QUARTERLY

STATE OF THE TYNE & WEAR ECONOMY REPORT Winter 2010/11

Job changes covering October to December 2010
Local News to Dec
Bank Lending Latest BoE Report Jan

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TWRI
1st Floor Provincial House
Northumberland Street
Newcastle upon Tyne
NE1 7DQ
Tel: (0191) 277 1912
Fax: (0191) 277 1911
E-MAIL: twri@twri.org.uk
WEBSITE: www.twri.org.uk

Supported jointly by Cities of Newcastle and Sunderland and the Metropolitan Boroughs of Gateshead, North Tyneside and South Tyneside

KEY POINTS

This report covers the 3 months to end-Dec.

UK Economic Overview

The **UK economy** has come somewhat **off-track;** GDP it is estimated to have **shrunk by 0.5%** in **Q4 (Oct-Dec)-ONS**. Even without the extreme weather, it would only have been "flattish" - ONS. This contrasts with strong 1.2% growth in Q2, and 0.7% growth in Q3. **Inflation at 3.7% (CPI)** has risen further above target in the year to December (even before VAT rose to 20%).

Growth in Q1 seems **to be critical,** determining whether the economy is seriously off-track. The consensus forecast for consumer spending to grow by over 1% in 2011 looks vulnerable.
a) **bank lending** growth continues to be **very weak**. It is **under 1%pa** for both mortgage debt and consumer credit.
b) **living standards are *falling* sharply (**by **about 3%pa).** As measured by the **RPI,** annual inflation has **remained** around **5% since April.**

Furthermore, the **Comprehensive Spending Review** (CSR), plus knock-on private sector losses, **could cost Tyne & Wear about 20,000 jobs** (about 4% of all jobs, over five years) – based on a PwC report which estimates 43,000 job losses in the NE. The Chancellor still needs a "Plan B" in case of significantly weaker economic growth than forecast.

Local Economy

Local business indicators (for TW) show **a return to growth in Q4** in **UK demand** (from the oddly low levels reported in Q3). Export demand remained positive. Nearly 1,000 net job losses were reported in Oct-Dec..

Unemployment

ONS' estimate of **UK unemployment** (the **official definition from LFS**) *rose* (after two successive 3-month falls), up 49,000 to *2.498m* in the 3 months to November. Thus the rate has risen 0.2pp from the previous 3 months to 7.9% (after falling 0.1pp in Jun-Aug). Caution: these LFS ests. can be volatile.

UK claimant unemployment fell **16,500 in the last 3 months** (after rising about 10,000 in the summer). It had fallen since autumn 2009 (except around January).
Claimant unemployment *fell* 4,100 in Dec. on the seasonally adjusted series. The same variable has also now fallen by over 170,000 since Nov 2009 (1.630m) to 1.457m. Recent falls have been small, around 5,000/month.

In **Tyne & Wear, claimant unemployment** has fallen by 550 from Sept to December. It was **lower from a year earlier by nearly 3,100** at 34,466. Caution: TW series is *not* seasonally adjusted.

TW's fall in claimant unemployment in the year to Dec. was **led by South Tyneside -749 (-11.4%) and Sunderland**, with a **fall of 1,036 (-10.1%).** Gateshead also fell faster than TW; (-9.3%, -565). The fall north of the Tyne has been slower than in TW; in Newcastle (-6.6%, -577) and North Tyneside (-2.9%, -170).
Caution: there is no seasonally adjusted (SA) series by ONS for TW claimant unemployment count.

Global Context

Globally growth remains quite strong. Germany's fast growth (3.6%) raises the prospect of faster growth of its consumer spending – a huge mkt for the NE.
In the **Eurozone** crisis[1], Ireland has been forced to take an €85bn bail-out loan package from the EU/IMF. Portugal and Spain are being scrutinised closely by the bond markets. Greece's, and Ireland's, debts remain so large that they are likely to have to be restructured (partially written off) at some point.
In the US, the Fed restarted QE[2] and the economy grew by 0.8% in Q4.
Some developing countries are growing over-rapidly.

The NE's goods exports in Q3 **were flat on the previous quarter (after a 17%, £425m jump in Q2[3]).** Export growth has oscillated over the last year or so (from Q3 8%, Q4 17%, Q1 -8%, Q2 17%). In Q3, exports to the EU fell 12% (down nearly £200m). But this was offset by growth of exports to Eastern Europe (up £148m or 95%), and to N. America (up £47m or 10%). NE goods exports have recovered to their level of 2008, and exports of machinery & transport goods (TW's speciality) are 13% higher.

Local Job Gains

The largest gains were:
Offshore Group Newcastle (1,000), at Wallsend in North Tyneside (re-opening an offshore yard until summer 2012).

Local Job Losses

The main announced job losses were **-1,200 at South Tyneside Council** and **-2,000 at Newcastle City Council** (both over 4 years).

