UK Financial Crisis

What is the issue?

A toxic mix of politics, inflation and higher interest rates is threatening the financial system in the U.K., sending a shock wave through global markets.

What about the status of the UK economy?

- **Historic inflation**- Between February 2021 and August 2022, UK gas prices shot up higher than the prices experienced at any time in the past.
- **Stagnant growth**- The UK's economy has largely been stagnant since the global financial crisis of 2008.
- Between 2007 and 2020, the UK's GDP has grown from 2.73 trillion dollars to 2.89 trillion dollars.
- **Currency**- The pound sterling has rapidly lost value against the dollar and fallen to a 37-year low.
- **Underinvestment**- Britain has one of the lowest shares of investment in GDP of any of the rich economies of the world (15-16 %).
- **Covid pandemic**- The UK economy has still not recovered to the pre-pandemic level.
- **Energy crisis**- Europe as a result of Russia's war on Ukraine and tensions in global gas markets worldwide is suffering an epic energy crisis.
- **Brexit**- It has generated inefficiencies which will cost GDP, thus providing very little incentive for investment.
- **The Mini Budget-** The announced measures are likely to require new government borrowing.
- It has deepened anxiety about Britain's public finances.

Recently, India overtook the UK as the fifth-largest economy.

What did the new mini Budget announce?

- **Inflation targeting**- To contain the inflation, a freeze on energy bills was announced.
- According to the government, this will reduce inflation by as much as 5 % points.
- **Kick-starting the economy**- The government has decided to scrap the 45% top rate for high earners.
- These tax cuts will benefit all taxpayers (individuals and companies) to varying degrees.
- The government's idea is to leave people and companies with more money in their hands.

- It is expected to boost consumer spending as well as incentivise businesses to invest in the economy, creating a virtuous cycle of rapid economic growth.

Why was the mini budget criticized?

- **Government borrowings**- The package comprises about 5% of the country's GDP.
- The energy support and the weaker economic outlook will increase the borrowing.
- **Interest rates**- Since, the UK's economy is facing the prospects of stagflation, the interest rates will rise.
- **Economic growth**- The markets are not convinced that growth will happen at the pace the government hopes for.
- **Investor confidence** Investors doubt the UK government's ability to pay back the money.
- They are unwilling to lend money to the UK, which, in turn, is reflected in the selling of UK government bonds.
- As a consequence, gilt yields are shooting through the roof.
- **Cost-of-living crisis** - The mini-Budget may end up in the cost-of-living crisis in the UK.
- **Inflation**- More money in the hands of the people could fuel spending and inflation.
- **Imports**- The sharp weakening of the pound's exchange rate will make imports (especially energy) costlier.
- **Inequality**- The International Monetary Fund (IMF) is reported to have said that the new UK Budget would disproportionately benefit the wealthy, thereby increasing the inequality in Britain.
- **Reaganomics**- The announced tax cuts have drawn comparisons to the tax policies of US President Ronald Reagan.
- **Starving the beast strategy-** The idea is that if the expenses of corporations are reduced, the savings trickle down to the rest of the economy.
- British Prime Minister Liz Truss said that her government will not reverse the economic plan despite the turmoil in the financial market.
- Britain, once a glorious imperial power where, the sun never sets, is now a country, post Brexit, that's fast losing its status, economically as well as geopolitically.

References

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Quick facts

Stagflation- Stagflation is an economic condition that is caused by a combination of slow economic growth, high unemployment, and rising prices.

Gilts- Gilts are bonds that are issued by the British government and generally considered low-risk equivalent to U.S. Treasury securities.

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