



Savers and the Crisis

LSE Financial Markets Group Financial Crisis Conference

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Outline

- Origins of crisis
- Failure of regulation
- Savers not in favour
- Demographic dangers
- What next?



Where did crisis start?

- Housing market - not just US, also UK
- Risk was incorrectly priced, carry trade and low rates
- Inflation moved from goods markets to asset markets
- Unwinding bubbles is painful – is this just the start?
- Moving risk does not eliminate it - uncertainty
- Sustaining growth overrides monetary policy objectives



Where were the Regulators?

- Regulation fine – as long as nothing bad happens!
- FSA had plenty of information – did it understand?
- Borrow short, lend long, classic mis-match
- Ignored compression of credit spreads
- Risk mis-priced – liquidity and confidence vital
- Protection regime inadequate
 - Trust gone - customers were entirely rational



Economic policy agenda since 1997

- Strengthen short-term growth, consumption, borrowing
- Culture of self-reliance/saving -> debt/dependency
- Growth prolonged by housing boom – house of cards?
- Self-certification mortgages, 125% loans, 5 x salary!
- Also sharp rises in public sector borrowing
- Great while the party continues...



Contribution to UK growth

	GDP	Central Gov. Cons	Local Gov. Cons	GFCF	Private Cons.
1993	5.0	3.8	-1.9	0	5.8
1994	6.0	3.1	3.7	7.3	5.0
1995	5.7	2.9	4.4	8.8	5.1
1996	6.3	5.1	2.2	7.3	7.2
1997	6.0	1.5	0.9	5.6	6.0
1998	6.1	3.5	4.6	13.1	6.6
1999	5.3	6.6	11.3	3.5	6.3
2000	5.1	7.0	7.7	3.3	5.8
2001	4.6	7.2	6.6	2.5	5.3
2002	5.2	9.7	8.4	4.9	5.1
2003	5.9	9.4	9.6	3.0	4.9
2004	6.0	6.8	9.2	8.8	5.1