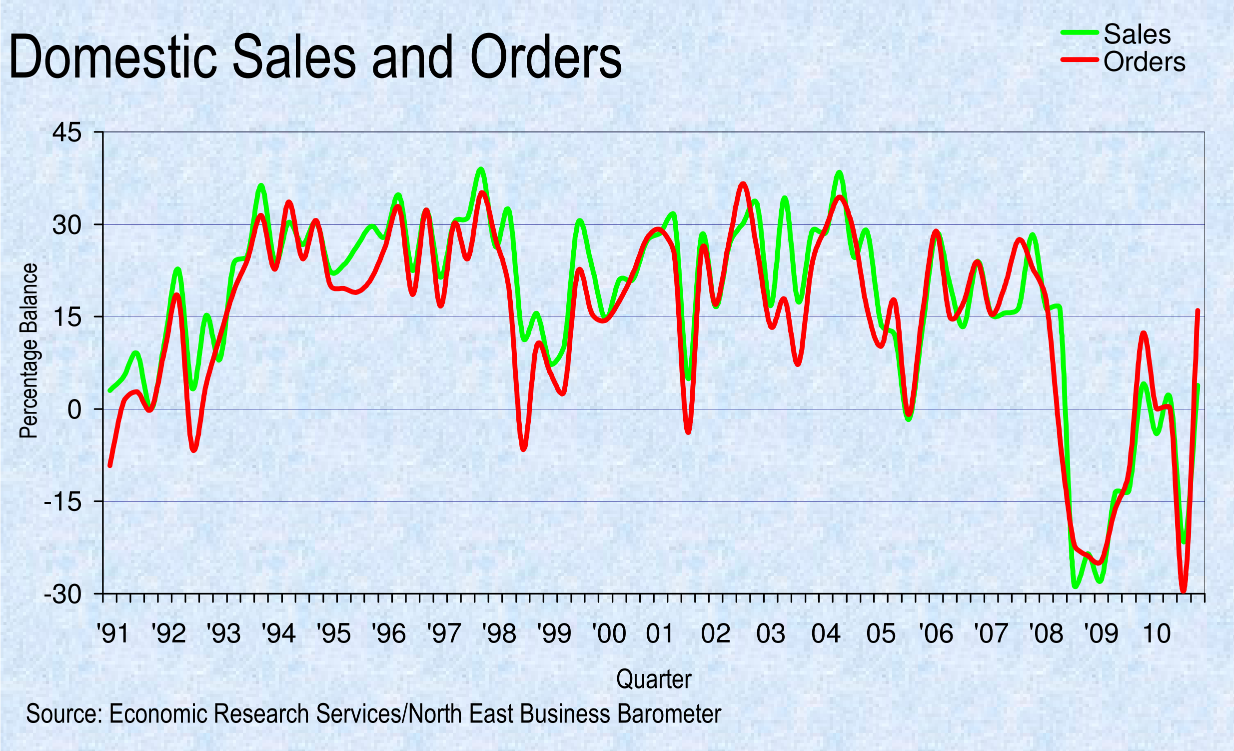
Date: 2nd February 2011.

[1] Shorthand for the crisis of govt debt and the banking system in the countries which use the Euro.
[2] QE is Quantitative Easing. $600bn is planned by June.
[3] This jump was worth about 3% of NE GDP (in the quarter).

