# 'Run on UK' sees foreign investors pull $1 trillion out of the City

By Global Research
Global Research, March 07, 2009
The Independent 7 March 2009

Region: Europe
Theme: Global Economy

**Banking crisis undermines Britain's reputation as a safe place to hold funds**

**By Sean O'Grady, Economics correspondent**

A silent $1 trillion "Run on Britain" by foreign investors was revealed yesterday in the latest statistical releases from the Bank of England. The external liabilities of banks operating in the UK – that is monies held in the UK on behalf of foreign investors – fell by $1 trillion (£700bn) between the spring and the end of 2008, representing a huge loss of funds and of confidence in the City of London.

Some $597.5bn was lost to the banks in the last quarter of last year alone, after a modest positive inflow in the summer, but a massive $682.5bn haemorrhaged in the second quarter of 2008 – a record. About 15 per cent of the monies held by foreigners in the UK were withdrawn over the period, leaving about $6 trillion. This is by far the largest withdrawal of foreign funds from the UK in recent decades – about 10 times what might flow out during a "normal" quarter.

The revelation will fuel fears that the UK's reputation as a safe place to hold funds is being fatally comp-romised by the acute crisis in the banking system and a general trend to financial protectionism internat- ionally. This week, Lloyds became the latest bank to approach the Government for more assistance. A deal was agreed last night for the Government to insure about £260bn of assets in return for a stake of up to 75 per cent in the bank. The slide in sterling – it has shed a quarter of its value since mid-2007 – has been both cause and effect of the run on London, seemingly becoming a self-fulfilling phenomenon. The danger is that the heavy depreciation of the pound could become a rout if confidence completely evaporates.

Colin Ellis, an economist at Daiwa Securities, commented: "The outflow of overseas banks' UK holdings is not surprising – indeed foreign investors in general will still be smarting from the sharp fall in the exchange rate last year, as many UK liabilities are priced in sterling terms. That raises the question of what could possibly tempt overseas investors to return to the UK. Further heavy outflows of funds are probably a given."

The Bank of England said that there had been a large fall in deposits from the United States, Switzerland, offshore centres such as Jersey and the Cayman Islands, and from Russia.

Paranoia that the UK could follow Iceland into effective national insolvency and jibes about "Reykjavik on Thames" will find an unwelcome substantiation in these statistics – which also show that stricken British banks are having to repatriate similar sums back to Britain. This is scant consolation for the authorities, however, as it means the UK and sterling are, like some emerging markets and currencies, suffering from a flight of capital. By contrast some financial centres and currencies – notably the US dollar and the Swiss franc – are enjoying a boost as "safe havens" in a troubled world.

The sudden international trend towards financial deglobalisation and the flight of money to "home" bases has nonetheless been dramatic. The Prime Minister has already warned about this drift to "financial protectionism" – even though UK banks brought back almost $600bn in the last months of 2008, as they attempted to repair fragile balance sheets. Mr Ellis added: "These data are consistent with UK banks reducing their overseas holdings, at the same time as overseas banks scale back their presence in the UK. That is not surprising, given that governments around the world are having to prop up their banking sectors, and in turn demanding that national institutions focus on domestic markets. But it does run the risk of being financial protectionism by the back door."

Investment from the West into developing countries has fallen from the level of about $1 trillion a year seen earlier this decade to about $150bn last year. Economies in eastern Europe such as Hungary and the Baltic republics, some in Asia such as Pakistan and developed nations such as Iceland have been severely hit by the collapse in foreign investment.

Like Iceland, the UK has an unusually large banking sector in relation to her national income, with liabilities four times GDP. Should the UK taxpayer have to assume these debts it will represent, in relation to GDP, about double the national debt the nation bore at the end of the Second World War, a near unsustainable burden.