Chapter 9
Slump, Recession and Austerity Politics

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The original date precedes each article.

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The time for inaction is over. We have to cut rates, and cut them now.

In the wake of financial upheaval, Britain is about to suffer a painful spike in unemployment. We can't afford to stay idle. I have argued recently that unemployment in Britain is likely to rise to around 2 million by the end of the year. Why do I think that? I put a lot of faith in a number of qualitative or attitudinal surveys, which turn out to be pretty good lead indicators. It is also based upon my analysis of the recent changes in both the UK and US economies in general and their labour markets in particular. What happens in the US tends to be repeated six to nine months later in Britain. Perhaps that is not surprising given that both countries are being hit by similar credit market and commodity price shocks. The recent, unprecedented convulsions in both the US and UK financial markets add to my concerns for the wellbeing of the British people in the months to come. The time for inaction is over.

First to the facts … Last week the Office for National Statistics painted a less than rosy picture of the UK labour market. Unemployment rose by just over 81,000, taking the official rate up from 5.3% to 5.5%. The numbers claiming benefit rose by 32,500 this month, the largest increase since December 1992. And there is a strong likelihood that number will be revised upwards, as it was in August. It takes time to process claims. Some 71,000 additional people reported becoming what's termed 'economically inactive' – they moved out of the labour force because they couldn't find a job. Worryingly, long-term unemployment has also risen disproportionately, and youth unemployment is also up.

We all know that the impact of unemployment is greater the longer somebody is out of work and is especially harmful if joblessness occurs for extended periods when young. So far not so good … But I think there is a lot worse to come on the jobs front. Why? My view is driven by an assessment of the data. At turning points forecasting becomes much more of an art than a science: looking at past trends means that forecasters tend to be overly pessimistic at upturns and overly optimistic in downturns. Both the OECD and the IMF in their recent prognostications on the scale of the likely loss of jobs have, in my view, been far too optimistic.

Overall activity in the economy, however measured, seems to be slowing fast. House prices are falling precipitously, and households expect their financial situation to weaken sharply. Surveys

of consumer confidence have plummeted. Surveys of business confidence are also down, as are companies' investment intentions. Firms are cutting back on employment as the demand for their products declines. Small falls in many of these indicators are often not good predictors of future activity, but the story is different when very large falls occur. I read these surveys as suggesting the UK economy is going to experience a number of quarters of negative growth.

Firms initially tend to respond to a decline in demand by reducing hours and cutting hiring, often by not replacing people who leave or retire. There is already evidence that firms have implemented freezes on recruitment and have started reducing overtime and closing shifts. Vacancies have fallen and the Bank of England's agents are already reporting sharp declines in firms' intentions to hire – confirmed by surveys of the British Chambers of Commerce, the Confederation of British Industry and Manpower. A recent survey by KPMG/REC suggested a big fall in the number of permanent and temporary placements. And a monthly survey conducted for the EU suggests that people believe unemployment is going to rise fast over the next 12 months. The lack of hiring is of particular concern now, with large numbers of school and college leavers having entered the job market over the summer. They could swell unemployment in unprecedented numbers over the next few months. And the length of time the unemployed spend searching for work rises, as has already started to occur. The worst- case scenario is that some firms start to announce compulsory redundancies, while others close altogether.

Sharp declines in comparable surveys in the US, such as that conducted by the Conference Board on the availability of jobs, predated both the increases in unemployment as well as subsequent declines in the official payroll data. I have spent a good deal of time studying these kinds of attitudinal surveys and think the evidence is instructive. They are, more timely than the official data and are not subject to revisions, which have been significant recently.

Lack of demand and the tightening of credit conditions are also bound to hit firm formation. Over the past two years a quarter of all jobs created were self-employed; lack of credit makes it harder to start a business especially in times of falling demand. The two other major sources of new jobs in the past five years have been the public sector and the finance and business services sector. Both seem unlikely to be a major source of job creation for some time. The decline in the exchange rate might be a welcome boost for manufacturing, but employment in that industry also continues to decline.