TYNE & WEAR ECONOMY

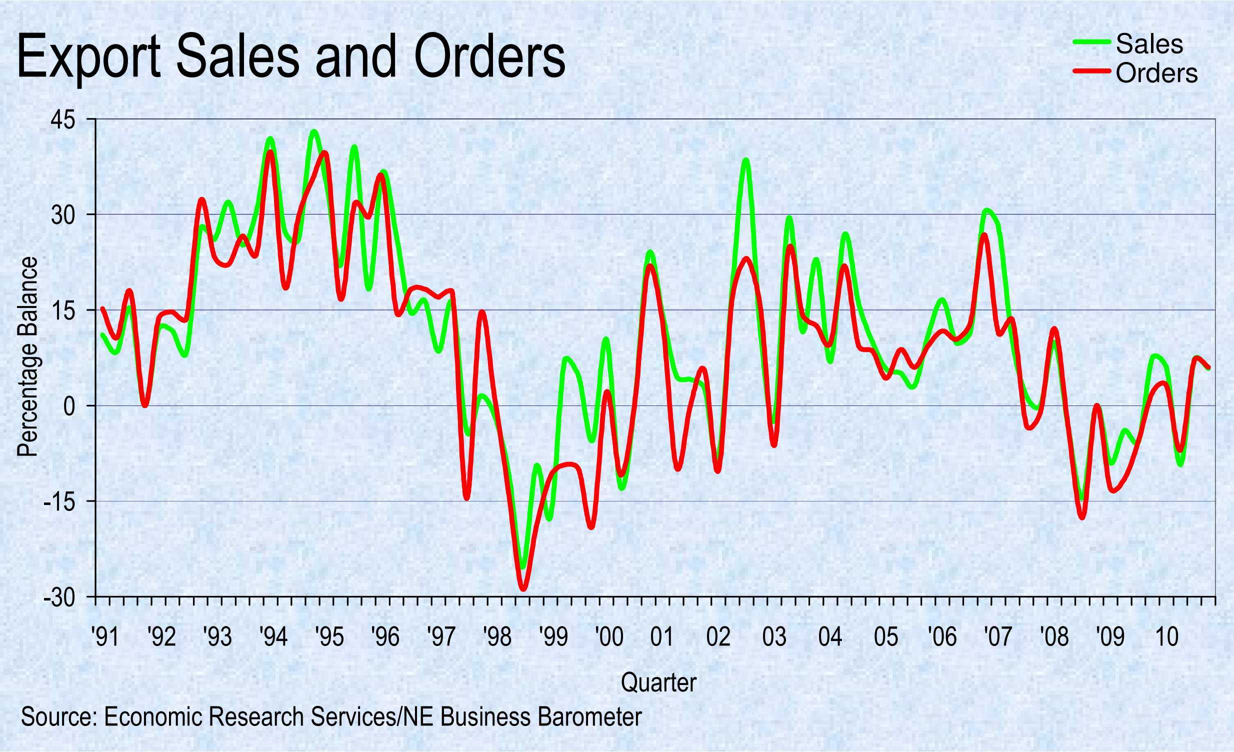
1. Indicators of Demand (in TW):

In the fourth quarter of 2010, TW firms reported domestic demand (UK customers) recovered to growth, with a sales balance of +3.8% (from -22%). Orders rose even more, to +16% (from -29%).



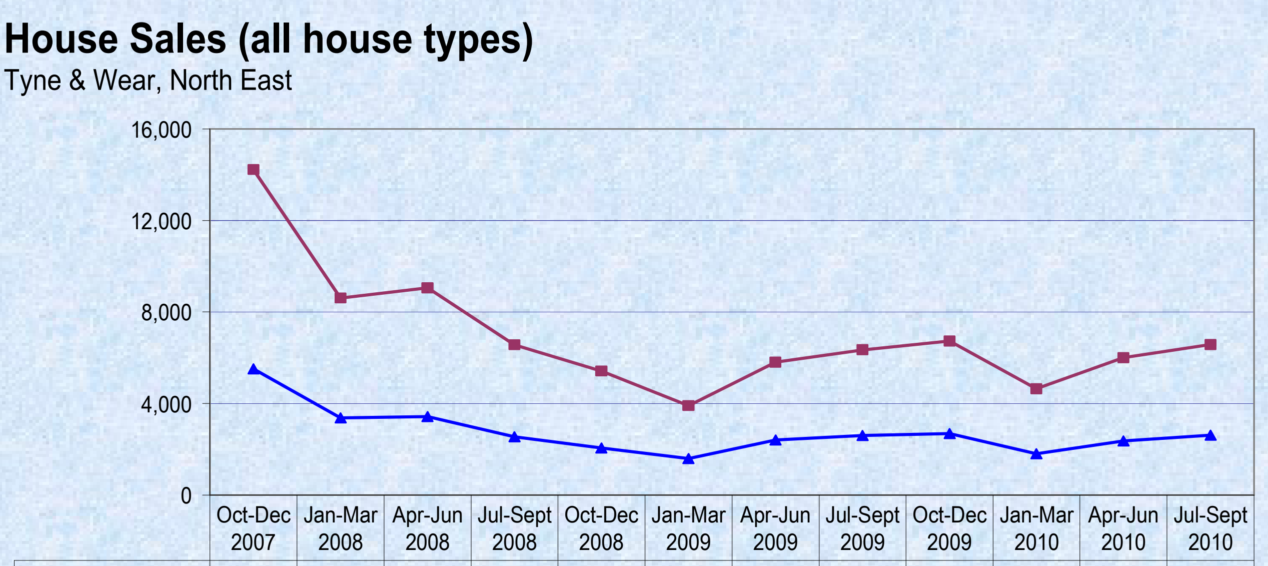
Note: these indicators of demand are from firms in Tyne & Wear (only).

Export demand continued to rise in Q4, with sales and orders both on a balance of about +6%.



2. Housing Market

In Q3 ‘summer’ 2010, house sales were little changed from a year earlier (TW up 0.4%, and NE up 4%)(chart below). Compared with 3 years earlier (in 2007) sales were still hugely down by over 56%[4]. Caution: sales are highly seasonal, in 2007 TW sales rose in the spring, falling 2% in the summer.



