Funding the Future

What happens in a crash?

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Crashes don’t just happen. They build, and then they tip. In this video, I explain what causes a financial crash, why we’re facing one now, and why only government – not markets – can save us from the chaos that follows. Donald Trump’s actions, market overvaluation, geopolitical shocks – any one of these could trigger collapse. The consequences? Unemployment, insecurity, spiralling debt costs. Only Keynesian counter-cyclical action can offer recovery. We need courageous government – now.

https://www.youtube.com/watch?v=RRDSHAjgJPQ?si=EguDY8yGsDGT1YHj

This is the audio version:

https://www.podbean.com/player-v2/?i=ik24z-191130a-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is the transcript:

"What happens in a financial crash?" is a question that lots of people are asking me, and they're also saying, "What are the consequences?", and even, "Well, why does a crash happen?" So let's talk about crashes.

Crashes don't happen for any single reason; it's important to say that.

The situation that gives rise to a crash builds up over time, and the reasons are various.

But lax financial regulation, overstretched financial institutions, governments who've taken their eyes off the ball and created bad policy, all of those things can lead to a situation where there's stress. But then, something trips us over the edge.

What might trip us over the edge into a crash, right now?

Well, most of those reasons relate to Donald Trump in some way or other.

His tariffs, coming in in August, might trigger a crash because it looks as though this time he's not backing down.

It could be that he'll trip us over the edge because of the Epstein files, and people will lose confidence in the USA and in the dollar as a result, and there could be massive capital outflows from that market.

There could be a crash in the stock markets because they are so heavily overvalued at present, and suddenly they realise the consequences of everything that Trump is doing.

Or it could be a war, or an extension of a war that creates a new situation, which pushes us into a crash scenario.

But the point is, whatever happens, there is this sudden and traumatic loss of confidence in the valuations in financial markets, and what happens then is that basically everybody who owns financial assets wants to sell them, and we see that most particularly in stock markets.

We saw that in 1929. We saw that in 1987. We saw that in 2008. We saw it a bit in 2020. We can see it again. In other words, these things happen.

And the point is that when they happen, we get a number of things as a consequence.

One is that we could get falling trade, and Trump would certainly contribute to that.

We could see rising prices because of the resulting panic and the shortages that are created because of falling trade.

And we could just get bad market reactions, which means that people flee out of assets and into cash or into government bonds.

And the point is that the neoliberal financial markets we've got can't fix this.

We'd see panic giving rise to share prices falling sharply.

We'd see that flight into safe assets. Gold would be one, although it's a meaningless asset, and most definitely government bonds would be another.

At the same time, central banks, who are programmed to react in a purely neoliberal way, would send out decidedly mixed messages. Because they would see inflation going up, almost certainly because trade would be damaged, we might well see them trying to increase interest rates, whilst at the same time they would want to reduce interest rates to assist markets to recover. Where would they go? Who knows?

And the point is that at this moment, when you begin to move into a crash, no one knows who to trust or why, and it's that uncertainty that is absolutely crippling. Whatever the cause, uncertainty is the thing that brings us down.

Companies always stop spending on investment when they face massive uncertainty. That we can say for sure; it's always happened that way. That means that there will be a falling demand for new jobs because new jobs are driven as much by investment in new productive assets as they ever are by demand from consumers.

We would see unemployment rising quickly. We would see a downward spiral in wages. But at the same time, as I've already said, we might see an upward shift in prices and even interest rates. The stress would become very real.

And in light of all of this, households would respond in what is a very rational way for the household by itself, which is to save. Now, Lord Keynes, John Maynard Keynes, the greatest economist of the 20th century as far as I'm concerned, had a description of this. He called it the paradox of thrift.

In other words, at the very moment when we want people to spend to take us out of recession, everyone starts to save. And it's quite rational for households to save, because they think 'Bad times are coming; we need a rainy day fund; we'll create it by not spending now', but that just exacerbates this decline in trade, this fall in demand, this loss of employment, and so on.

What we're going to see, if we move towards a crash, is a situation where we literally have everything going wrong simultaneously. That is what a crash means.

