, but also on the social sphere. As it was noted in the National and International Issues, retail sales declined greatly, " especially in the furnishing and DIY – sectors" (2010). Besides, problems with falling sales and profitability, businesses faced problems related securing bank support for continued trading

Some well-known brands were forced to go out of business or to close their outlets, for instance, MFI, Woolworths and Blacks. Thus, the unemployment rose, especially male rate: from nearly 6 percent (2008) to less than 9 percent (2009). This trend can be seen from the fig. 5. Furthermore, today, the unemployment rate remains stable with a slight fluctuation.

Falls in retail sales and rises in unemployment lead to " falling taxes revenues for governments worldwide." (Anon, n. d.)

The UK was among such countries. In the 4th quarter of 2008 UK Gross Domestic Product (GDP)* fell by 1. 5% and the country officially entered a period of recession.

Looking at the fig. 6 about the inflation rate, it can be noticed that the government succeeded in solving this problem, because it falls in 2009 and after its rise in 2011, the inflation rate decreased again in circa 2 percent till 2012.

Source: Office for National Statistics, 2014.

The first country suffered from the crisis was the US. The second one was the UK, which came into a deep phase of the recession.

In the United Kingdom the crisis began from the Northern Rock bank, which was forced to apply to the Bank of England for emergency financial support. This situation led to decline in main macroeconomic indicators: gross domestic product (GDP), employment indicators, retail sales, and many others. However, the UK government pursued a new fiscal policy in order to stabilize the situation. It cannot be said without a doubt that the new policy failed or succeed. However, the indicators shows the situation in the UK now is more or less stable. But, who knows, it could be worse with no changes in the fiscal policy.

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