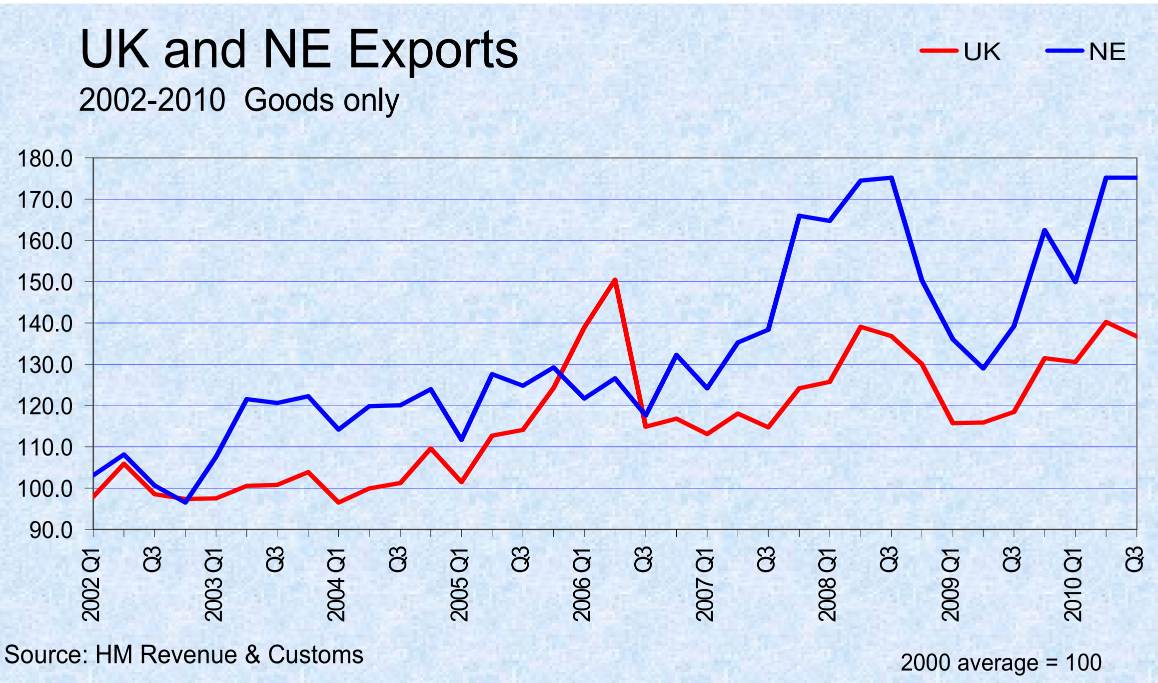
	Oct-Dec 2007	Jan-Mar 2008	Apr-Jun 2008	Jul-Sept 2008	Oct-Dec 2008	Jan-Mar 2009	Apr-Jun 2009	Jul-Sept 2009	Oct-Dec 2009	Jan-Mar 2010	Apr-Jun 2010	Jul-Sept 2010
Tyne and Wear	5,513	3,372	3,429	2,546	2,049	1,599	2,396	2,602	2,690	1,803	2,358	2,613
North East	14,225	8,606	9,048	6,563	5,415	3,899	5,801	6,344	6,721	4,637	5,999	6,576

Source: Land Registry Address file (compiled by TWRI). Caution: data are not seasonally adjusted.

Source: Land Registry Address file (compiled by TWRI). Caution: data are not seasonally adjusted.

3. Exports Note: exports may be critical to NE economic recovery in the medium-term (say 2011-15).

NE[5] goods exports (by value) were flat in Q3 after a 17% jump in Q2 (graph below); at £2.98bn. Exports to the EU fell by 12%[6] (down almost £200m to £1,437m). This was largely offset by Eastern Europe (up 95% or £148m to £304m) and N. America (up 10% or £47m to £533m). Nissan sales in Russia in December were up 110% from a year ago[7]. But NE exports to Asia fell by 10% (to £342m).



[4] Sales were down about two-thirds over the 2 years to late 2009.
[5] HMRC Tyne & Wear data are not available to TWRI.
[6] UK exports to the EU fell by 9%.
[7] Nissan Dec sales in Russia of 10,900 cars were 70% higher than in the UK (6,400).

Machinery & Transport goods, TW's key exports (and which includes vehicles), however, grew by 5% to £1,554m (even after 22% growth in Q2). NE exports of Machinery & Transport now exceed the 2008Q1 peak, by 13%. Total NE goods exports have matched the level of mid-2008.

4. Aggregate Job Gains and Losses in TW (Oct-Dec 2010) – reported in the press:

There was a *reported* net job loss for TW of about 950. This follows gains of about 1,300 in each of the last two quarters of 2009, then losses of around 400 in each of the first two quarters of 2010 and a gain of about 150 in the third quarter.

Summary of job gains and losses (announced in the press).

Oct. 1st – Dec. 31st 2010, for Tyne & Wear

District	Gain	Loss	Net
Gateshead	147	22	125
Newcastle	517	2,193	-1,676
North Tyneside	1125	-	1125
South Tyneside	250	1200	-950
Sunderland	859	-	859
Unallocated #	20	460	-440
Tyne and Wear	2918	3875	-957

Unallocated gains and losses are usually estimates at County level of regional change.

