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Welcome to the economics of the madhouse

Joe owns a bar in Kuala Lumpur. In order to increase sales, he decides to allow his loyal customers – most of whom are unemployed alcoholics – to drink now and pay later

He notes the drinks consumed on a ledger (thereby granting the customers loans). Word gets around and as a result increasing numbers of customers flood into Joe's bar. Taking advantage of his customers' freedom from immediate payment constraints, Joe increases his prices for wine and beer, the most consumed beverages. His sales volume increases massively. A dynamic account manager at the bank recognises these customer debts as valuable future assets and increases Joe's borrowing limit. Joe sees no reason for undue concern since he has the debts of the alcoholics as collateral.

Estates of unemployment by next year lie at around 3.5 million

At the bank's corporate headquarters, expert bankers transform these customer assets into drinkbonds, alcbonds and vomibonds. These securities are then traded on markets worldwide. No one really understands what these abbreviations mean and how the securities are guaranteed. Nevertheless, as their prices continuously climb, the securities become top-selling items. One day, although the prices are still climbing, a risk manager of the bank, (subsequently of course fired due to his negativity), decides that slowly the time has come to demand payment of the debts incurred by the drinkers at Joe's bar. However they cannot pay back the debts.

Joe cannot fulfil his loan obligations and claims bankruptcy. Drinkbonds and alcbonds drop in price by 95 percent. Vomibonds performs better, stabilising in price after dropping by 80 percent. The suppliers of Joe's bar, having granted him generous payment due dates and having invested in the securities are faced with a new situation. His wine supplier claims bankruptcy; his beer supplier is taken over by a competitor. The bank is saved by the Government following dramatic round-the-clock consultations by leaders from the governing political parties. The funds required for this purpose are obtained by a tax levied on the non-drinkers. We hope you understand the above is a metaphor for property and mortgages and the economic situation in which the UK put itself.

SOME INTERESTING STATISTICS TO CONSIDER:

1 Since 1900 to 2009, the real rate of return on equities (above inflation) is 0.4 percent pa. (Source: Credit Suisse) Did you expect it to be five or 10 percent pa? OK, it doesn't include dividends. Still, it's unsurprising when most people believe what the marketers have told them – invest in stocks and you'll be OK. (Didn't they say that about housing too?)

2 Prof David (Danny) Blanchflower, retiring member of the interest rate setting Monetary Policy Committee, expects 100,000 extra unemployed per month between now and the rest of the year. Estimates of unemployment by next year lie at around 3.5 million. Do you believe house prices will recover soon? No, neither do we. (No trend follows a straight line)

3 Elsewhere in the world, there are now as many homes for sale in Spain as there are in The USA. Spanish unemployment is now 17 percent, and rising. (Source: Variant Perception) Do you think the Spanish property market will carry on falling for years? Yes, so do we.

4 The US stock market shot up approximately 40 percent from early March to end May 2009. Of course it fell by more than a half from the end of 2007 to March 2009. Do you think the worst is over? No, neither do we. Green shoots? Have you seen government debt? Household debt? Banks loans? Need we say more?