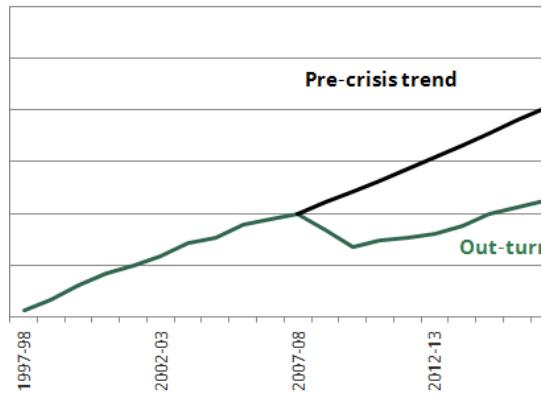


GDP per head - out-turn and pre-crisis trend since 1997-98



Calculations using Office for Budget Responsibility Public Finances Databank (<http://>

AY 2025-26

Department of Political
Economy

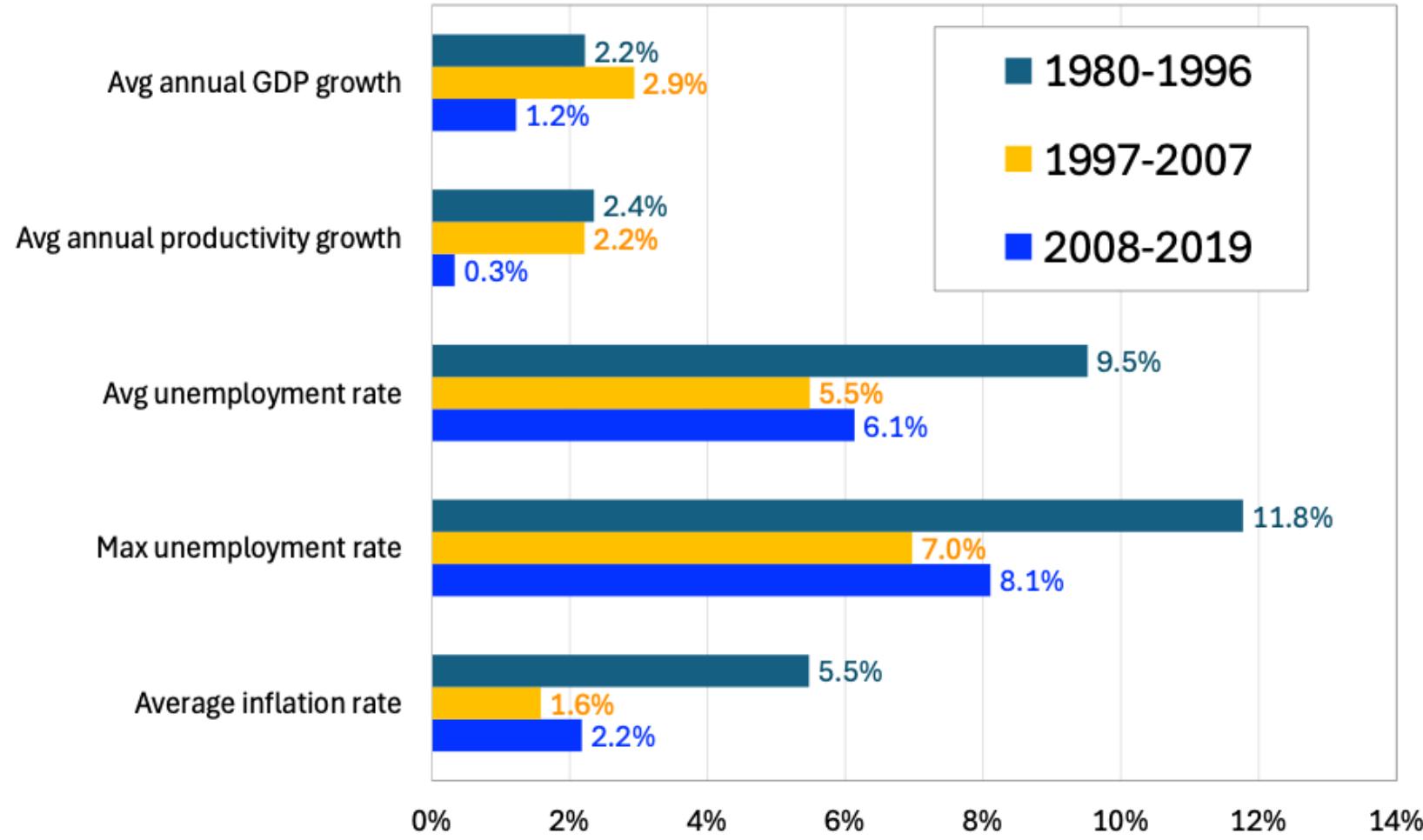
Daniele Girardi

Managing the UK economy

Fiscal and monetary policy since 1945

Week 9 – 2008-19: Great Recession,
unconventional monetary policy, and austerity