Source: UK Input-Output Analysis, ONS

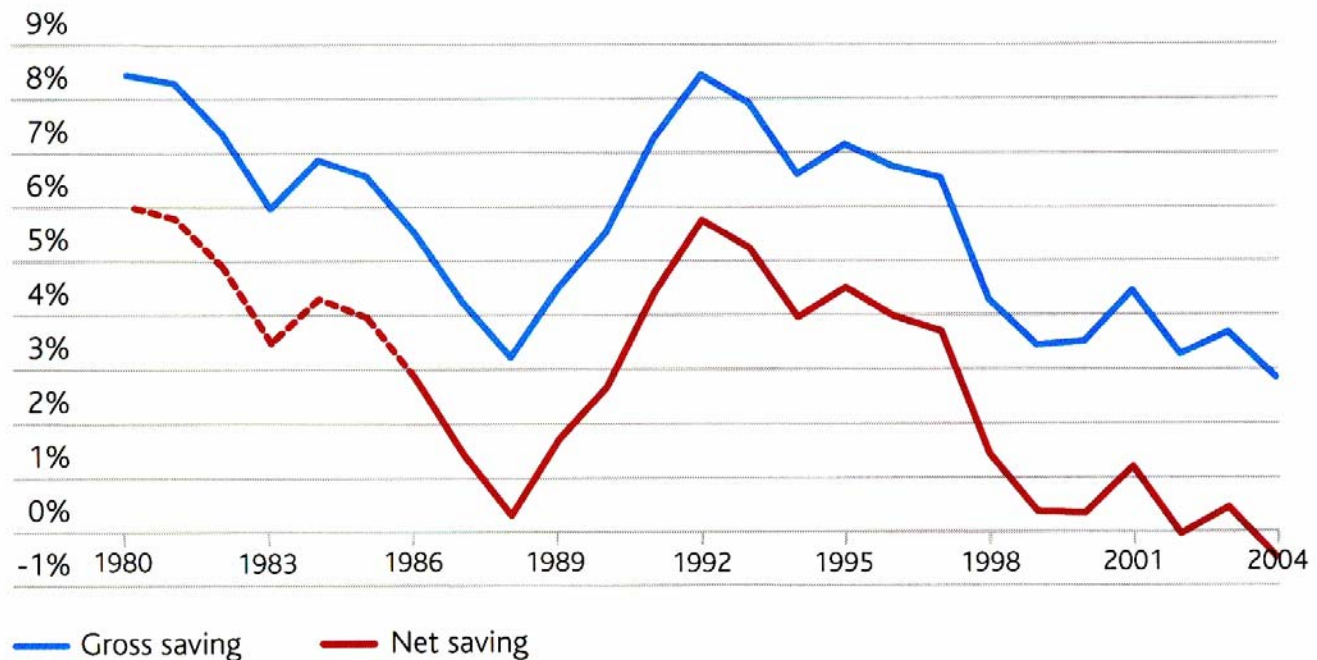


Savers not in favour

- Policy encouraged borrowing, disincentivised saving
- FSA regulation tougher for saving than for borrowing
- Much easier to take out unaffordable £200,000 loan than to put £20 a month into a pension
- Confidence in long-term savings fallen sharply – this cannot be ignored in retail banking system
- Depositors didn't trust Government or FSA – with good reason!

UK households saving negative

household gross and net saving as % of gross national disposable income

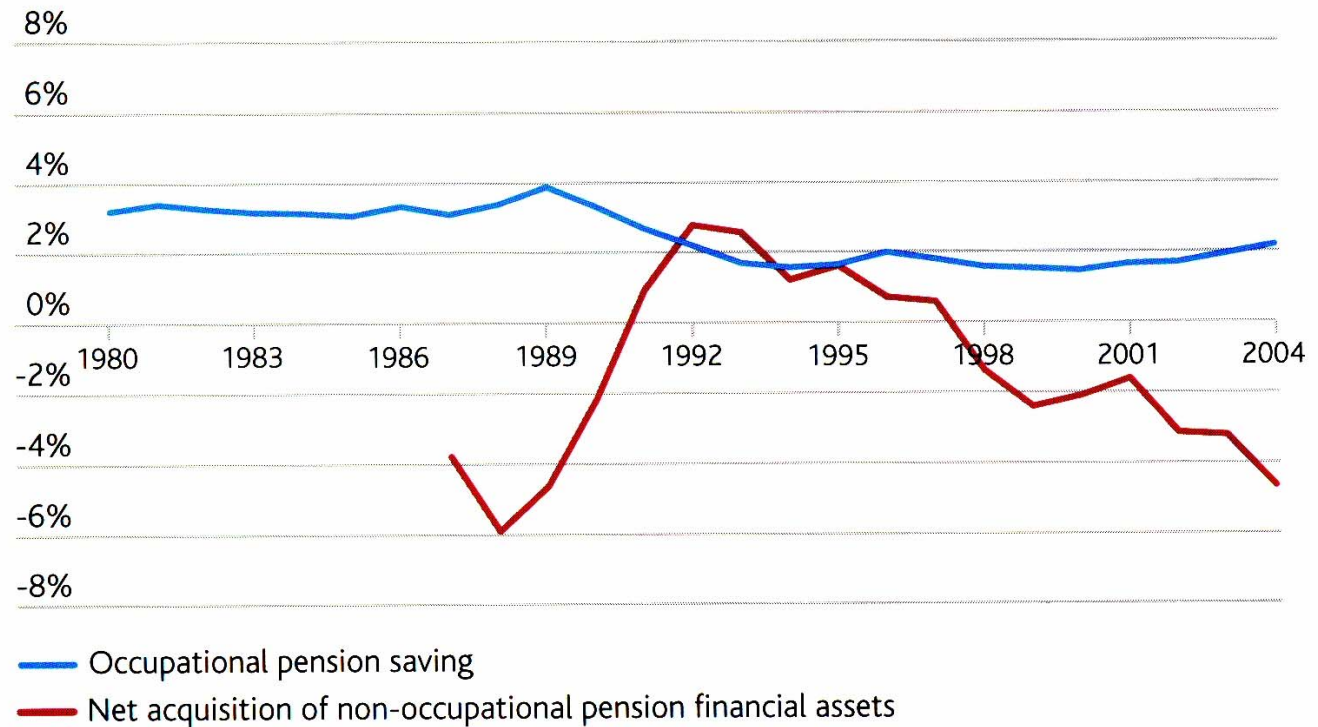


Source: Blue Book

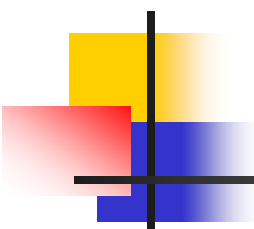
Note: Net saving figures prior to 1987 have been estimated using other household data.