Source: compiled by TWRI from the Journal and other local media.

Caution: press reports are very incomplete. In particular, they essentially omit construction job change, small job losses in retailers and other service firms. Historically they have omitted major growth in public service employment in health and education. Nevertheless, the reported job changes give a sense of overall employment change.

Note: the table above, for the quarter to December, contains the (likely) Local Authority job losses announced in the press, including 2,000 from Newcastle City Council and 1,200 from South Tyneside Council (both over four years). The Newcastle losses for the first year have since been limited (from 1,000) to about 650.
The table does not include job losses from Gateshead (600) and North Tyneside (300), which are figures from the GMB union.

By December 2010 claimant unemployment was down by about 3,100 over the last 12 months[8], much the same as the fall in the year to June and the year to Sept.. Claimant unemployment had been falling since autumn 2009. Previously it had risen by about 15,000 in TW in the year to June 2009 and stabilised in the second half of 2009 at around 38,000.
More details, including an itemised list of gains and losses, will be presented in the TWRI State of the Tyne & Wear Labour Market Report for Winter 2010/11.

5. Structural Change in the TW economy:

There have been expansions, takeovers plus a handful of significant retail property developments:

<u>Expansions:</u>

Offshore Group Newcastle (OGN) won a £150m deal to build a new oil production platform for US-based Apache Corporation over a 20-month period. (J 23/11). The work will be based in the former AMEC yard in Wallsend. OGN is to employ 700 with 300 at subcontractors.

[8] To about 34,500.

Aesica Pharmaceuticals has doubled in size after expanding into Europe. It recently acquired three factories; two German manufacturing plants and one Italian plant from UCB of Belgium. Aesica plans to make further acquisitions in 2011. (J 16/12) [Aesica's HQ is at Quorum Business Park, North Tyneside.]

Longbenton Foods (which runs the Findus factory) confirmed it has acquired Northumberland Foods after the Amble-based frozen food producer went into administration in August. (J 29/10)

Three large wind-turbine manufacturers are planning to invest in the UK: Siemens announced an £80m investment plan for a turbine factory, creating 700 jobs in the East or in the NE [location yet to be decided]. Also, GE will invest £100m in a manufacturing plant, creating about 1,900 jobs by 2020. Gamesa of Spain will spend €150m (£133m) setting up its world-wide centre for offshore wind in Britain, including a research and development centre and a turbine-manufacturing plant. These would generate 1,000 jobs, with a further 800 jobs at local suppliers. (FT 26/10)

Nissan's electric car, the *Leaf*, is being sold in the NE from January 2011. Benfield has been selected to sell the first models. Production in Sunderland of the *Leaf* begins in 2013 (J 2/12).

Take-overs:

Arriva has been acquired by Deutsche Bahn (DB) for £1.6bn. Arriva has been Tyne & Wear's largest company (by turnover) in some previous years. (J 21/10). [DB is also the operator of the Tyne & Wear Metro – Ed.]

Wellstream is close to agreeing a £800m takeover by General Electric (GE). Wellstream (based in Walker, Nc) makes flexible piping for the offshore oil industry, particularly for Brazil [where some very major finds are to be developed over coming years] (J, FT 13/12).

Tanfield was expected to sell the UK wing of its Smith Electric Vehicles (SEV) division to its US offshoot by the end of 2010. SEV US, which is 40% owned by Tanfield, is considering stock market floatation and has won a £20m US government grant to speed up its product development (J 21/10). Late news: Tanfield concluded the deal to sell the SEV electric van business to SEVUS by Jan. 1st. Tanfield retains a 49% stake in SEVUS (N. Echo 2/2).

Robson Brown (RB) was acquired by London-based ThinkBDW, part of Mission Marketing Group. The Newcastle advertising company was thought to be the subject of a management buyout, but the directors were outbid by ThinkBDW to buy RB's assets. (J 15/12)

Major Property Developments

At the Stephenson Quarter regeneration project, behind Newcastle's Central Station, work is due to start in March 2011. The scheme will include a Crowne Plaza Hotel (251-bed four-star), a 60-bed boutique hotel, a business centre, exhibition space, commercial offices and 156 residential apartments. The project will be developed by Silverlink Holdings, with funding from Newcastle City Council. Phase one is expected to be completed in late summer 2013. (J 28/10)

Retail Developments

At Gateshead's town centre, work is also due to start by spring 2011 and is due for completion in March 2013. The scheme includes a new Tesco Extra superstore, a 993-bed student village, 45 commercial units and an office block. It will be carried out by SpenHill Developments, the commercial property arm of Tesco. (J 27/11)

Tesco is to create up to 759 jobs in Sunderland as it plans to open a new store and four smaller retail units. Sunderland City Council said it was "minded to approve" plans to build the new superstore, at the Sunderland Retail Park (J 15/10).