2008-2019: Overview

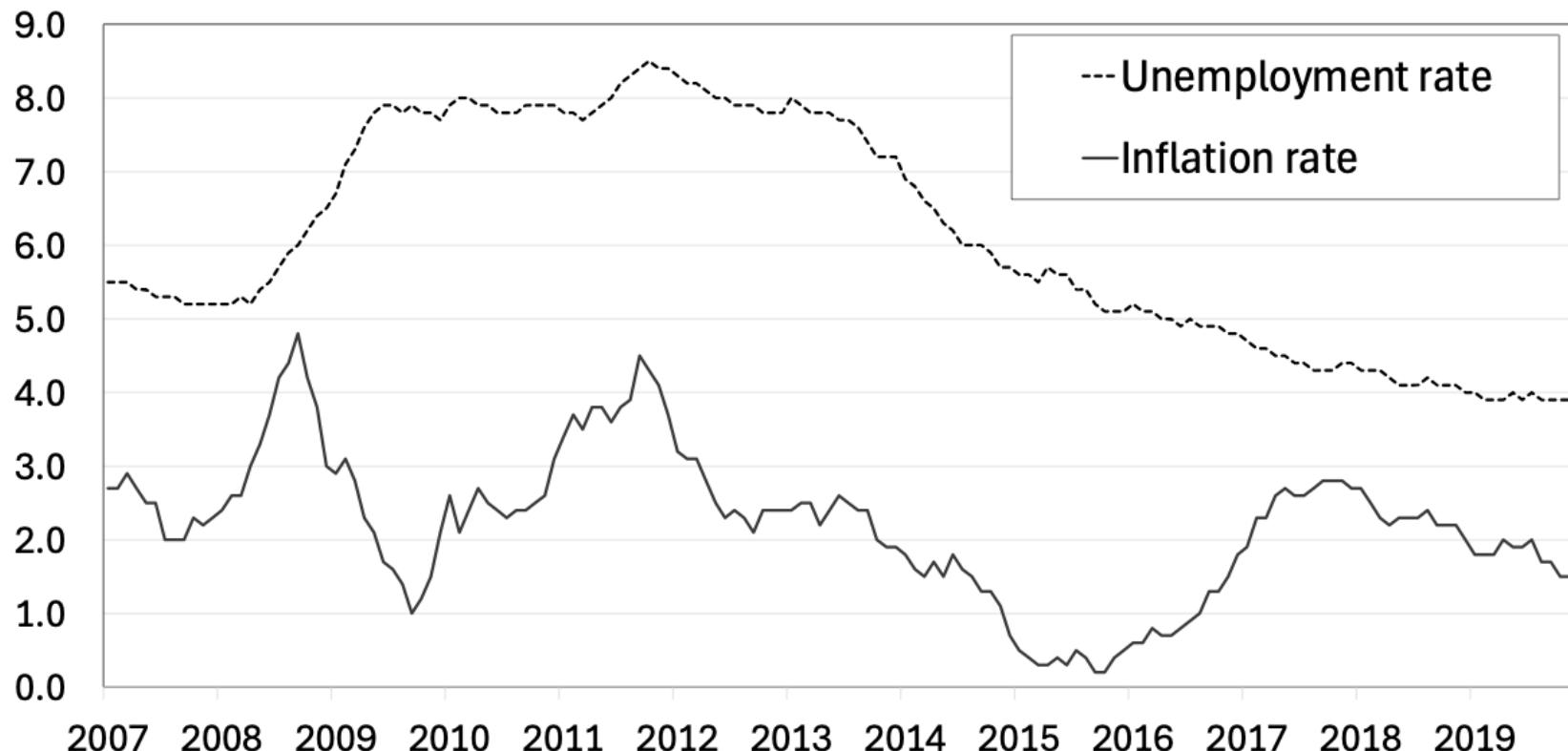


Great Recession and its aftermath:

- Dismal performance.
- Low GDP growth.
- Productivity stagnation.
- Unemployment peak relatively contained amid huge recession.
- But recovery very slow and incomplete.

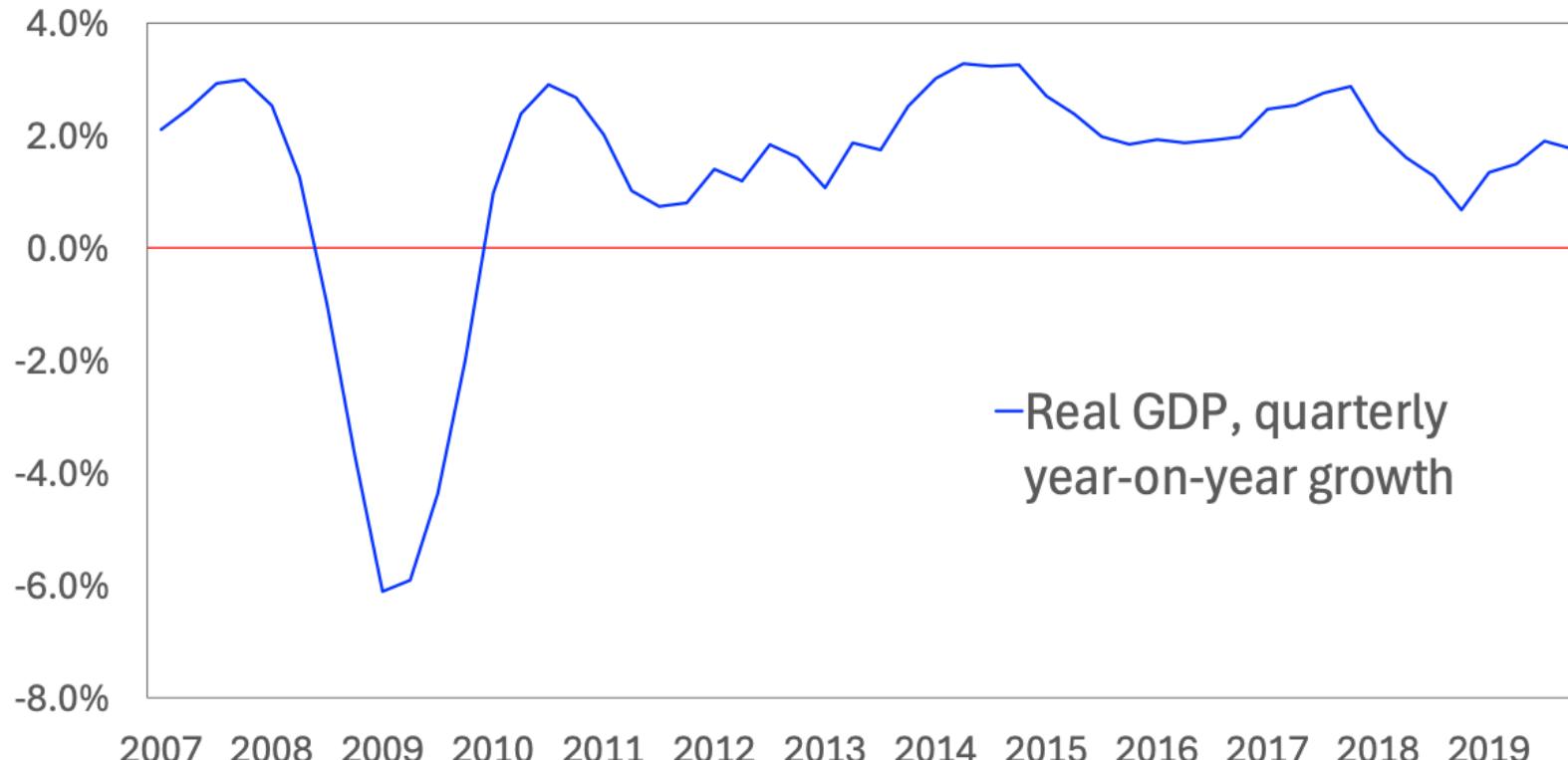
2008-2019: Overview

- Unemployment peaks at 8%, only comes down since 2014.
- Inflation close to 2% target most of the time.