Savings rate fallen to historic low

occupational pensions + other savings as % of gross national disposable income



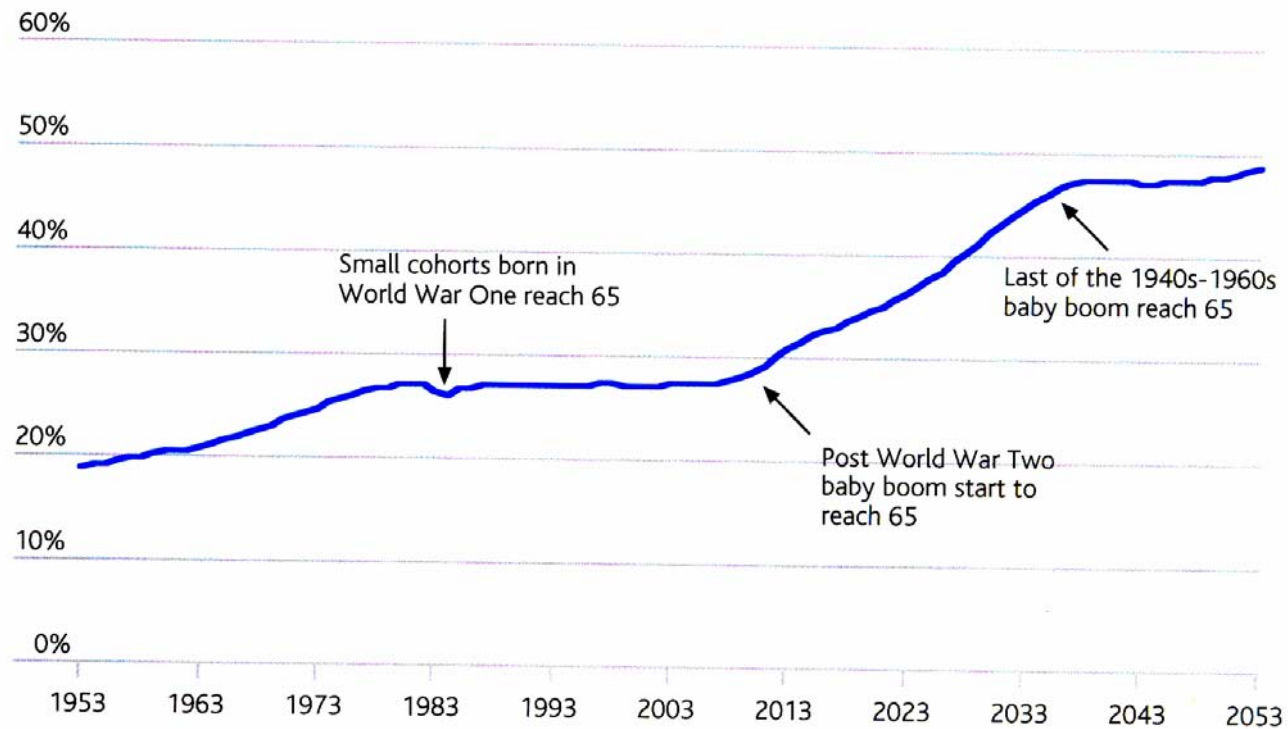
Source: Blue Book



Demographic boost becomes demographic drag

- Don't ignore demographics
- Pensioner population been remarkably stable
- Demographic boost to growth been underestimated
- Workforce boosted by baby boomers, plus higher female LFP, lower dependency ratio
- But pensions in decline as savings ratios fall
 - Implications for long-term growth very worrying
- Dramatic demographic change in about 5 years' time
 - What to live on? Pathetic pensions? Rely on housing?