Sainsbury's hopes to create 500 jobs in Sunderland. The supermarket chain has signed an agreement with developer Terrace Hill, which is currently in pre-application discussions with Sunderland City Council. The store is planned on the former Jennings car showroom site, on Riverside Road (J 11/10).

At the Sainsburys store in Heaton, Newcastle, Hanro is close to completing a £15m deal to build a new 100,000sq ft superstore. It would build a new store on land adjacent to the existing one on Benton Road. The existing store would then be demolished and the land used as a car park. (J 17/11)

Other Retail Developments:

At Washington Galleries in Sunderland, work on Phase 2 of the £10m refurbishment programme is set to start in February. This will include the reconfiguration of Wessington Square, with a new fully-glazed roof, new floor tiling and the creation of two café areas. (J 15/12)

At the Bridges shopping centre, in Sunderland city centre, Land Securities has submitted a planning application to Sunderland City Council for an extension. This will include a 60,000sq ft Primark store, doubling the size of the existing outlet, as well as a new entrance on High Street West. Work is scheduled to start in 2011. (J 17/11)

At the Northumberland Retail Park, in North Tyneside, work is set to start on Phase 3. The development comprises a number of units totalling 15,761sq ft.. It is located adjacent to Sainsbury's supermarket, at the Northumberland Park Metro interchange. (J 22/12)

Other Developments:

Sunderland Software City has proposed building a £10m complex in the Sunniside Quarter's Tavistock Place. The 53,000sq ft development could house 60 hi-tech businesses and up to 140 staff. A planning application has been submitted by construction firm BAM. (J 11/10)

A £40m digester plant will convert sewage into electricity. Work is set to begin in 2011 at Northumbrian Water's Howdon sewage treatment works in North Tyneside, building the advanced anaerobic plant. It will process 32,000 tonnes of sewage sludge a year (J 14/10).

UK ECONOMY

6. UK Economic Context:

The UK economy stalled in Q4 with a -0.5% fall in GDP[9]. Discounting the effect of bad weather, the economy was "flattish"-ONS. This follows, and contrasts with, strong growth in Q2 (of 1.2%) and 0.8% in Q2. Services shrank -0.5%, reversing the growth in Q3. Construction, affected by the weather, fell by -3.3% (after 3.9% growth in Q3). Manufacturing growth accelerated to 1.4% (from 1.1%).

Employment *fell* by 69,000 in the **3 months to November.** Both full-time and part-time employment fell (by 37,000 and 32,000 respectively). This **follows two** successive **quarters** of **strong growth,** by 178,000 in the 3 months to August, after 160,000 (0.6%) in the 3 months to May. About three-quarters of the 6-month growth was, however, in part-time employment (est. at 148,000 to May then 143,000 to August). This suggested a continuing high degree of hesitancy by employers about the strength of the recovery.

UK economic growth remains constrained by;
a) Weak consumer spending[10], which began to grow in Q2, up 0.8%, and then by 0.3% in Q3. This follows a big fall of 3% in 2009 from 2008[11]. **Households remain under great pressure**, with **real earnings down about 3%** (earnings excl bonuses grew by 2.3%[12] and RPI prices rose 4.7% in the year to November). This makes growth of consumer spending hard to achieve. It can be achieved by households cutting their saving rate and by firms expanding employment.

b) Bank Lending remains **weak;** UK **businesses paid back (net) around £5bn in the 3 months to November** – BoE Trends in Lending Jan 2011. The rate of decline in net borrowing by businesses has, however, slowed from 2009 to about -4% in 2010[13]. TWRI estimates[14] companies repaid (gross) over £120bn in 2010, down from over £140bn in 2009. There was a further positive sign; lending to business rose (net) in Nov. by £1.3bn, the first positive figure for net lending since Feb. 2010. Outstanding mortgage lending is still growing at under 1%pa. House prices continued to weaken over the summer and autumn [Note: this could be the start of further weakness, and needs to be closely watched].

The public spending cuts and tax rises will also tend to constrain consumer spending; the prospect of them seems to have dampened consumer spending even before they are implemented.

The UK is **now reliant upon investment and net exports**[15] to drive growth of the economy:
Investment is growing; overall investment in the UK (across all sectors) was up 8% in Q3 compared with the low point in the last quarter of 2009. Business investment was up 12% in the same period. Starting to cut the deficit may well have supported business confidence to invest (by keeping long-term interest rates low, and by reducing a major uncertainty).

Fortunately for NE exports, principal markets in **northern Europe** have **been growing**. In particular, the German economy has grown strongly in 2010 (3.6%), the fastest rate since unification[16]. The NE's exports[17] to the EU, however, actually fell 12% in Q3; perhaps as re-stocking came to an end, but it is not clear why. The crisis in the eurozone has continued, and presents a threat of potentially large disruption to the UK recovery (see section on the Eurozone crisis, below).