Given the strong decline in demand that is coming, I expect unemployment to spike quite considerably over the next few months. I draw on the US experience here, where there were two surprisingly large increases in the unemployment rate in a single month of 0.4% for August 2008 and 0.5% in May of 2008. I am not saying it will happen here, but I do not rule out the possibility that one or more of the monthly increases in the unemployment rate this year could be as much as 0.4%, which would translate to an unprecedented increase of 125,000.

The wellbeing of the British people will be severely impacted by the increase in unemployment that is surely on its way. The labour market is slowing fast and we need to do something about it. As I have said before, it appears that wages are the dog that hasn't barked. There is no evidence that wage growth has picked up. Workers have little bargaining power at the moment and bosses have little ability to pay, given the low levels of profitability. Public sector pay deals are well

contained. Workers are worried about job security, which has helped to contain their wage demands. I see little likelihood that pay growth will pick up any time soon. In the wake of the Wall Street financial fallout, we need to look through the short-run increase in inflation. Inflation will fall sharply as demand declines and the impact of rising oil and commodity prices starts to wane. The time has come to cut interest rates decisively and soon.
https://www.theguardian.com/commentisfree/2008/sep/24/interestrates.bankofenglandgovernor

7 June 2009

My time at Threadneedle St certainly wasn't boring

I was convinced we were heading into recession but, as an apparent outsider, found it hard to convince my colleagues. I completed my three-year term on the Bank of England's monetary policy committee (MPC) at the end of last month. I certainly hadn't expected it to be as eventful as it turned out to be. I was told that central banking was going to be boring – it wasn't. I first found out that I was a candidate for the job in a story in the Financial Times: honestly, that was the first I knew about it. Three weeks later I received the call, much to my surprise. When I was appointed, there was much discussion about why an American should be brought in. I found this rather surprising, given that I was born in Brighton and didn't move to the United States until I was nearly 40.

It also didn't seem to help much that I wasn't a macro-economist or from Oxbridge or the Bank's pick. Having written several papers on happiness certainly didn't help either. Nobody seemed very impressed that I had worked on liquidity constraints, entrepreneurship, recessions, wages, attitudinal surveys, unemployment, and US and British comparisons. I do recall, though, being much uplifted by a letter published in the Financial Times by a certain Richard Scott from Devon, to whom I will always be grateful.

He wrote, and I quote, that 'a parochial view in setting monetary policy is outdated. An understanding of global forces is probably more important than a view on national economic trends. If Mr Blanchflower can improve the MPC's working by bringing an improved understanding of US and global-economic trends, then his appointment should be welcomed'. Phew.

For a long while I was treated as something of a pariah. The arch-dove: the uber-dove. Somebody even called me 'an idiot without a village'. One ex-member of the MPC who I have never met was reported by the BBC as saying that I was very much an outsider and that 'those involved in the financial world would not take what he says as any indication of what is likely to happen in future'. I learned to get a thick skin pretty quickly.

Through 2007 onward I was worried that there was much more slack in the economy, than my MPC colleagues seemed to believe. Consumer confidence started to collapse from November 2007. Capacity utilisation, and the investment and employment intentions of companies were falling fast. Rising oil prices were pushing up on the consumer price index, but it was clear that this was a speculative bubble: falling demand around the world would soon pull the oil price down.

The National Bureau of Economic Research dating committee called the start of the recession in the US as December 2007. Interestingly, this was based on slack that developed first in the labour market. Output in the US didn't start to decline until much later in 2008. Based on employment, the UK and the euro area entered recession around April 2008. In contrast to previous recessions, the labour market has not been a lagged indicator. It helped to know about the workings of the labour market.

I took my cue from my colleague at Dartmouth College in the US, Syd Finkelstein, who has written a book on why executives fail. He argues that the best leaders are willing to make the tough calls, face up to negative data and feedback, and do something about the problem rather than deny it's happening.

Interest rates had been too low in 2003 through 2005 as house prices were roaring. But they had also started to fall by November 2007, according to the Nationwide housing index – and by that point monetary policy was much too tight. I voted against the rate increases in August and November 2006 and again in January 2007. I made a mistake in voting for the increase in May 2007: that was my only vote for an increase. I didn't make that mistake again and voted against the increase in July 2007. I voted for a cut at every meeting from October 2007 through to March 2009, and when rates were close to zero I voted for quantitative easing.

