The UK’s experience of austerity

Robert Skidelsky
ONS growth forecasts

UK GDP growth
Quarter on quarter % change

Source: ONS
Reinhart & Rogoff: Debt-GDP over 90% leads to median growth roughly 1% lower and mean growth 4% lower.
George Osborne:

“As Ken Rogoff himself puts it, ‘there’s no question that the most significant vulnerability as we emerge from recession is the soaring government debt.

[...]

To entrench economic stability for the long term, our aim will be to eliminate the bulk of the structural current budget deficit over a Parliament.”
“A more adequate analysis differentiates between the direct demand effect of cutting the growth of government expenditure and the indirect effect on an induced change in expectations.

The direct demand impact of slower public expenditure growth is clearly negative. The indirect effect on aggregate demand of the initial reduction in expenditure growth occurs though an improvement in expectations if the measures taken are understood to be part of a credible medium-run program of consolidation, designed to permanently reduce the share of government in GDP, and thus taxation in the future.”
Eurozone GDP %-change on previous year

Source: Eurostat
The US economy is now larger than before

Widening Gap
GDP, change since 2007; adjusted for inflation and the seasons

Sources: U.S. Commerce Department; Eurostat
The Wall Street Journal
Taylor & Jordá: Each year of Osborne knocked 1% off growth, 3% in total.
Bank lending and Portfolio rebalancing channels

Portfolio substitution channel (always operates)

Gilt yields ↓

Term premia ↓
Yields on long-dated risky assets ↓

Wealth ↑

Cost of accessing credit in financial markets ↓

Credit risk premia ↓

Bank deposits and liquid assets ↑

Availability of bank credit ↑

Domestic demand

Bank of England gilt purchases

Bank funding channel (may operate in conditions of stressed bank funding)
Money supply growth since the crisis
GDP and main components, 2000-2013
Inflation vs. earnings growth, 2001-2013
Changes in major UK asset prices
Distribution of financial assets

Source: Bank of England