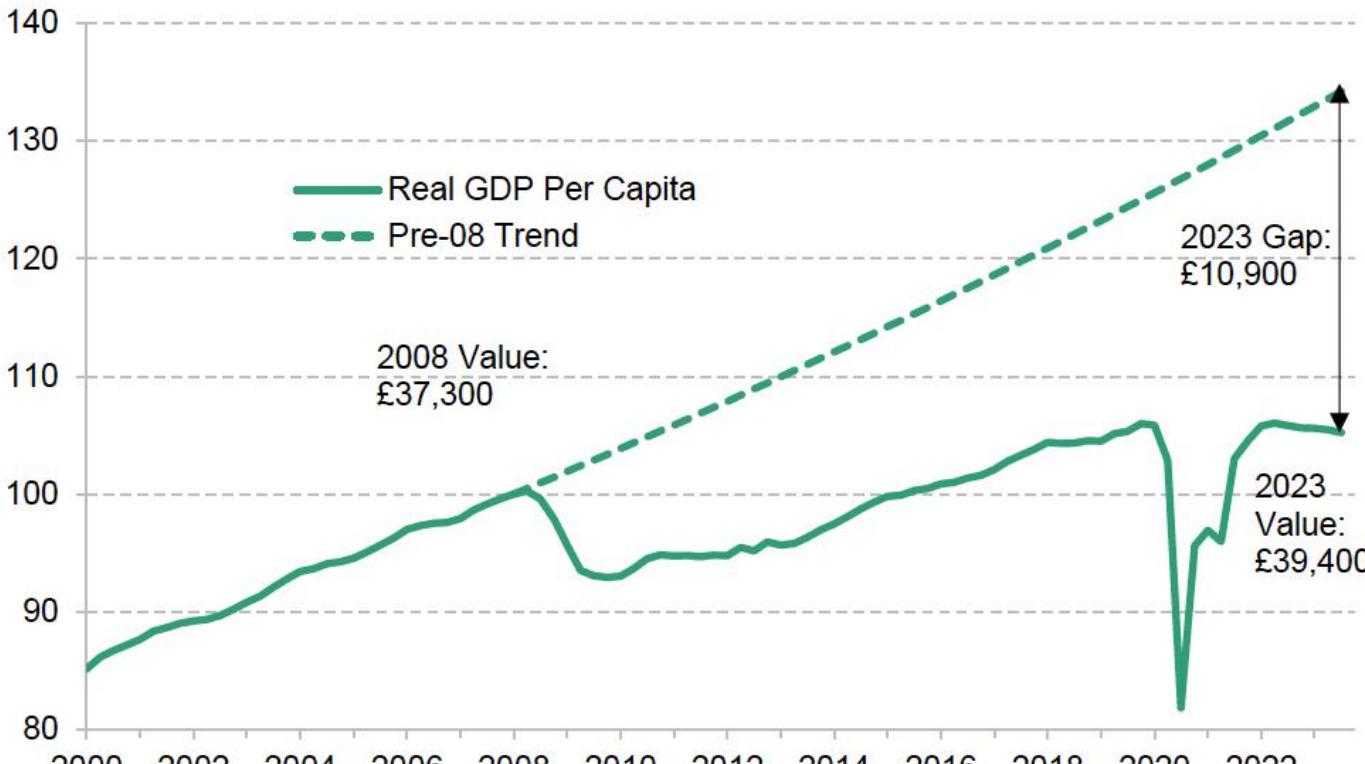
2008-2019: Overview

- 2008-09: Deepest recession since at least World War II.
- Very slow recovery



2008-2019: Overview

We still live under the shadow of the Great Recession

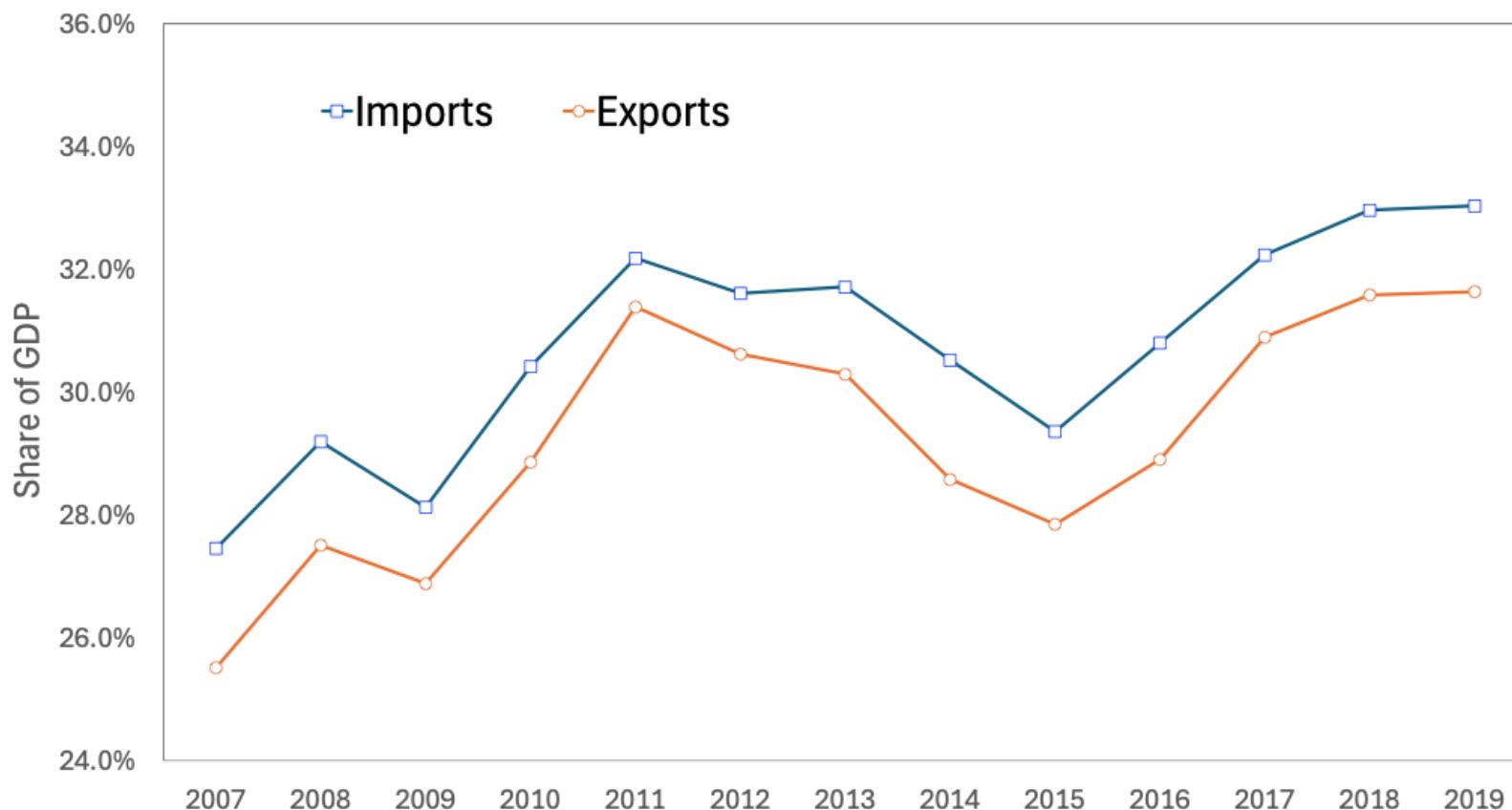


- Recovery slow & incomplete.
- Only in 2015 GDP p.c. was back at the 2008 level.