These were not easy times for me. I did an interview in January 2008 and said the MPC was 'fiddling while Rome burns.' I called the August 2008 inflation report 'wishful thinking', which got me into trouble at the Bank. I was pretty sure the UK was headed into deep recession by spring 2008 and convinced of it by the summer, but still nobody was listening. Eventually, the MPC started to cut rates, and fast. I felt especially vindicated by the 150 basis-point cut in November that I worked so hard for.

Unemployment is going to rise at an average of 100,000 a month for at least a year. CPI inflation will fall below the target later this year and, in my view, for the first time the MPC will be writing a letter to the chancellor on the low side (for being more than one percentage point below target). There has been some positive evidence from the housing market, but house prices still have a long way to fall. It should be remembered that during the period of declining house price of the early 1990s, approximately one month in three house prices actually increased. There are some small signs of green shoots but they can be easily killed off. The hope is that the mistakes that were made by the MPC on the downside will not be repeated on the upside.
https://www.theguardian.com/commentisfree/2009/jun/07/bank-england-business-finance

14 July 2009

And next for Britain, the semi-slump

British economic history warns us to beware false dawns. Those calling for spending cuts have got it wrong – again. 'The duration of the slump may be much more prolonged than most people are expecting and … much will be changed both in our ideas and in our methods before we emerge.

Not, of course the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least sub-normal prosperity, which may be expected to succeed the acute phase.' John Maynard Keynes' lucid warning, delivered in 1930, might equally apply today.

It is instructive to look at the pattern of the Great Depression. The level of Britain's gross domestic product in 1930 was not reached again until 1934. The annual unemployment rate of 1929, 8.2%, was lower than in every year during the 1930s, reaching a high of 17.6% in 1932. Today, we are probably out of the acute phase of the present recession, but the recovery is likely to be protracted.

Output for the first quarter of 2009 was revised down to –2.4%. That is the biggest drop since 1958, as the Office for National Statistics revised its initial estimate of 1.9%. In addition, the fourth quarter of the 2008 figure was revised down to a fall of 1.8% – as was the figure for the second quarter of last year, from zero to –0.1%, meaning the recession started in April 2008. Data from the Index of Production published this month also suggests little evidence of any recovery. Manufacturing output continues to decline and is at a 17-year low.

The 1980s' recession began in the first quarter of 1980 and lasted for four quarters. The unemployment rate at that time was 5.8%; it did not return to that level for 20 years. From the third quarter of 1990 onwards, the economy recorded five successive quarters of negative growth. In the second quarter of 1990 unemployment was 6.9% and did not return to that rate for seven years.

And the current slump? Employment peaked in April 2008; since then Britain has lost 430,000 jobs. That unemployment has increased more than employment has fallen is of particular concern, because it shows that firms have stopped hiring, which particularly affects the young. So, based on output, employment and unemployment, the recession started in the spring of 2008. We have already experienced four quarters of negative growth, with more to come.

Economists are uncertain about the likely path of recovery. For example, less than a year ago Britain's National Institute of Economic and Social Research was predicting that the UK economy would 'escape recession', forecasting positive economic growth in both 2008 and 2009. On 10 June this year, the NIESR said, 'The monthly profile points to March as having been the trough of the depression'. But on 7 July it had changed its mind again, arguing, 'March can no longer be considered the trough of the recession'. A month is a long time in economics these days.

I continue to be struck by the similarities between the US and the UK. The American National Bureau of Economic Research called the start of the recession in the US when employment began falling in December 2007. Since that time US unemployment has increased by 7.17 million, whereas employment has fallen by only 6.46 million. The unemployment rate has risen from 4.9% to 9.4%.

The US is six quarters into recession. Despite a substantial fiscal stimulus and very accommodating monetary policy there is little sign that recovery is imminent. There have been several false dawns. The monthly decline in US payroll employment, for example, slowed in May but increased again to 467,000 in June. The Conference Board's consumer confidence index, which had improved considerably in May, fell again in June. The job outlook section of the index was also more

pessimistic. Those respondents anticipating more jobs in the months ahead decreased to 17.4% from 19.3%, while those anticipating fewer jobs increased to 27.3% from 25.6%.

