Group Economics

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“2008 all over again? The economist says yes and no.....”

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Parallels have abounded in the financial media of late between current events and those of autumn 2008, when there was a collapse in world trade, financial market mayhem, and co-ordinated and unprecedented policy action by the world’s central banks and governments. So, is 2008 happening all over again? In the true spirit of economics, I think it is fair to say that on the one hand there are strong similarities yet on the other hand there are clear differences.

In terms of differences, the emphasis has shifted somewhat from the US to the eurozone. In 2008, George W. Bush’s Treasury secretary, Hank Paulson, knelt on bended knee before the House speaker and appealed for her support in passing the $700bn bailout package, and President Bush profoundly stated that *“if money isn’t loosened up, this sucker could go down”*. Today it is eurozone governments that have been pleading with their respective parliaments to back and enhance the European Financial Stability Facility (EFSF) – aka the European bailout fund – to ensure that Greece would not go down.

China’s role is a similarity and difference. Back in 2008, China embarked upon an infrastructure splurge to keep its economy, and to a lesser extent the global economy, growing. Once again, China is being asked to save capitalism by investing in the EFSF. But, notwithstanding current strong rates of economic growth in China, there are growing concerns over aspects of its banking system that funded the huge growth in infrastructure spending. The Chinese banking system will be unable to repeat the capital investment boost that occurred in 2008. Furthermore, many commentators are anticipating the bursting of the Chinese property bubble.

Like 2008, bank recapitalisations are currently all the rage, only this time it is in the eurozone rather than the UK and Ireland. Meanwhile, the faces behind these actions have changed. Brown and Darling have been replaced by Cameron and Osborne. Brian Cowen and the late Brian Lenihan by Enda Kenny and Michael Noonan. The ECB’s Jean-Claude Trichet has also been replaced with ‘Super’ Mario Draghi who will experience a baptism of fire. Further changes in the leadership of Spain and Italy are anticipated in the coming weeks and months.

In Northern Ireland, by contrast, continuity has been the order of the day, with Sammy Wilson and Arlene Foster remaining in their respective finance and enterprise departments, and the economy remaining the number one priority. However the forthcoming Programme for Government needs to be markedly different from the last one. The sacred cows that protect the status quo have to be dealt with, otherwise the history books and the next generation will not look too kindly.

A major difference in Northern Ireland between 2008 and today is the view that Northern Ireland doesn’t do recessions. In 2008, talk of recession was viewed with significant scepticism, even when Sir Mervyn King announced that the UK economy was facing “the most serious banking crisis since the outbreak of the First World War.” To our cost, we have learned that we have consistently underestimated the length and depth of the recession and overestimated the recovery. Whilst the local economy is not contracting at the break-neck speed of late-2008 / 2009, Northern Ireland is still expected to contract in 2011, as in 2008.

Other similarities in the Northern Ireland economy include the fact that house prices and construction output are still falling. In terms of unemployment, the dole queue breached the 30k mark in the autumn of 2008; it has already passed the 60k mark today. The key difference between autumn 2008 and autumn 2011 is the sheer scale of the collateral damage inflicted on the private sector. Meanwhile, households, through inflation and falling incomes, are feeling the full force of the deferred pain from the recession that was absent in 2008. This explains why consumer sensitive sectors, such as retail, prospered in 2008 but are suffering now. Similarly, the public sector provided insulation for the economy in 2008. Now, however, our over-exposure to the public sector will be a source of economic weakness going forward.

Inflation is a common theme. The latest UK CPI figures hit 5.2% y/y, the same record high posted three years ago. Back then, CPI inflation plunged to 1.1% the following year. A further sharp fall in inflation is expected in 2012 but the UK economy will not have the temporary reduction in VAT to help drive inflation down. It should also be remembered that whilst the annual rate of inflation is the same as September 2008, the price level is not. CPI is almost 10% higher over the last 3 years whilst the price of food and petrol are 12% and 20% higher respectively. Inflationary fears are arguably greater now than they were in 2008 with gold prices – an inflation hedge – having more than doubled. Meanwhile, equity markets such as the UK FTSE 100 have posted a rather less impressive 30% gain.

As in 2008, Sir Mervyn has tempered expectations, last month warning in the media that the world was facing its worst financial crisis in history. He was also quick to pour cold water on the recent eurozone bailout package, stating that *"the plan as it stands would buy no more than one to two years' breathing space".* So whilst there are a number of differences between today and 2008, like three years ago a meaningful recovery seems a long way off.

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