- Remains far below pre-recession *trend*.
- True also in other rich countries (especially Europe).

Source: IFS (June 2024, available on Keats)

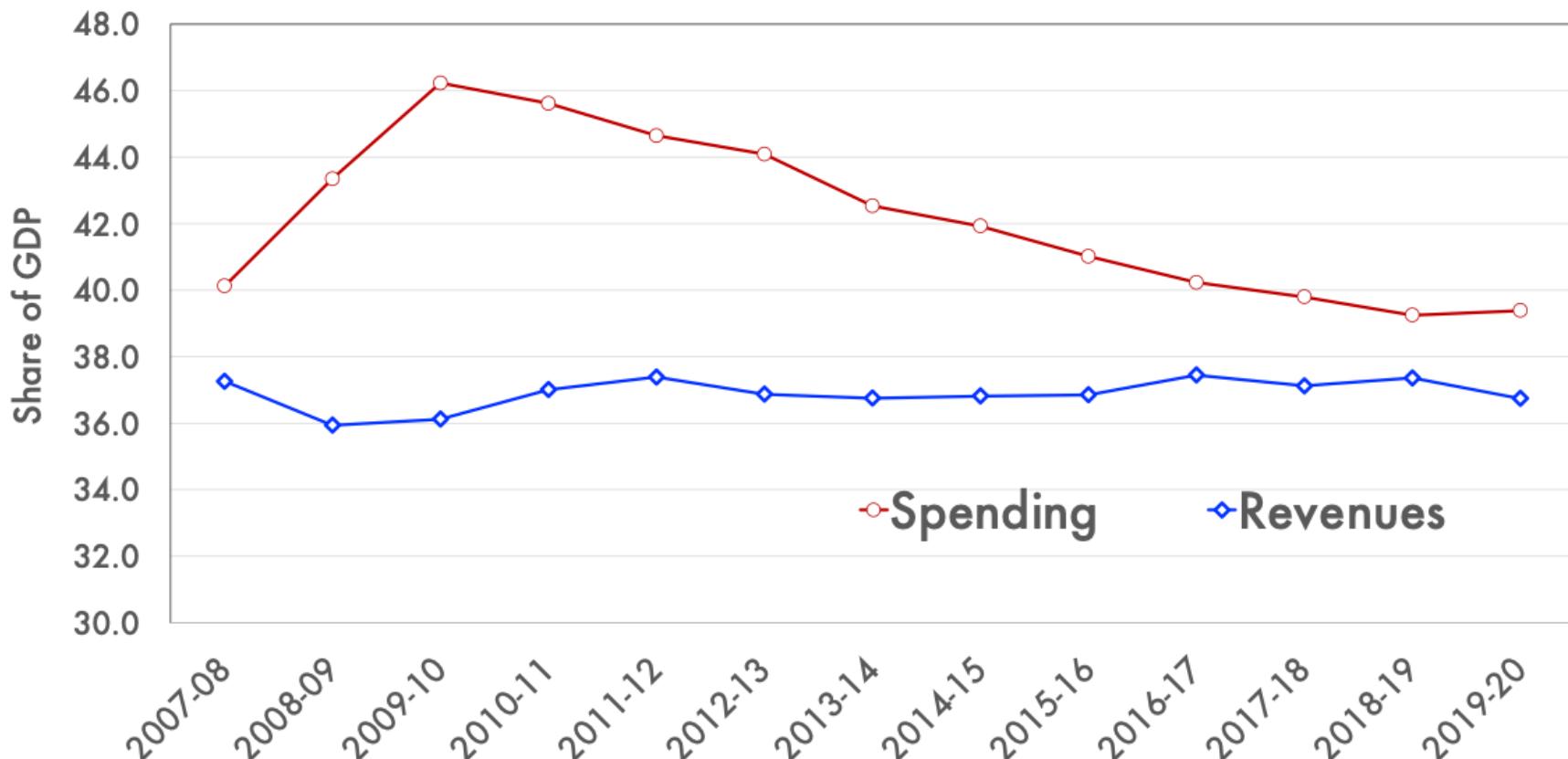
2008-2019: Overview

- Trade deficit persists, still financed by new financial inflows
- Openness (trade/GDP) continues to increase



