

Effect of the financial crisis on the british economy



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To what extent has Britain been affected by the financial crisis and what efforts contribute to recovery of the British economy?

The worldwide financial crisis of 2007-2008 almost brought down the global financial system. The fundamental cause agreed broadly was the combination of credit and the housing bubble crunch (Acharya and Richardson, 2009). Most people are placed on the same side of credit ranking relaxing area; however, the question may be raised that why the housing bubble would bring the financial system instead of having an effect on just on the housing sector of the economy. The answer is assigned to the bankers and regulators on the Wall Street. In this global economic crisis, banks had shirked regulatory capital requirements with the temporarily placed assets increasing and the reduction on the number of holding capital requirement allowed by the regulators.

The financial crisis began to out of control after September 2008 and led to a number of fairly large financial institutions bankrupt or takeover by governments. As a financial industry and service oriented country, although Britain has a smaller size of economies of scale than America, financial industry accounted for a greater proportion of the national economy, the real estate market existing bubble as well. Therefore, the British economy suffered a massive hit by the crisis and shaped the current British commercial and business scene (Hodson and Mabbett, 2009, pp. 1041-1061). These factors are making a huge influence on the public now, either at national or individual level. Under such circumstances, Britain tends to cut government expenditure to repay debt rather than cause inflation. In terms

of the latest data from the Office for National Statistics, the British economy is picking up by 0.2% and confidence of consumers is being improved.

This essay will contain two main parts. The first part aims to give an overview of the British economy has been affected by the financial crisis on the following aspects. They are currency devaluation, housing and mortgage market bubble as well as the employment policy. In the second part, this essay will demonstrate the consequences of these aspects and efforts contributing to the British economic recovery, especially for employment policy. For a better understanding, efforts and consequences will follow behind by introducing the three aspects.

First of all, devaluation is a natural process in financial markets. All currencies exchange rates will rise or fall based on the international situation and the state's financial condition. Assume 5 British pounds were able to buy 10 U. S. dollars years ago, today the pound could be devalued and its purchasing power would only be enough to buy 7 dollars. Compared with the devaluation of the market, governments around the world sometimes use devaluation as a balance tool to protect their trade. For instance, the country could benefit from the lower cost of its export of goods if the currency is devaluated. Meanwhile, the lower currency value encourages exports and discourages imports, which could improve trade deficit and imbalances for the country. So far, the sharp depreciation of sterling in 2008 was not due to naturally devaluation process but by the true power-driven, the global financial crisis (Broadbent, 2011).

In addition, trade performance of the UK since financial crisis in 2008 has been part of an essential developments in the British economy. Despite a fact that extensive depreciation in the value of sterling, which should have enhanced the UK's competitiveness theoretically, the performance of UK trade has remained relatively stable (Hardie et al., 2003). As can be observed in the figure 1, there was a massive depreciation from 2007 to 2008 and the trade deficit stayed open. At the same time, import prices went up by a fairly large amount as well as export prices according to the figure 2. Which is not coherence with economic theory that currency depreciation encourages exports and discourages imports.

Figure 1: Sterling effective exchange rate and balance of UK trade

Figure 2: Sterling effective exchange rate index and UK import and export price indices

Figure 3: Earnings against inflation

Moreover, the reason for why there was a large depreciation of sterling during 2007 and 2009 is because the value of the sterling is tied up with the price and turnover of financial assets in the City of London. While, the UK does not contribute to the same position as America, which has the Worlds' reserve currency. And hence when asset prices took the hardest hit in 2007-2008, the sterling did as well. This phenomenon demonstrates the sensitivity of the sterling that might occur in the financial markets. Furthermore, based on figure 3, the consequences of sterling depreciation cause a dramatic decline with earnings growth from around 4.5 per cent in 2007 to just above 1 per cent in 2009, even though the price inflation decrease during 2008.

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Forecast could be made from the data that standards of living quality for British people fall markedly (Hardie et al., 2003).

The second impact by the 2007-2008 global financial crisis within the British economy is housing and mortgage market bubble. The Royal Institute of Chartered Surveyors (2010) point out that the housing market is playing an essential role in UK economic activity, and there was a high owner-occupation rate stood at 68% in 2010 (Niklewski et al., 2013, PP. 518-530). However, the financial crisis associated with the credit crunch means that the UK market faced a further problem relating to the housing and mortgage market. Prior to the financial crash, borrowers were in a position to finance at least 95% of the purchase price using mortgage debt (Niklewski et al., 2013, PP. 518-530). By contrast, banks withdrew the majority of these offers after crash, and many increased the required down-payment from the historical average of 10 percent to 25 percent (Niklewski et al., 2013, PP. 518-530). The British Banking Association (2013) indicates that house purchases sum reduced from almost £12 billion in November 2006 to around £2000 in November 2008. Prima facie this had improved slightly to £4550 million by July 2012, but this was still below the historical average. In terms of credit becomes more readily available eventually, the housing market still performs unlikely to revert to pre-crisis levels. Hence, the UK Financial Services Authority (FSA) placed proposals to a greater formal restriction on mortgage lending. The Council of Mortgage lenders suggested that the implementation of these proposed restrictions could see four million fewer mortgages in the United Kingdom over the subsequent four years (Niklewski et al., 2013, PP. 518-530).

