PRACTICAL POLITICS

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Only yesterday, it seems, lamentations spread throughout the nation: young people are unable to get a foot on the housing ladder, young couples cannot afford to live in the place where they were born and raised! Now, house prices are coming down and will come down further. Do we hear joy bells? No, we hear imprecations for action to reverse this calamity – the speculative price of housing land must be kept up, to support the collateral pledged by eager over-borrowers to reckless over-lenders. Affordable housing, bah! Pour on the liquidity! No, not from the wine presses – from the printing presses of the central banks! Yes, the economics pantomime season is in full swing again. It's not so funny this year, though, is it?

We have devoted three of our pages this month to the ongoing travails of our own country's and others' economies as they appear to be moving towards a general depression, in the style of the crash of 1992. Events have moved quickly in the last month, and we have felt obliged to take note of them. We again recall that the mechanism of the trade cycle was explained in a special feature, "Landing In Trouble", in our Issue No. 29 (July 1992). Now, though, for something different…

AGE-OLD PRINCIPLE AND PRACTICE SURVIVE IN THE SPANISH PYRENEES

Fago is an isolated hamlet in the Spanish Pyrenees. It is the poor relation of Ansó, "one of the oldest and most emblematic villages of the Pyrenees. The two settlements are only 8km apart" (Leslie Crawford, "Financial Times Magazine", 9th. June). Ansó's 500 inhabitants still speak the local dialect, a mixture of Basque and Spanish. "One of its most deeply rooted traditions is the communal holding of land. 'Our wealth lies in our houses and our livestock. We have never owned any land. It belongs to the community', explains Enrique Ipas, the mayor, whose forebears settled in Ansó in the 15th century."

"The municipality of Ansó extends over 26,000 hectares of woodlands and meadows, and shares a 50km border with France. Every year, the town hall holds a draw to allocate pastures among shepherds and cattle farmers. Fago, by contrast, has no land of its own. Since 1870, the two settlements have shared the income earned from Ansó's land-holdings. Fago receives one fifth of all earnings, according to its share of the population 140 years ago."

Here is a system that works, in an isolated pastoral situation. Viewed on a national scale, its defects are obvious, but the straightforward principle, "We have never owned any land. It belongs to the community" is utterly sound. The article, headed "Murder in the Pyrenees", is not about economic theory, however. For the mysterious death of the mayor of Fago, of a confession and its retraction, and of the holes in a tale the police could not reconstruct, we must regretfully leave you to locate and read the account for yourselves.

DEPRESSION OR NO DEPRESSION?

In our previous Issue, No. 159, we noted the rapidly accumulating evidence that all was not well with the world economies, and suggested it could be the start of another general economic depression, as in 1992. The authorities have only feeble defences, “navigating a treacherous course between the Scylla of inflation and the Charybdis of the credit crunch” [a].

[a] Richard Fletcher, “Daily Telegraph”, 27th. November

Evidence accrues

“Gross rental yields on property are running at around 5.3pc – below mortgage rates of roughly 6pc. This means that once you take account of all the incidental costs, landlords are making a running loss. It is only the hope of future capital gains that can justify hanging on” [b]. “Companies are starting to go bankrupt at a disturbing rate in Britain, the United States and Europe as the debt crisis spreads…The first signs of a global trade slowdown have already begun to emerge in the red-hot market for industrial metals” [c] such as lead, copper, and zinc, with falls even on the Shanghai exchange “where traders have begun betting on a slowdown in 2008” [c]. There are accompanying signs of a decline in global freight demand, “typically a leading indicator of broader troubles” [c]. A further bad omen is news from the U.S.A. of “an increase in new claims for unemployment insurance, an indication that the job market is beginning to deteriorate” [d]. Although sackings in the U.K. so far have mainly affected “the relatively well-paid staff of large international banks…there is now a real threat we will start to see job losses from employers in other parts of the economy” [e].

Merrill Lynch, Morgan Stanley, HSBC, Bear Stearns, Deutsche Bank, Bank of America, Royal Bank of Scotland, and Barclays have all admitted to heavy losses in the sub-prime mortgage market. French bank Société Générale “has said it will bail out a $4.3bn investment fund it owns that was hit by the global credit turmoil…HSBC, Standard Chartered, and Rabobank of the Netherlands recently took similar action to support the liquidity of specialised funds by taking some of these vehicles on to their own balance sheet. In the US, Bank of America, Citigroup, and JPMorgan said they would set up a SIV [structured investment vehicle – ed.] superfund to buy the assets of struggling SIVs” [f]. “Mighty UBS – formerly the Union Bank of Switzerland – has turned to the government of Singapore for a recapitalisation, after losing $13.5bn in the US sub-prime market. The Singaporeans have injected nearly $10bn into the bank, with an extra $1.7bn coming from the Middle East (probably Oman)…Singapore’s move comes shortly after the Chinese bought a stake in Barclays, and Abu Dhabi shored up Citigroup” [g]. Meanwhile, it emerged that “Germany’s IKB bank has racked up losses of €6.15bn on sub-prime ventures and has been rescued by a pool of German banks" [h].