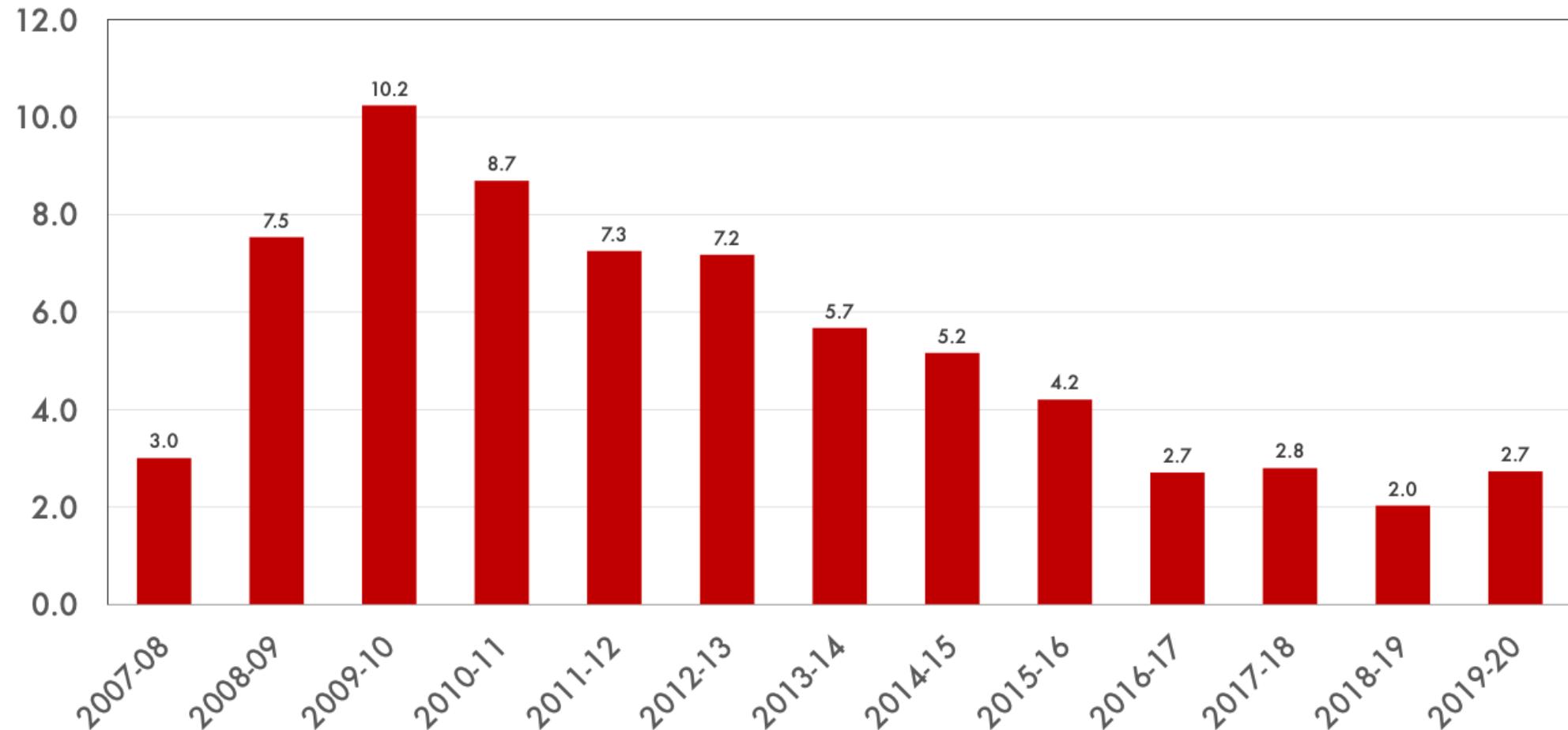
2008-2019: Overview

- Shares of GDP harder to interpret amid a very large change in GDP.
- 2008-09 increase in spending/GDP due both to increased spending and decreased GDP.

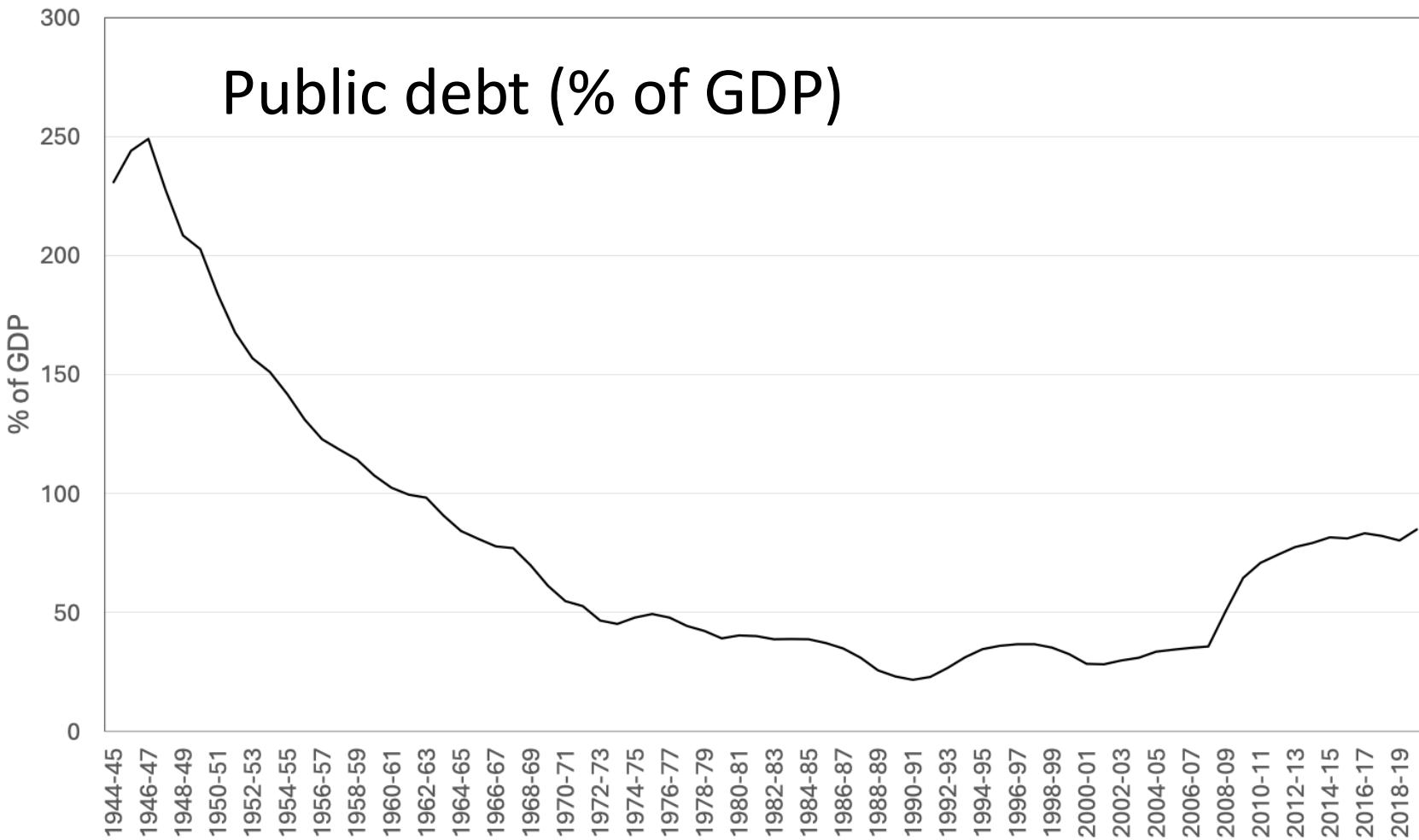


2008-2019: Overview

- Deficit explodes amid the Great Recession, then slowly comes down.