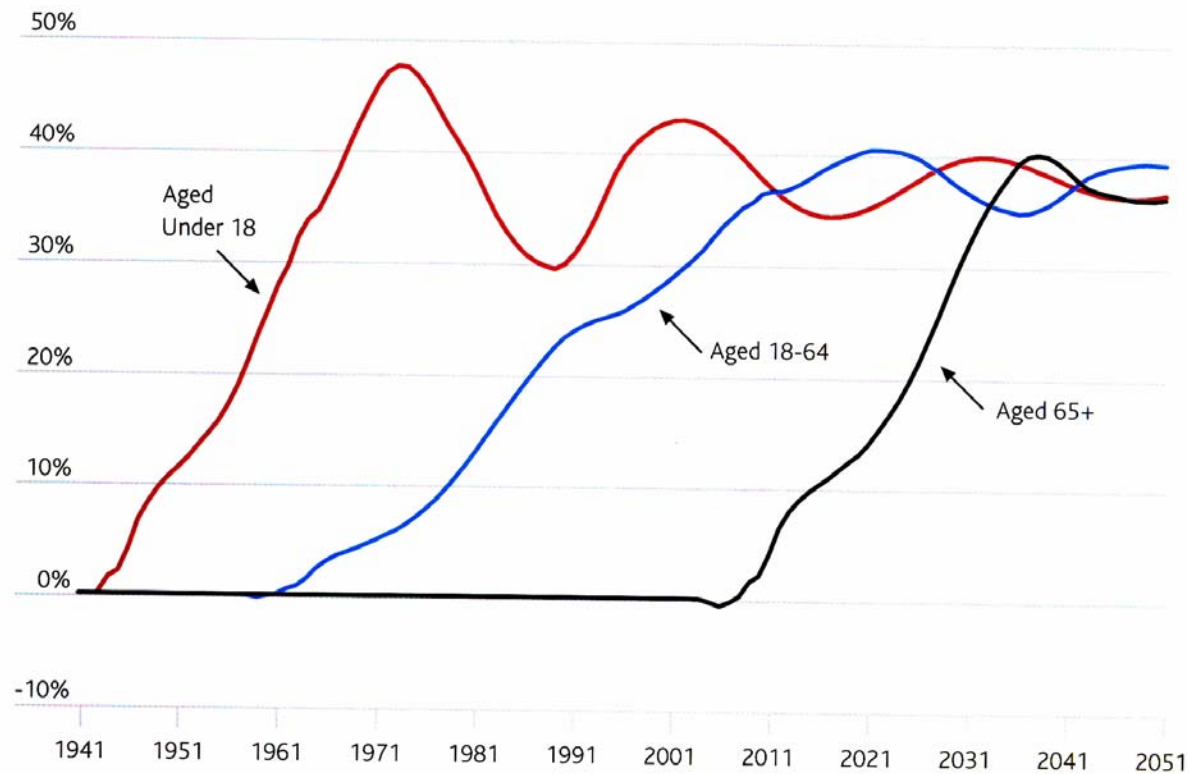
UK Population old age dependency ratio



Source: GAD 2002-based population projection, GB
Population Estimates Unit, ONS

Demographic dangers huge

(% change in UK population size)



Source: Pensions Commission analysis based on a synthetic model of the England and Wales population



Wake-up call for Regulators

- Or just press snooze button and carry on sleeping?!
- 100% Northern Rock guarantee dangerous precedent
 - Must rethink protection regime in the round
- Pensions protected much less – wrong messages
- Vital to revitalise retirement saving culture
- Need to remove regulatory bias – aim for higher savings, reduced borrowings, will be some pain
 - Not just cost of credit, but availability
- Can't just rely on housing wealth



What next?

- Curb irresponsible lending – reduce debt levels
 - Private and public sector
- Market re-pricing of risk to reflect reality of default
- Perhaps Northern Rock needs to fail
- Re-assess regulatory regime – proper risk assessment
 - Inflationary solution, deflationary solution or goldilocks
- Unwind excessive leverage and encourage prudence
 - Penalties for irresponsibility needed
- Revisit consumer protection regime



Thank you for listening

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