Britain ‘at particular risk from credit crunch’

Gary Duncan

Britain’s reliance on the financial sector as an engine for the economy has left it more exposed than most developed nations to fallout from turmoil in the money markets and from the global credit squeeze, the World Economic Forum (WEF) said yesterday.

Challenges to global prospects this year from a slate of economic and political risks are the most severe that the world has faced in a decade, with dangers from global financial upheavals the most immediate and acute threat, according to the forum.

In a bleak analysis that raises fears over the serious risk that the credit squeeze could trigger a recession in the United States, the WEF’s annual Global Risks report emphasises that Britain may also bear the brunt of any trouble. “In Europe, the prominence of the UK’s financial sector makes it vulnerable,” it notes.

The wave of turmoil that has engulfed world credit markets since the US sub-prime home loans crisis began last summer has raised “fundamental questions over the vulnerabilities of the current model of financial markets”, the report’s authors argue.

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Although rapid market innovation, deregulation and increasingly complex financial instruments have made the system more resilient under normal conditions, the forum argues that not enough attention has been paid to the impact of serious stresses.

It said: “Many would argue that the overall resilience of the global financial system will only become evident under conditions of severe stress over the next year. The complexity and near-infinite feedback loops of the modern financial system have exposed it to a small risk of very large systemic shocks . . . Hence, we may be facing a paradox: while the financial system has been made more efficient and stable in normal times, it is also now more prone to excessive instability in really bad times.”

The authors urge a radical and swift re-examination of the global financial system’s operation to seek ways to limit present and future dangers. “New thinking may be urgently required,” they say, calling for “increased public and private sector collaboration on stress testing, liquidity management, risk assessment and prevention”.

The report is set to form a key plank of the agenda for this month’s gathering of hundreds of world political and business leaders at the annual World Economic Forum in Switzerland.