The Bank of England's timid monetary policy committee should not have sat on its hands last week; it should have expanded further its programme of quantitative easing. In the current circumstances, if we are to avoid the 'dragging conditions of semi-slump', public spending cuts make absolutely no sense. The government should be increasing spending now – and by a lot – not least because it can borrow at such a low long-run rate of interest. In such circumstances, infrastructure and education are smart investments for all our futures. Most of the self-proclaimed experts calling for public spending cuts missed the recession in the first place.

So I have a question for Gordon Brown, David Cameron and Nick Clegg. What plans do you have to get unemployment down any time soon? If you want to transform a recession into a depression, go ahead and cut public spending. I would advise against it and so, I believe, would John Maynard Keynes. Voters want jobs.
https://www.theguardian.com/commentisfree/2009/jul/14/recession-unemployment-uk-economics-keynes

18 October 2010

Osborne has taken the coward's route

The chancellor should fight the war against the recession first instead of running up the white flag with his deficit-cutting plans. We have been faced with the greatest financial crisis in a century; banks have failed, and credit is still hard to come by. Normality has not yet returned even though we are in the recovery phase, which is going to be a long slog. A good way to think of what has happened is that we are struggling to recover from the effects of an economic war that has hit us hard.

Imagine if, God forbid, some country was about to invade this green and pleasant land. A great leader – Churchill, say – would invoke the Dunkirk spirit and fight back. And the people would be right behind a great leader; that is the British way.

But faced with this economic war, this misguided coalition government has instead shown appalling cowardice; rather than fight, Osborne is about to run up the white flag of defeat. His response is the equivalent of surrendering immediately because of the potential impact of the war on the deficit. It's as ridiculous as that.

He should fight the war first and then deal with the deficit later, even if it means taking many years to pay it back, because time is needed to rebuild our damaged infrastructure. While you are fighting the war you need to develop a plan to rebuild and to grow when the war is over – just as we did after the second world war.

During this recession what happens in America repeats itself six months or so later in the UK. It turns out that right now the small amount of job growth in the US private sector is simply not large enough to make up for the job destruction that is happening in the public sector. And this is not

just census workers. Hence the need for a second round of quantitative easing that is likely coming at the next Federal Open Market Committee meeting in November.

But Osborne expects us to believe that just the opposite will occur in the UK. His economic strategy is to cross his fingers and hope that the private sector will create 2.5m jobs within five years, despite the fact that between 2000 and 2008 only 1.6m private sector jobs were created. Recovery is going to be a long slog.

Contrary to claims made by various members of the government, there is no believable evidence that fiscal tightening on the scale that is being proposed has ever worked. When Canada implemented its fiscal tightening, its neighbour was experiencing the Clinton boom, plus it was able to cut interest rates.

In contrast there is a lot of evidence to suggest that fiscal retrenchment when a recovery is not firmly established can be disastrous. At the end of the 1930s in the US policy was tightened too soon, which quickly pushed it back into recession.

And there is no evidence whatsoever that the markets are actually demanding these cuts. The government continues to be able to borrow cheaply. It is true that government bond rates in the UK have fallen since the ConDem government took office, but they have fallen even faster in the US, which is not engaging in a suicidal austerity programme.

And there is growing opposition to Slasher Osborne's strategy. Even Boris Johnson, Ken Clarke and latterly Chris Huhne are worried about the possibilities of a double dip, which is a likely prospect.

Of particular note was the joint statement by the first ministers and finance ministers of Scotland, Wales and Northern Ireland this week. They made clear their opposition to the cuts:

The proposals to cut public spending to such an extent run the risk of stalling any recovery. Private sector demand remains fragile and access to finance continues to be constrained. The current plans for fiscal consolidation could therefore have a significant and lasting negative impact on the economy, including people's jobs, which would undermine the very efforts to address the UK's fiscal position.