2008-2019: Overview



- Increase in debt-to-GDP ratio
- 35% in 2007
- 85% in 2019
- Should be expected after an exceptionally severe recession.

2008-2019: Overview

- 2008-09: Fiscal & monetary stimulus in response to Great Recession
- New Conservative era since 2010
 - Until 2015 in coalition with Lib-Dems
 - Cameron-Osborne (2010-16)
 - May-Hammond (2016-19)
- Since 2010 fiscal policy turns to austerity
- Monetary policy remains expansionary
- 2016: Brexit referendum & end of austerity



2008-09 crisis

- Global Financial Crisis and Great Recession
 - Deepest negative shock since at least WWII
 - Starts in Spring 2007, escalates in Fall 2008
 - Originates in the US mortgage markets
 - Rapidly spreads to the global financial system and affects real economies world-wide, turning into a Great Recession in 2008-09
- UK hit especially hard
 - Financial services large share of the economy
 - Close links with US & global finance
 - UK private sector had accumulated large debts
 - Five banks failed, several were rescued by gov't
 - Real GDP falls 6.4% between Mar 08-June 09



Policy reaction to the 2008-09 crisis

- Bank rescue package
 - Recapitalisations & nationalizations (Lloyds, RBS, Northern Rock, ...)
 - Credit Guarantee & Asset Protection Schemes
 - BoE Special liquidity scheme
- Fiscal & monetary stimulus
 - Fiscal rules replaced by ‘temporary operating rule’
 - Temporary VAT cut ($17.5 \rightarrow 15\%$)
 - Public investments anticipated
 - Interest rate cut $5 \rightarrow 0.5\%$ (Sep 08-Mar 09)
 - £200bn Quantitative Easing
- International coordination
 - Apr 2009 G20 London summit



The Coalition's new fiscal framework



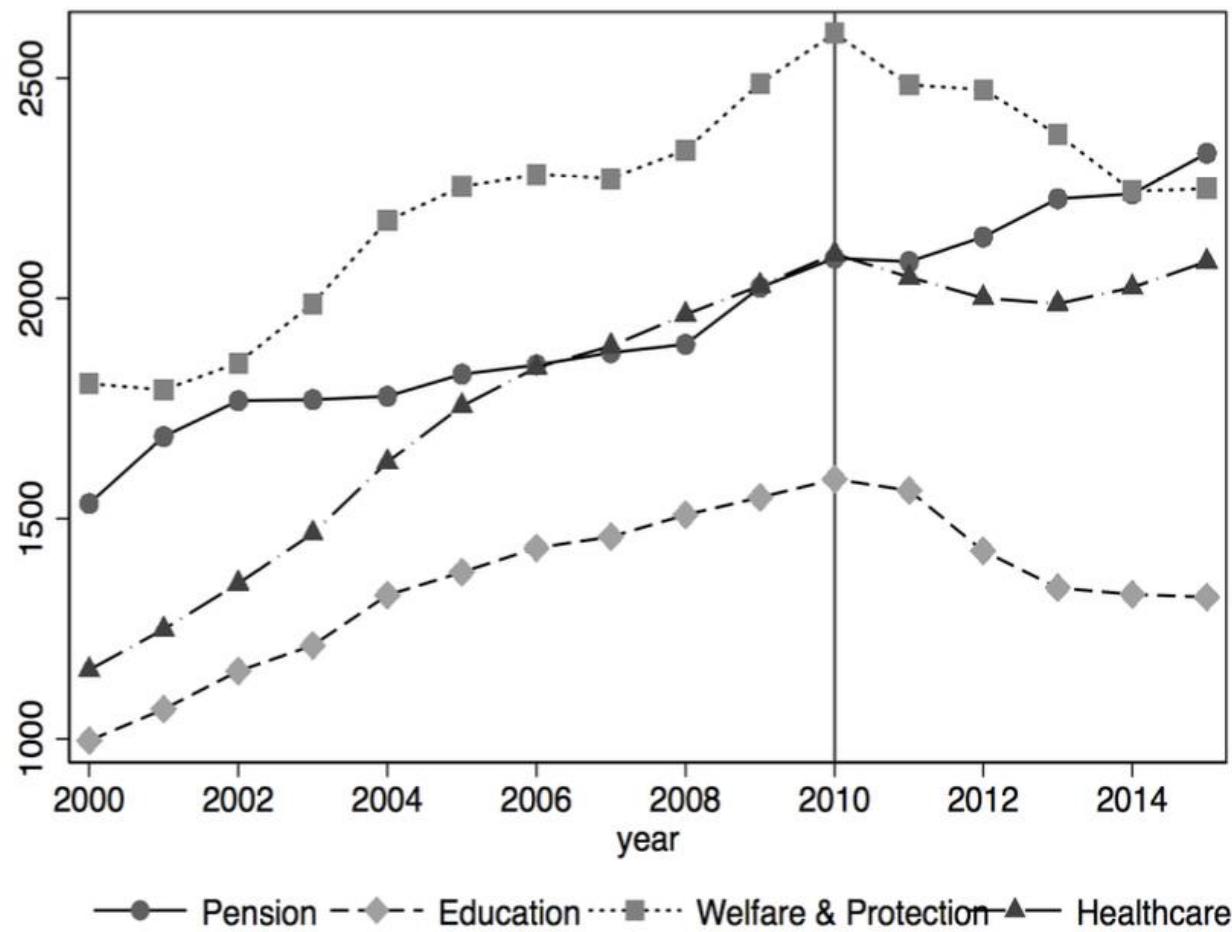
- Office for Budget Responsibility
 - In charge of the fiscal forecasts
 - Independent of government
 - (But cannot evaluate alternative policies)
- ‘Modified Golden Rule’
 - Current spending covered by taxes in medium-run
 - But applies to cyclically-adjusted deficit 5-years ahead.
 - Rolling target: each budget looks 5-years ahead
- Debt target over parliamentary term
 - Debt/GDP decreasing by 2015-16
 - No adjustment for economic conditions
 - No conditions on previous years

