Written by **Alex Newman** on January 26, 2009

British Pound, Banks Sinking

A *New York Times* article from January 21 entitled "Falling Pound Raises Fears of Stagnation" compares the situation in the U.K. with the crisis in Iceland where major banks were nationalized and the nation's economy has nearly collapsed, noting that observers have referred to London as "Reykjavik-on-Thames." The article comes on the heels of another 300 billion pound bailout for the banks announced by the British government after an injection of nearly $100 billion and a loan of another $350 billion of the taxpayers' money. The money has been doled out in exchange for preference shares and control over dividend payments and executive compensation. The move may also be accompanied by a new program to insure banks' losses on toxic assets using public money.

Royal Bank of Scotland recently announced the largest loss in the corporate history of the U.K. Its shares have since dropped 70 percent, and since the government already owns a 70 percent stake in it, full-blown nationalization may be the next step. "I think we're moving inevitably towards nationalizing the major banks and I think we should, not just because that's the way to recapitalize them but we also need a big culture shift and strategy shift in the way banks operate, and it's the best way to do it," author and economist John Kay told CNBC. The chairman of the British parliament's Treasury Committee also has tried to convince the government to nationalize Royal Bank of Scotland and Lloyds TSB, a bank in which the government already owns a 43 percent stake. "At this point it would probably be cheaper to nationalize troubled banks than throw good money after bad money," said Marino Valensise, Chief Investment Officer at Barings Asset Management. "If you nationalize the banks, one thing you can do right away is to write down the troubled assets completely."

Of course, if the banks are nationalized, share holders will likely be wiped out. *The New York Times* article referenced earlier speculated that "the Obama administration, along with the rest of the world, could watch Britain to see what a bank nationalization might look like, and what it might suggest for American banks."

Another big problem affecting the British economy with the falling value of the pound is the effect this has on their foreign liabilities. The nearly $3 trillion economy has relied on a heavy stream of debt to finance its expansion over the last decade, and with the pound worth less versus foreign currencies, paying off the debt becomes increasingly more difficult. And the economy keeps shrinking. According to Gilles Moëc, senior economist with Bank of America in London, the island nation's economy is expected to shrink by 2.9 percent this year, worse than the 2.6 percent fall in the euro zone and the 2.1 percent dip in the United States. He also predicted that the U.K.'s budget deficit this year will approach 10 percent of GDP, a startling figure even higher than the U.S.'s 8.4 percent.

Earlier this month the Bank of England tried to cut interest rates to nearly zero percent in an effort to stave off the credit crunch, but so far the economy continues to worsen. The Royal Bank of Scotland is now working out a deal with its government owner as to how much money it will lend and on what terms, acting as a sort of "guinea-pig," in the words of its CEO, for the future of bank nationalization.

Though the United States has been following a similar course, let's hope the disaster currently heading for Britain wakes the American government up before it's too late.

(AP Images)