All of this brings us to Northern Rock, where "total catastrophe" has, so far, been avoided only by "the biggest financial support operation ever offered to any private company by any government anywhere in the world… Even more ominous is that the Government was forced to guarantee all deposits in all British banks as part of the bailout" [i].

"The flow of money into the world of commercial property has turned negative for the first time in many years as investors flee the troubled sector" and a Bank of England report "raises particular alarm over the state of the office building market…To the extent that commercial property funds became forced sellers of their assets, this could potentially further undermine returns" [j]. According to a property agent, "Large lot-size transactions, principally central London offices and shopping centres, have been particularly hit" [k]. "The commercial property market has enjoyed extraordinary growth over the past few years, which led to an investment stampede…However, almost all the worst-performing funds this year have been in the property sector, with those invested in property equities performing particularly badly" [l]. This perfectly encapsulates the rush of speculation which pushes up land prices to illusory and ultimately unsustainable levels, but in the meantime has lured reckless lenders into advancing funding against this bubble collateral.

According to Morgan Stanley analysts, "The world's largest banks have around $212bn of assets at risk of default as a result of the severe contraction in lending on commercial property and the expected fall in real estate values…The sums at risk are dwarfed by the losses on residential property, estimated at as much as $400bn. [Furthermore] banks are stuck with about $88bn of 'hung' loans – commercial property loans that they purchased from others intending to repackage them into CMBS [commercial mortgage-backed securities – ed.] before the market seized up…Morgan Stanley estimates that writedowns on hung loans alone will be $1.8bn in the US and a further $2.6bn in Europe" [m].

[b] Roger Bootle, "Daily Telegraph", 3rd. December [c] [h] Ambrose Evans-Pritchard, "Daily Telegraph", 20th. November and 30th. November [d] David Litterick, "Daily Telegraph", 30th. November [e] Damian Reece, "Daily Telegraph", 4th. December [f] "Daily Telegraph", 11th. December [g] Jeff Randall, "Daily Telegraph", 12th. December [i] Anatole Kaletsky, "Times", 6th. December [j] Edmund Conway, "Daily Telegraph", 17th. December [k] Sophie Brodie, "Daily Telegraph", 11th. December [l] Daniel Thomas, "Financial Times", 8th. December [m] Norma Cohen, "Financial Times", 13th. December

Entry of the central banks…and the aftermath

On 12th. December, the US Federal Reserve, the Bank of England, the European Central Bank, the Swiss National Bank, and the Bank of Canada made “an unprecedented intervention in the faltering financial markets… pumping billions of dollars, euros, and pounds…into the money markets…to ease the credit crisis by making it easier for banks to borrow money” [n]. Both the Federal Reserve and the Bank of England will accept “a broader range of collateral than before” and for the first time the Bank of England will accept “mortgage-backed securities, covered bonds and dollar-denominated securities” [o]. “Assume…that central banks end up buying a vast amount of paper and so providing liquidity to institutions that have deliberately taken on big risks, by lending long and borrowing short…So, does the action by the central banks give us good reason to stop worrying? Only if you like huge rescue operations of incompetent bankers, would be my answer” [p]. The conclusion the world has drawn is that things must be worse than they seemed, to get these central banks acting together in such concord. A lot more money is going to be thrown at this problem, and still it will not go away. Prepare, then, for further interventions. In effect, taxpayer-citizens, via governments and central banks, are going to take on the risks of those dodgy loans and underwrite the speculation that has been going on in the land market, unchecked by prudence or even by fear of failure.

Developments in the day or so immediately following the central banks' intervention, do not hint at returning optimism. “Base metals prices fell as fears over a US economic slowdown hit demand expectations. Lead fell 8.4 per cent…and copper 5.3 per cent” [q]. “As valuers battle to price properties in a market shell-shocked by the credit crunch, portfolios are being written down by hundreds of millions of pounds every week” [r]. “Buy-to-let investors are being stalled by lenders taking a more cautious view to property valuations…Lenders have also reduced how much they will lend in total or as a proportion of property value” [s]. “The fundamental problem is lower asset values stemming from the past excessive growth of credit and the related excessive strength of certain asset prices, especially property…We have lived through a massive asset price bubble both here and in the US, as well as in selected other countries, including Ireland and Spain, and when the bubble bursts there is bound to be pain” [t]. OK so far as it goes, but ‘asset’ and ‘property’ are just cover words for ‘land’. The boom/slump cycle is a land question. Let our resolution for the New Year be to drag it out into the open!

[n] Edmund Conway, “Daily Telegraph”, 13th. December [o] Scheherazade Daneshkhu, “Financial Times”, 13th. December [p] Martin Wolf, “Financial Times”, 13th. December [q] Neil Dennis, “Financial Times”, 15th. December [r] Richard Dyson, “Mail On Sunday”, 16th. December [s] Sharlene Goff, “Financial Times”, 15th. December [t] Roger Bootle, “Daily Telegraph”, 17th. December

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