And the data makes it clear that the economic activity has turned down sharply from the moment this government took power and started talking the economy down. Huhne even called the economy 'shattered' and 'bankrupt', which it clearly is not.

Consumer confidence has collapsed, and unemployment has started to rise again. Most worryingly, business confidence has dropped precipitously since May. The economy is slowing.

The cutting agenda looks even more dangerous now than it did in the spring, when the economy was growing. That is why the MPC is going to have to do more QE to compensate for Osborne's incompetence.

To this point the government has ticked off the following groups: public sector workers, students and school leavers, families with children, stay-at-home mums, the police, the armed forces and Lib Dem voters. That list is going to be added to on Wednesday.

There is a realistic alternative. Cutting payroll taxes would be a very good start, which would give firms incentives to hire. Investing in the infrastructure right now makes a lot of sense given that the government can borrow so cheaply.

The austerity package is likely to turn out to be the greatest macro-economic mistake in a century. We will fight them on the beaches. We will never surrender. That is the British way.
https://www.theguardian.com/commentisfree/2010/oct/18/george-osborne-spending-review

8 November 2011

After the crash: the semi-slump we're in

Cut spending in a recession, insist on austerity and what do you get? Crushed economic recovery: Keynes and I did tell you so. In a *Guardian* op-ed on 14 July 2009, I warned:

If you want to transform a recession into a depression, go ahead and cut public spending. I would advise against it and so, I believe, would John Maynard Keynes

Not that it gives me any pleasure to say so, but that warning seems rather prescient right now, as did the famous quote from Keynes written in 1930, just after the Great Crash but before the Great Depression, which I used to open the column.

For it is a possibility that the duration of the slump may be much more prolonged than most people are expecting and much will be changed both in our ideas and in our methods before we emerge. Not, of course, the duration of the acute phase of the slump, but that of the long, dragging conditions of semi-slump, or at least sub-normal prosperity, which may be expected to succeed the acute phase.

A *Guardian* editorial on 10 September 2009 also cautioned about what would happen if the stimulus was reversed too soon:

Politicians must remember that a semi-slump will be almost as painful as the real thing. If the government – Labour or Tory – cut back now, they will crush a fragile recovery. The economy is unlikely to return to normal for a long time; neither should economic policy.

Unfortunately, policymakers did not heed these warnings and the strong growth that was generated by global action on both the fiscal and monetary fronts has now been tipped into reverse. Growth has gone south. Leaders failed to learn from the lessons of the US in 1937 when policy was tightened too soon, which then plunged the economy into a double-dip recession. It's a classic example of the old adage that if you don't learn from the lessons of history, you are doomed to repeat them.

Consumer and business confidence around the world is falling, real incomes are stagnating or even falling and unemployment remains unacceptably high across the OECD countries. Indeed, both in France and in the UK, unemployment has started to rise again, and both countries appear to be headed back into recession. The French government this week announced new austerity measures that are likely to compromise growth, just as they have in the UK. Italy continues to struggle to pass austerity measures as bond yields spike as growth slows.

Last week, the Federal Open Market Committee (FOMC) lowered its forecasts for growth in the United States, and in recognition of the slowing, the three hawks moved away from tightening – and there was even a lone dissenter, Charles Evans, president of the Chicago Fed, who wanted further easing. The latest labour market release from the BLS showed that employment grew by 80,000, but faster job creation than that is needed to get the unemployment rate down to more acceptable levels.

However, large cuts in public spending are on the way, as the super committee considers which areas of federal spending are to be slashed, while Obama's jobs package is on hold in Congress. That will reduce growth and raise unemployment, and this seems likely to push the Fed into doing a further burst of quantitative easing or QE3.

At the beginning of October, the Bank of England's MPC voted unanimously for more QE, in a move that few in the markets had expected, because of fears that the spreading crisis, which, it said in its statement, threatened the UK recovery. Employment over the last rolling three-month period fell by 178,000, and youth unemployment stands close to 1 million.

