We have created a monster … banks with access to public funds

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THE ECONOMY: an apology.

"Readers of the nation's press over the last six months might have been forgiven for believing that there was an economic recession. Headlines like: Doom Britain, It's Worse Than The Great Depression and Mothers Start Selling Children For Food might have led casual readers to conclude that Britain was in a very severe financial crisis. We would like to make it clear that there was not a jot or tittle of truth in these reports and that the British economy is bouncing back, house prices are booming and happy days are here again. On behalf of all newspapers and politicians, we would like to apologise for any confusion. Mr Robert Peston of the BBC has agreed to a 40% salary reduction, which he will donate to charity."

It is the most dramatic turnaround in economic history: from bust to boom in a matter of weeks. The pound is up, oil prices are up, consumer confidence is up, bank lending is up and house prices rose 2.6% in May. That last figure is the most astonishing, since hardly any houses are actually being sold right now, and the vast majority of mortgages require a 25% deposit. But who am I to argue with the green shoots consensus? Killjoys might point out that unemployment is still growing fast, that most of our manufacturing industry is collapsing, and that personal and public debt levels remain at intolerable levels. You could point out that the Baltic Dry Shipping index – a measure of world trade – has collapsed again. But the word has gone out that the recession has "bottomed out" and anyone who departs from it is seen as talking down the economy.

So, what has happened exactly to achieve this remarkable turnaround? Well, it's just a guess, but £1.3 trillion in public money may have had something to do with it. That's how much the government has put at the disposal of the banking system in loans, equity, swaps and asset protection schemes. All this cash has to go somewhere, and it is going, first to bank profits and then indirectly to middle-class home-owners. Anyone with a relatively large mortgage has just had a colossal windfall, with their monthly repayments slashed in many cases by more than half. So long as interest rates are kept artificially low the relatively well-off are being insulated from economic uncertainty. They are also feeling better off because the stock market has increased by nearly a third in the last six months. This feeds into pensions and other investments. Banks can start selling mortgage bonds again; they lend more, people buy houses, retail sales rise, taxes recover and we're all off to the races again.

Except, of course, that it isn't quite that easy. This is all being done at a cost, and that money used to bail out insolvent banks has to come from somewhere. And as the real economy sheds jobs, the government has to pay more money in unemployment benefits while getting less revenue from taxes because fewer people are in work. Hence the “great debate” last week about who is going to cut public spending most: Labour or the Tories. The Conservative health spokesman, Andrew Lansley, admitted that there would have to be a 10% cut in spending in non-health departments. This allowed Labour to indulge in some electioneering by painting the Tories as the party of cuts in services. In reality, the cuts are clearly set out in the government’s own spending forecasts to 2014. These show that spending will have to rise much more slowly than before, which means that planned spending is being cut even if it is rising in cash terms.

The government doesn’t want to admit this because it is banking on our flexible friend, inflation, to come along and pay off the debt for it. The Bank of England is in the process of effectively printing billions of pounds through Quantitative Easing, which will have the effect of undermining the purchasing power of the pound. The government hopes this will erode the deficit, expected to rise to over £150 billion.

And the losers? Well, the usual victims. Older people living on fixed incomes have seen their wealth transferred to middle-aged home-owners. Anyone who has had the misfortune to save for the future is being robbed blind right now because interest rates are less than CPI inflation. Young families will have to take on immense debt to buy a house which will chain them for life to the banks. Public services will decline as inflation erodes the pounds we put into health and education and public service workers lose their jobs.

The real winners are the big banks – the ones left standing, that is. Recessions generally involve structural changes in the economy, and the big gain for the financial sector this time is consolidation. We have been left with a handful of giant financial behemoths like Lloyds, which alone has one-third of all UK mortgages and 40% of retail banking. We already had banks that were too big to fail; now we have banks that are so big, they can make the government fail.

Last week, Lloyds axed hundreds jobs by closing the Cheltenham & Gloucester branches without a murmur from government, even though we own nearly half of Lloyds. The government is desperate for the economic recovery to be sustained, and the last thing it wants to do is interfere. It wants to go back to the golden days of bank lending in 2006/07, when money was so cheap HBOS was practically giving it away. We no longer hear Lord Turner of the Financial Services Authority, threatening to get tough on the banks. Britain is even resisting EU reforms which would regulate private equity and hedge fund activity.

We are emerging from this recession with a new kind of economy: a banking kleptocracy that has captured government and regulators. After a two-year financial crisis, largely of their own making, the banks have been rewarded by massive public subsidies, freedom from regulation and the lifting of anti-monopoly rules. No government will stand up to banks for fear of precipitating another crisis, such as the one that followed the collapse of Lehmans last October. Talk about moral hazard. The banks can return to their gambling table again, confident that the government will bail them out, should they lose. Notice how few bankers lost their jobs and how rapidly bosses of even nationalised banks like RBS have returned to paying themselves multi-million-pound bonuses again.

We may now have six months of “recovery” from the latest trauma, but we have assuredly laid the foundations for another even more epic crash a few years down the line. We have created a monster: banks which have ceased being capitalist entities working in a market, and have effectively become a branch of the state, with a pipeline straight into our wallets.

Enjoy.

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