And the consequences for households, as I've just described, are severe.

There'll be less income.

There'll be more insecurity.

There may be unemployment.

There will be higher interest rates. Debts will be more expensive. Everything becomes more costly. And if you have fixed outgoings, like rents, for example, then they are going to consume more of your income in real terms, and living standards collapse. This is the consequence of a crash.

The point is that markets have no way of correcting for this. There is no mechanism to restore confidence within markets when it's gone. Nobody has ever found it. There isn't a secret button; there isn't something you can flick. It just doesn't happen. Once markets have settled to the point where employment is at well below the level that full employment would require, then high unemployment becomes the norm.

And there is only one agency within the whole of the economy that can put that right, because businesses won't, and households won't, and a crash when it happens is international, so no foreign influence is going to put it right either. The only agency that can put this right is the government.

And this is what Lord Keynes said in the 1930s, and he was right. The role of the government in a crash is to act counter-cyclically. In other words, if the market's going down, government spending has to go up. That's what counter-cyclical spending means: simply behaving in the opposite way to everyone else.

The government has to invest in that situation to use the resources made idle by the crash.

If there are builders not at work, the government has to build.

If there are teachers not at work, the government has to increase the amount spent on education.

If there are people who've been trained as nurses in the past who aren't at work, the government has to recruit them back into the NHS, and so on.

Government deficits at this point make sense.

In fact, increasing government deficits make sense because people want to save in safe assets, and the safe asset they want to save in is more government bonds, and they're created by government deficits, so in fact, there's a virtuous cycle to actually running deficits. This is the moment when, above all else, a government shouldn't be trying to balance its books.

In particular, public investment makes sense in a recovery situation like this because it will increase employment.

So what we need is that investment to create new jobs, plus higher wages, because the demand for people will grow, and as a consequence, the private sector will follow the public lead, and it will begin to also think that things might get better and therefore changes behavior, and households who are seeing that actually wages might not be under threat anymore, and there could be the chance of a continuing employment in the future, will go out and spend again.

Unused capacity will be put back into use. But so long as there is still unused capacity, the risk of inflation because of the government putting it into use is very low. In fact, the biggest risk to inflation is the initial market disruption when we move into a crash, but not what happens thereafter.

We can recover without overheating, in other words. But it takes time, and this is really important to note. We can't afford crashes because recovering from them and getting the government to swing into action and to then do all these programmes is necessarily something that takes several years to effect.

So the best thing we can do is to stop going into a crash in the first instance. This is why I keep talking about the fact that Trump is wrong to do what he's doing right now. If he's trying to precipitate a crash, by crashing the dollar, by crashing the stock markets in the USA, by crashing US living standards, by crashing US employment and everything else, all of which will have ripple effects around the world, he's creating a crisis that could last for years.

He's creating panic that, without government action, carries on without end. And that's the point that is so serious about a crash. These things are desperate because it's not clear when the end, the reverse, and growth will happen.

So crashes reflect political and market failure simultaneously. I cannot stress that point enough. Politicians and markets fail at the same time.

We are seeing that risk in the USA.

We're seeing it elsewhere, because let's be honest, right across Europe and in the UK, people have very little faith in their governments because they know that neoliberalism has no answers to any of the questions they've now got.

They know there must be something better. I can tell you there is. That is the economics of Lord Keynes; this is what we need again. But we need courage in that case, and not austerity, and governments very rarely are courageous these days. But if they were, and if they are, and if they're going to be, governments who are courageous could lead the recovery out of the crash that I believe could be coming our way.

We need to have courageous governments, competent politicians, and people who understand what will be demanded of them at this moment.

My worry is we haven't got them.

So we need to be lining up a new mob if necessary, because this lot might have the biggest challenge of our lifetimes ahead of them.

Taking further action

If you want to write a letter to your MP on the issues raised in this blog post, there is a ChatGPT prompt to assist you in doing so, with full instructions, **here.**

One word of warning, though: please ensure you have the correct MP. ChatGPT can get it wrong.