It now appears that the current recession is as deep but longer-lasting there than the 1930–34 double-dip recession, which had restored the level of output within four years, whereas in the current slump, under a half of the drop has been recovered after 44 months. The independent forecasting group NIESR now predicts that the UK would only achieve growth of 0.8% in 2011 and 0.9% in 2012, well below official forecasts, so it may well take several more years to get back to the level of output at the start of the recession. GDP growth over the last year has only been 0.5% and the November UK PMIs – for manufacturing, construction and services – suggest that growth in October was negative. There is every prospect, then, that fourth quarter 2011 and first quarter 2012 will both be negative and hence consistent with a technical recession. The UK coalition government seems to have no idea what to do.

Even though we have now moved from the acute phase of the Great Recession, which occurred in the fall of 2008, the long, dragging conditions of semi-slump and sub-normal prosperity have arrived – and they aren't going away any time soon, as Keynes warned. The whole idea of an expansionary fiscal contraction was always fanciful in the extreme; now, it's time for a change of course – given that austerity has failed. Growth is going to be low for many years, living standards are not going to rise, and the high levels of income inequality are all likely to contribute to increasing levels of social unrest. Much, indeed, will need to be changed.
https://www.theguardian.com/commentisfree/cifamerica/2011/nov/08/after-crash-semi-slump

8 August 2018

Raising interest rates is a big mistake. This will have to be reversed

The MPC has made this decision on the basis that wage growth is about to finally skyrocket. It isn't.

UK interest rates have risen from 0.5% to 0.75% because the monetary policy committee (MPC) believes the labour market is at full employment and wage growth is set to explode. Pull the other one, it's got bells on. I don't buy it.

The pound initially rose on the news and then fell back by more than a cent against the US dollar in a sign that the markets didn't like what they heard and didn't believe the MPC's claims either. The Institute of Directors came out against the increase, as have many economists who see no basis for a rise that lowers spending power. This in the same week when the Bank of Japan said it would loosen monetary policy further. Along with the European central bank it has negative rates and is still operating quantitative easing programmes.

Astonishingly, the decision to raise rates was a unanimous 9-0, which was a big surprise given there was essentially no hard data supportive of a rise. One smart journalist at the press conference suggested that this may well be an example of 'group think' – so it's OK if we are all wrong together. The reality is there are stronger arguments to be made for a cut in rates.

Personal insolvencies are up; there has been a slowing in the commercial property market, which is often suggestive of a slowing economy. The number of homes on the market is up but the number of buyers is not. The housing market is slowing and raising the cost of a mortgage will slow it further. Brexit represents a major downside risk to the UK economy as does the possibility of trade wars.

The latest data from the Office for National Statistics shows that GDP growth was 0.2 per cent in the three months to May 2018, the same rate as in the first quarter from January to March. Growth in the first quarter was lower than in 26 out of 28 EU countries; only Romania and Estonia were worse. The UK economy's weakness doesn't look temporary as the MPC claims. There is also no inflation to speak of, and no sign of a big pick-up coming. The consumer price index has come down from 3 per cent in January to 2.4 per cent in June 2018.

The MPC's main reason for raising rates is that it believes, wrongly in my view, that wage growth is set to skyrocket. It isn't. According to the UK's national pay statistic average weekly earnings, total pay growth averaged at 4.3 per cent from January 2001 to March 2008, just before the onset of recession in April 2008. From that point through to the end of 2017 wage growth averaged 1.8 per cent. It picked up a little in the last year and now stands at 2.5 per cent, down from 3.1 per cent in December 2017. In its last 18 forecasts in a row, the MPC wrongly forecast that wage growth was going to return to pre-recession levels of around 4 per cent or so. The MPC has cried wolf in its past 18 forecasts, including this one, and I see no reason to believe it is right this time. Wage growth is slowing.

My research with economist David Bell suggests that the UK is a long way from full employment. It is underemployment, not unemployment that is impacting wage growth, and that has not returned

to pre-recession levels. When full employment is reached, wage growth will start to strengthen towards 4 per cent. That isn't going to happen any time soon. The MPC has just made a major error it will have to reverse fairly quickly as bad data flows in. I have deja vu of 2008.
https://www.theguardian.com/commentisfree/2018/aug/03/raising-interest-rates-mpc-wage-growth

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