2010-2015: Turn to fiscal austerity

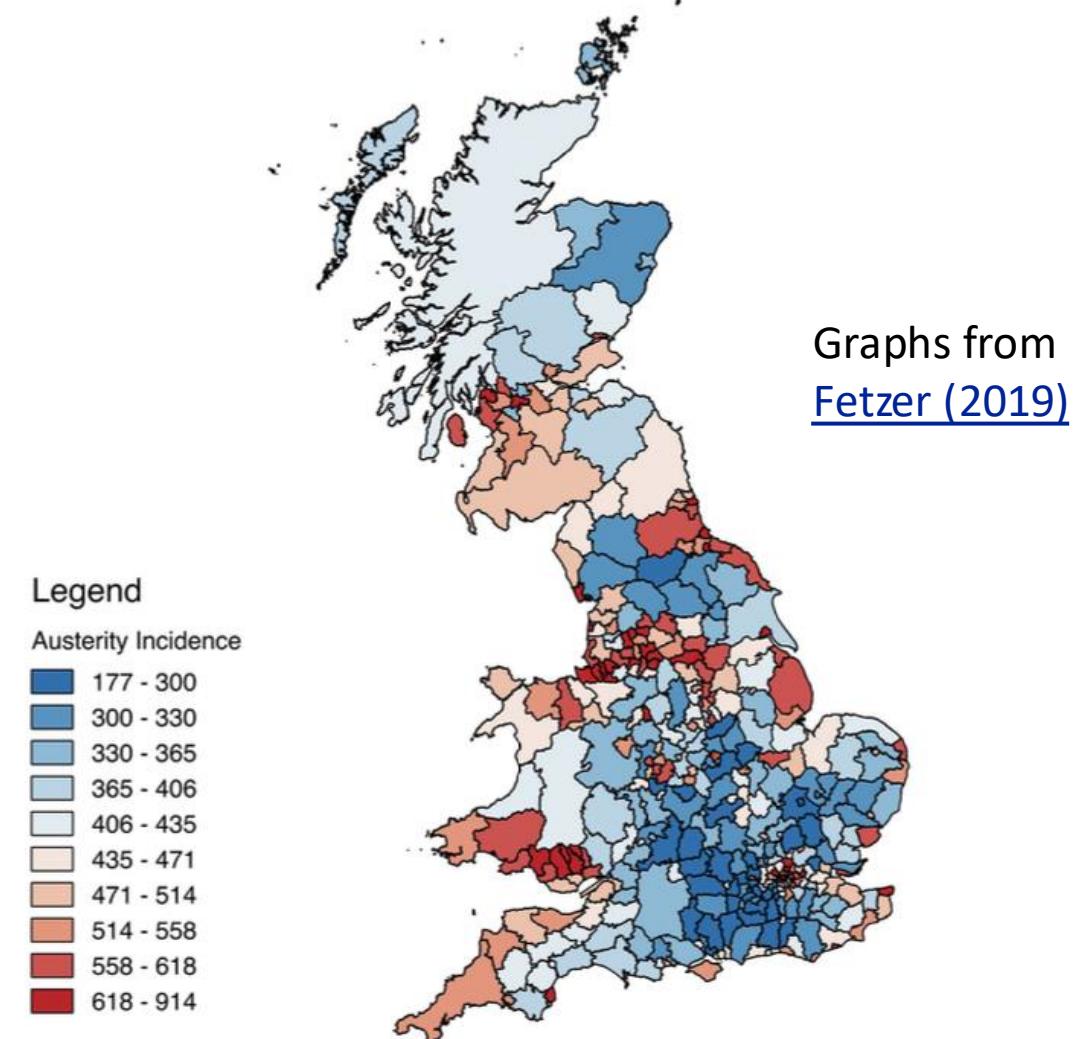
- Coalition government's June 2010 budget
 - Historically unprecedented spending cuts
 - 5-years horizon, reaching £35bn (~1.4% of GDP) in 2015
 - Large VAT increase (17.5 → 20%) but personal income & corporation tax cuts
- 2012 Welfare Reform Act
- Funding for Lending (FFL) & Help to Buy (HTB)
 - Incentives for restarting credit creation
- Outcomes over 2010-15:
 - Significant deficit reduction was achieved
 - But sharp slowdown in economic recovery, decline in public services, underinvestment
 - Fiscal targets not met due to economic stagnation



Panel A: Composition of government spending



Panel B: Spatial variation in austerity shock



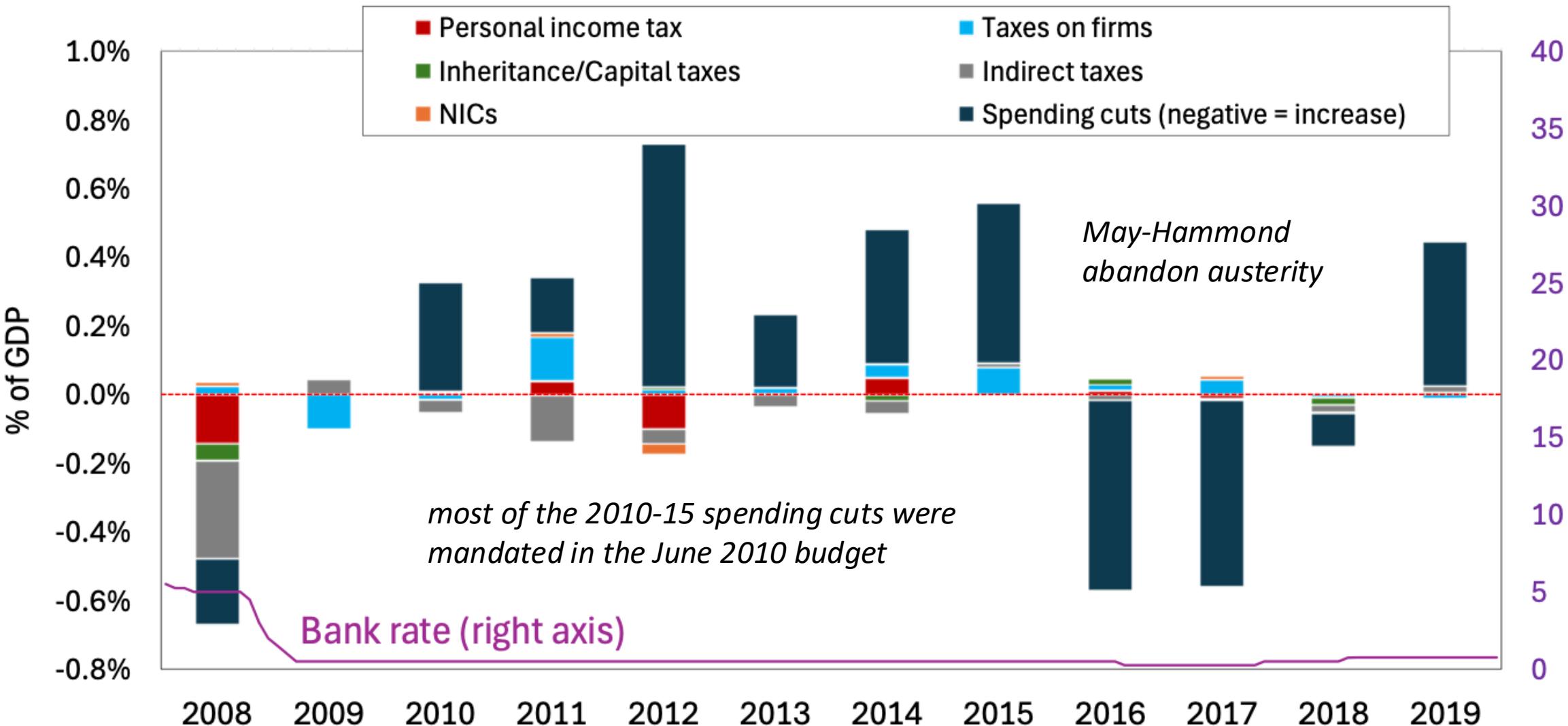
Notes: The left panel A plots real aggregate spending per capita in £ using data from HMRC for the years between 2000-2015. Aggregate totals are divided by total population from the National Office of Statistics and the annual CPI with 2015 being the base year. The four series account for, on average, 68% of government spending over the sample period. Panel B displays the spatial distribution of the austerity shock across local authority areas. The size of the shock is measured as the expected loss in benefit income in pounds per working age individual and year from [Beatty and Fothergill \(2013\)](#).