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[9] Caution: these ONS preliminary estimates are always based on very incomplete data.
[10] Known in the National Accounts by the Treasury code ABJR, in Economic & Labour Mkt Trends Oct 2010.
[11] And by 5.0% between 2008Q1 and 2009Q3.
[12] Sept-Nov. 2010.
[13] Based on 3-monthly rates annualised.
[14] From Trends in Lending, Jan 2011, chart 1.2.
[15] Net exports are exports minus imports; these are forecast to rise in 2011.
[16] The Economist, Jan 15th, p31.
[17] Of goods. No data on services.

7. Prospects:

The OBR expected economic growth to slow in the first quarter of 2011 to around 0.3% (as it did in the first quarter of 2010, when VAT also rose by 2.5 percentage points). This was before GDP fell in Q4. GDP could now re-bound by +0.5% just from the snow effect.

Future UK economic prospects are for growth to continue in 2011 (although about 0.5pp below the normal rate) and for unemployment to rise by under 100,000 in 2011 (table, below). Note: the forecasters still do *not* expect unemployment to rise substantially.

	2010	2011	Comments
Economic Growth	1.7%	2.0%	Economic growth forecasts for 2011 have strengthened since Oct. by about 0.3pp.
Claimant Unemployment	1.48m (Q4)	1.55m (Q4)	Claimant Unemployment to rise just 70,000 in 2011[18].
Govt Borrowing (PSNB)	£144.8bn (2010/11)	£119.6bn (2011/12)	Govt. borrowing to fall by about £25bn (about 1.7% of GDP) in year beginning April 2011; VAT rise to raise £13bn.
CPI inflation (Q4 in each year)	3.2% and RPI inflation to be 4.6%	3.0% and RPI inflation to be 3.9%	Inflation forecasts for 2010 raised by 0.4pp since Oct.. RPI inflation to slow by over 0.6pp (from 4.6% in year to Dec.) by end of 2011.

Source: average latest revised UK forecasts, from HM Treasury's survey of independent forecasts (published by the Treasury in January 2011).

Caution: these forecasts were issued before the weak GDP figures for Q4 were issued.

Independent forecasters, on average, expect in 2011 private consumption to grow by 1.1%, govt consumption to fall by 0.6% and fixed investment to grow 4.1%. Domestic demand grows by only 1.4%, but exports grow faster (up 6.4%) than imports (up 4.2%), so that the change in the net trade position adds 0.5% to GDP. Base rate is expected to rise to 1% by the end of 2011.

In the 2011 labour market, independent forecasters expect average earnings to grow 2.6%, and employment to grow 0.3% [i.e. about 100,000]. Due to inflation, real household disposable income actually falls -0.1%. In effect, forecasters are expecting public sector job losses to be more than offset by private sector gains.

Growth will feel slow because in most of the economy, which satisfies domestic demand, growth will be under 1½%.

Note: the above independent view of prospects is close to those set out by the Treasury. The main risk over the next 3 years (to mid-2013) is downside, that growth could be slower. This could come from weak consumer spending, weak investment or from an economic shock from the Eurozone.

The indications are that Tyne & Wear could lose around 15,000 jobs from the public sector (from a base of around 135,000). The evidence for this is threefold;

the House of Commons Library figures were around 13,500[19] for TW;

the PwC report[20] suggests about 22,000 from the NE public sector. It estimates this swells to 43,000 NE losses when combined with private sector losses;

the OBR estimate of 490,000[21] public sector job losses across the UK. If TW lost 2% of these this would be around 10,000 job losses, but the public sector is relatively large in TW.

Tyne & Wear might therefore expect to lose about 25,000 jobs (about 5%) of its total employment (by 2014/15), due to the fiscal squeeze. Some of these losses, however, can be expected to be offset by growth in the rest of the private sector.

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18 TWRI calculation on the assumption that forecasters use UK seasonally adjusted unemployment. This was about 1.473m in Sept 2010.

19 The expected losses given by the House of Commons Library were 10,591 from Tyneside and 2,967 from Sunderland; this gives 13,558 from Tyne & Wear (J 23/7).

20 PwC report 'The Sectoral and Regional Impact of the Fiscal Squeeze' (Oct.13th).

21 The OBR later cut its estimate of public sector job losses to around 330,000, after it took into account the effect of pay freezes (Nov. 2010). Conversely, the LGA has forecast 140,000 job losses in local govt alone.

Note: the actual job losses will vary according to the budget impacts on particular departments and institutions. For example, in TW the DWP, universities and Local Authorities may be hit differently and/or respond differently from the views set out above.

The combination of the recession (-15,000 jobs in 2008 and 2009) and the fiscal retrenchment to come (-25,000 jobs) could together equate to about half the scale of job losses in the 1980s recession (when TW lost about 80,000 jobs[22]).

