# Storms may blow away first rays of recovery sunshine

SUNSHINE is breaking through, as stock markets rise and liquidity returns. The financial crisis looks over. Rising house prices, quarterly growth and consumer confidence signal the end of recession.

Look closer, though: for every relieved homeowner there is one in negative equity; the economy's tiny uptick is dwarfed by the downside risks of the looming end of fiscal stimulus and ensuing public sector cuts.

In the aftermath of the average recession, unemployment continues to rise and GDP to fall, taking 10 years to return to pre-crisis peak. House prices fall 36 per cent over six years – and this is not the average recession: much evidence suggests its effects in the western world will be abnormally prolonged.

This is due to the massive global imbalances that made the crisis so deep in the first

## Comment

Baron Frankal is director of economic strategy at Manchester's Commission for the New Economy

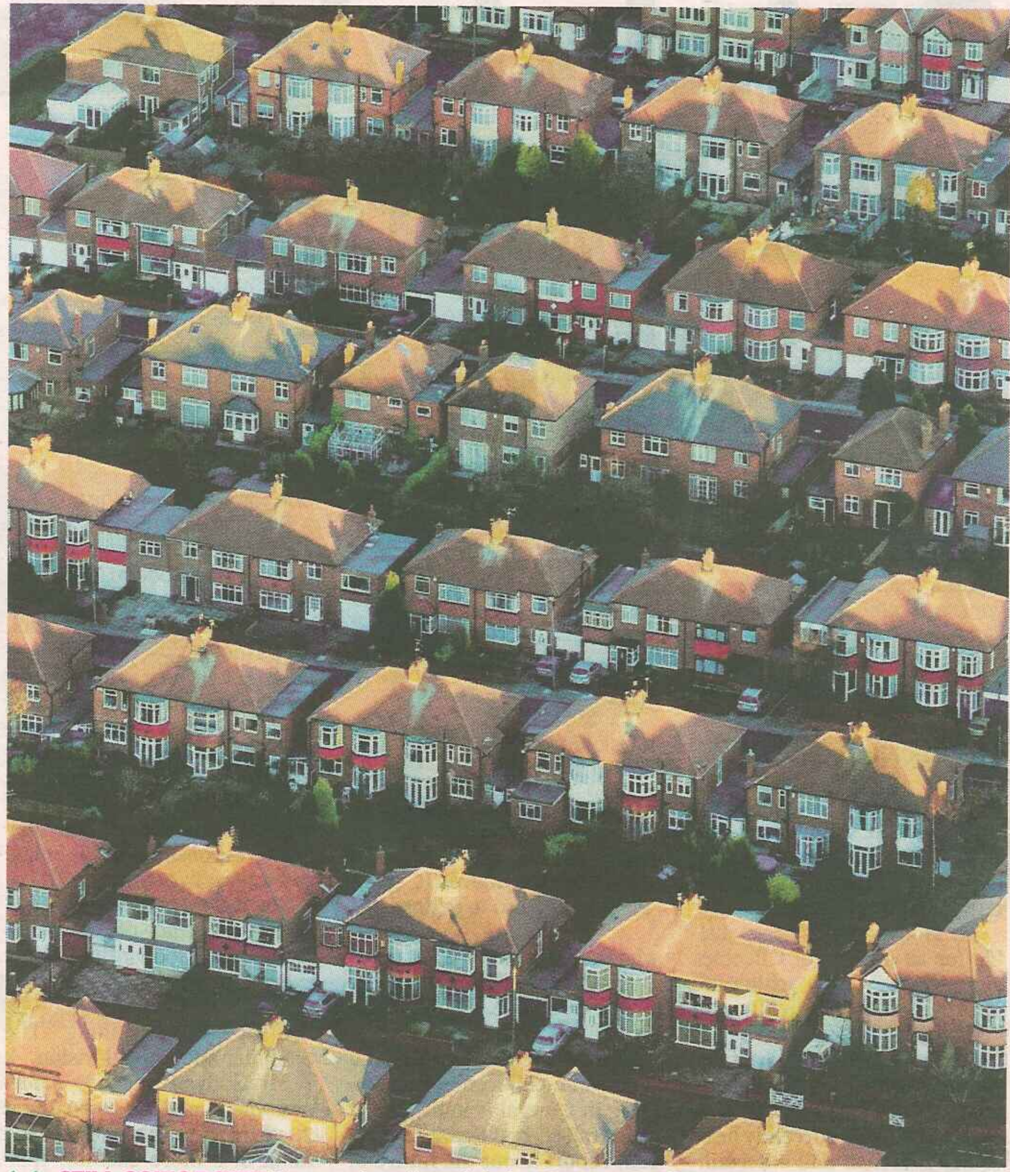
place. Put simply, deep uncertainty in the emerging world (individuals with no faith in health and pension systems, governments immunising themselves against needing IMF loans) led to the massive accumulation of foreign currency reserves.

Today, China alone holds more than the US, UK, Germany, France, Italy, Canada and Japan combined. That's what enabled easy credit and what now enables our massive debt. In the same boat, the whole western world is now competing for global savings, and the global dollar and euro have huge advantages over currencies like our own.

It's almost unthinkable that politicians of any stripe can cut or tax enough to repay the debt, especially given prolonged stagnation. That essentially leaves two strategies: devalue the pound (a strategy already in play) and inflate away the debt. Although they'll stay low as long as possible, the medium-term outlook for interest rates is high for a sustained period.

This steep rise in the cost of capital, consistent with a repricing throughout the system of risk (artificially low before the crisis) strongly suggests that today's severe curtailment in investment is less aberration and more trend.

If successful places like Manchester and businesses based here want renewed investment, that means looking for it in very different places.



» **STILL GOING DOWN** House prices dipped during August, the first monthly fall for four months, figures showed earlier this week. In the average recession, prices fall over six years

O_FD_CtP-5_1st_bbb_004-009