2016-2019: Brexit referendum & the end of austerity

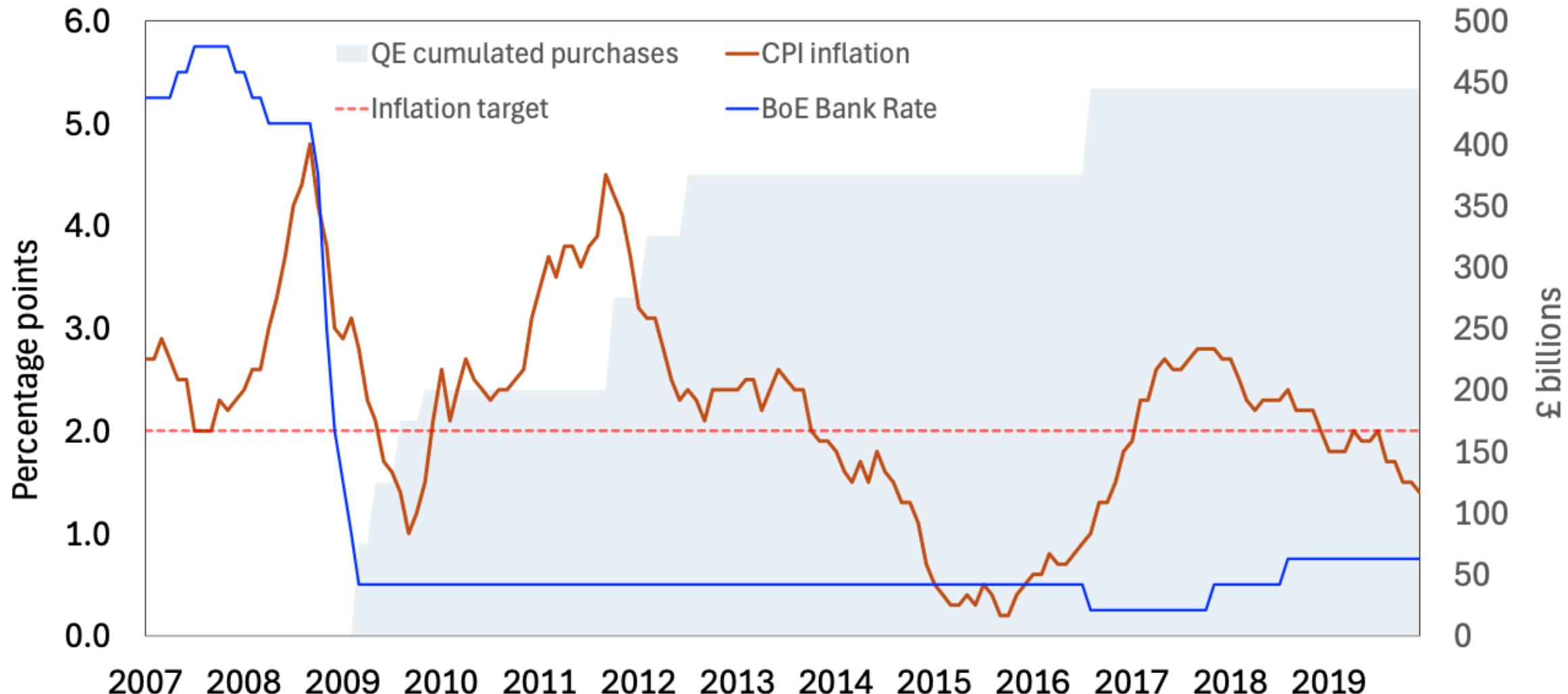
- Re-elected, Cameron-Osborne plan new & even larger austerity over 2015-20
 - Target overall budget surplus by 2019-20
- But June 2016 Brexit referendum changes political landscape.
- May PM, Hammond Chancellor.
- Brexit negotiations dominate the agenda
- End of austerity
 - Cameron-Osborne targets abandoned
 - 2016-2019 budgets mostly neutral on the tax side
 - Partial reversal of the 2010-2014 spending cuts



Fiscal policy in 2008-19 in a graph



Monetary policy in 2008-19 in a graph



Concluding thoughts on 2008-19

- Macroeconomic policy had a good crisis in 2008-09
 - Bank bail-outs (for how unfair) saved the system from total collapse
 - Prompt fiscal and monetary stimulus contained the damage from the deepest recession in decades.
 - International coordination strengthened the response
- But then pivoted too early towards fiscal consolidation, with disastrous consequences
 - Trying to eliminate deficits before the economy had fully recovered proved to be unfeasible & damaging.
 - Not specific to the UK: Europe & (to lesser extent) US did it too
 - Underestimation of economic damage from the crisis, and excessive confidence in monetary policy.
- As a result, we are still living in the shadow of the Great Recession



Thank you for your attention