8. Credit Crunch[23] – recent developments

Bank Lending remains weak.

- **Bank lending to businesses** has continued to be **negative** (this **means businesses, overall, repaid** loans to **the banks**)*. Around £5bn was repaid by companies in the 3 months to November. This negative net lending has continued since early 2009. In 2007, growth of bank lending to business had been over 20%. In November, bank net lending to business actually rose by £1.3bn.
- Mortgage lending continues to grow at under 1%pa.
- Consumer credit continues to grow at under 1%pa.[24]
- **Liquidity** has **replaced capital** as **the main problem of the banks**. UK banks have to re-finance over £750bn of their borrowings by end-2012 – the BoE Financial Stability Report warned (June 2010). They have been doing this re-financing at only about half the rate required. [As an alternative, banks are, therefore, shrinking their balance sheets (i.e. cutting lending) to meet this target.]

* This information comes from a survey of the six big UK lenders. The Bank of England has cut the frequency of its monthly report 'Trends in Lending' (TIL) to quarterly.
TIL has two major weaknesses; i) it only presents data from the banks, not from customers (and potential customers) ii) it excludes the lending of foreign banks to UK businesses, which is understood to have fallen very significantly.
Information on the impact of bank behaviour on *NE* business remains meagre. The survey by BENE gives some indications.

Eurozone Govt Debt Crisis

In the periphery of the **Eurozone**, the sovereign debt crisis has virtually halted economic growth in the very small EU markets of Greece and Ireland. Ireland, however, accounts for 7% of UK exports (as much as the BRICs, the four big emerging countries). The UK govt has agreed to a loan of about £3.25bn to Ireland. UK banks have very significant exposures in Ireland; RBS about £55bn and Lloyds about £20bn. The non-performing portion of this portfolio is over 40% in the case of Lloyds.
Portugal had to pay 6.7% interest, even at a "successful" bond auction on Jan 12th. 'Unless its borrowing costs plummet, Portugal will eventually have to seek rescue funds from its euro-zone partners and the IMF…' (EcN. Jan 15th). It can also be expected to be pushed, by cuts, into a new period of slow growth. The EFSF[25] (the EU "bail-out fund") has sufficient funds to lend the possible €80bn or so Portugal might need.

The **real question** for the eurozone is whether **Spain** can manage without special funding. On the one hand, Spain has a much lower ratio of public debt to GDP (around 65%), and claims its unlisted savings banks will need no more govt-assisted capital in 2011 than the €11bn already committed by the state's €99bn Fund for Orderly Bank Restructuring (FROB). The Economist reckons in 'a doomsday scenario' lenders' gross losses would be €270bn, and require '€140bn of new capital, or 13% of GDP, to achieve a tier-1 ratio of 10%.' On the other, if the state's cost of borrowing rises above 7%, it may well have to

[22] 1978-86.
[23] Credit Crunch means the restriction of credit by lenders, by quantity and prices. This section covers the health of the banking system.
[24] Source: The Bank of England's monthly 'Trends in Lending' report (July). This is largely based upon a survey of the Big Six lenders; caution: it omits foreign lenders.
[25] The European Financial Stability Fund (announced in May 2010, which had €440bn from member states)

seek funds from the EFSF. This could empty the existing EFSF; the EFSF could well have to be enlarged.

The bail-out fund is only a temporary measure as it addresses liquidity; it does not address the underlying problem that some govts may be insolvent (i.e. so in debt that they cannot service their debts). Restructuring debts would mean a degree of write-off by creditors.

The direct costs if these four countries restructured their debts (or even defaulted and devalued) ‘might be bearable’ for the banks (EcN 11 Dec p83); the hit would be about €300bn if eurozone and UK banks were to lose a fifth of their combined exposure to Greece, Ireland, Portugal and Spain (the “PIGS”). This is a fraction (about a third) of the €1.1trillion aggregate Tier 1 capital of the 91 European banks stress-tested in July.

Furthermore, if southern European countries are unable to grow their economies (for example if they did not devalue by leaving the eurozone), the crisis can be expected to return. The current EU/IMF fund runs until mid-2013. EU heads of govt have agreed to a treaty change which allows the creation of a permanent facility from 2013.

Quantitative Easing (QE)

The Bank of England’s MPC QE programme remains suspended, after it created £200bn (of new money) in the year from March 2009. If the economy were to be heading into a second recession (“a double dip”), QE could be resumed. Conversely, if wage inflation were to accelerate significantly (say in the spring), it would pressure the Bank to raise rates.

If an economy faces deflation (falling prices), central banks should loosen. The USA and the eurozone have similarly very low inflation (only around 1%).
In the USA, the Fed has re-started its QE with a $600bn programme to be completed by end of June 2011. In Europe, the ECB has not used QE, so it effectively retains this policy option.

The Bank of England faces higher inflation in the UK, so further QE looks less likely here than in the USA.