Finally, international financial crisis caused serious problems on the status of British employment. And the National Bureau of Statistics report shows that by October 2008, there were more than 150, 000 jobs to be cut. Thus, UK jobless claims have increased by 257, 500. Moreover, the British company lay off up to 38, 588 people mainly due to high cost and low demand during the preceding three months.

Under such situations, the British government had taken a number of steps to slow the further development of expanding unemployment and helped to recover the British economy to some certain extent. This could be split into two points. The first one is to encourage employment directly. And there are four policies will be presented at this point. Policy one: at least 100, 000 new jobs were established through infrastructure projects. The British government implemented a total of £10 billion for infrastructure investment plans in 2009, including education, transportation and other infrastructure projects in order to create at least 100, 000 additional jobs. This measure was appropriate to provide a large number of jobs for British workers, reducing the unemployment rate as well as promoting the improvement of infrastructure. This has encouraged the development of economy and city construction in the long run. However, the biggest problem is the huge pressure for fiscal policy of expenditure, which may lead to British citizens' tax burden in the future.

The second policy was for women were received training allowance for re-employment. This policy had improved the housewife job enthusiasm to some significant extent, and it relieved the economic pressure due to decrease income by husband unemployment; also promoted the sex ratio of

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the employment market equilibrium. However, this policy has intensified competition among job markets, the employment situation will deteriorate further, and the effect may deviate from the original purposes. Policy three was the “ National Program” to promote the employment of university students. Based on the view of the great employment pressure, the British government launched a “ National Program” in 2009, helped the college students who were failed to find a job to get an internship in enterprise or other organizations, improving their occupation and comprehensive quality by skill training (White Paper, 2011). Then, reach the goal for the final realization of employment. This policy increased the quantity and quality of employment. At the same time, because of financial crisis, British unemployment rate for young people under the age of 25 continues to increase. Hence, the British government introduced a number of youth employment measures for 18 to 24 years old people, to help them find work or study, where can improve their employment skills (White Paper, 2011). The positive effect of this policy is obvious. For instance, recent figures from the Office for National Statistics show that about 30 million people were in work at the end of 2012, an increase of 154000 on the quarter to September, which is the most obvious improvement since 2007 (King, 2013)

The last policy was restricting immigration. The British government started to increase the difficulty of immigrants in October 2008 (GOV. UK, 2014), and limited the number of British immigrants to the open jobs. This policy has reduced the British resident employment pressure to a certain extent, but it will cause hatred between the British and foreign immigrants, which may lead to the problem of racial discrimination. Meanwhile, this policy made life

more difficult for immigrating people who have already lived in the UK.

Therefore, government had to increase fiscal expenditure on their housing and daily expenses. Which was also made the foreign immigrants cannot engage in some work that British people do not want to engage in, it may hinder the British economic development to some extent.

The second point was to pay a subsidy to the unemployed class, and this will be introduced by three policies. The first one was spending £50 million to help the unemployed people. In order to cushion the impact of the economic recession, the British government planned to apply for a package of measures to help the long-term jobless workers back to the positions in the next two years since April 2009. Spending on this plan was around £50million, which including paying compensation to the company to hiring workers who are unemployed for more than six months. These measures improved the re-employed workers' skills and promoted the employment rate. However, paying subsidy to jobless people may cause ethical risks of enterprises. Because of obtain the compensation payment from the government, enterprises may take negative training even repeat its layoffs behavior, which leads to the re-employment rights and interests cannot be ensured.

The second policy was that an unemployed worker could delay the mortgage interest payments up to 2 years. The British government provided guarantees to lenders, allowing those property buyers who lost their jobs and income appear serious decline can delay the mortgage interest payments up to 2 years. It helps to prevent the default risk on interest payment. If this policy is implemented, buyers can afford the monthly repayment, the risk of <https://assignbuster.com/effect-of-the-financial-crisis-on-the-british-economy/>

default will be reduced. Also, it helps the buyers overcome the current financial crisis smoothly. Nevertheless, there is no accurate calculation on the cost of risky loan guarantee provided by the government. If the cost is quite high, the reachability and feasibility of the reformed policy are still far from satisfactory. At the same time, the Bank of England offers loan, if the government is responsible for guaranteeing costs, the liquidity will become worse, which may lead to continuing market turmoil.

The final policy was raising the minimum wage standard. The British government raised the minimum wage standards in the late 2008. However, it was obvious to see the dual characters of this policy during the recession. On the one hand, there is an undeniable fact that an increase in the minimum wage will increase the income of workers living at the bottom of society relatively, which strengthens their basic livelihood security and maintains their basic living standard for low income groups. It serves to sustain the stability of British society. On the other hand, minimum wage standards will also increase the labor cost of enterprises directly. The increased burden would have a negative effect on employing workers, and cause the amount of jobless people to increase, which deteriorates the employment environment. Even bring negative effect on the British economic recovery.