

International market turmoil: A sea-change in world economy

Nick Beams
28 August 1998

It must surely rank as one of the greatest historical ironies that the economic breakdown in Russia should have set in motion a crisis on world financial markets. The restoration of capitalism in Russia at the start of the decade was hailed as the ultimate triumph of the market and the opening of a new era for world capitalism. Seven years on, the world capitalist economy stands on the brink of a global collapse of 1929 proportions and worse.

World markets went into a tailspin on Thursday, as panic spread over the global implications of the Russian meltdown and the deepening crisis in Asia. Wall Street plunged 357 points, or 4.1 percent--the third largest point drop in history. The London FTSE index dropped 177 points, or just over 3 percent, the German Dax index dropped by more than 200 points or 3.3 percent, the Paris index lost 167 points or 3 percent while Zurich lost 330 points or 4.5 percent.

Eastern European markets also experienced big falls. In Hungary, stocks plunged 12 percent, Poland 6 percent and the Czech Republic 5 percent.

The falls this week are part of a trend. London shares are down 10 percent since July, the German Dax index has dropped 15 percent, with European markets as a whole down by 13 percent.

In Russia, the main stock exchange index fell by 14.8 percent to hit its all-time low of 65.8 percent. One year ago, Russia was hailed as the best performing market in the world, with the RTS index at 570.

When trading opened in the East on Friday morning, the Tokyo Nikkei index, which two days before had crashed through the crucial 15,000 mark, dropped a further 566 points, or almost 4 percent, taking the index to 13,847--the lowest level since March 1986.

When share trading closed on Wall Street, discussion by media commentators and financial analysts centred on whether the long-running US bull market had finally turned bearish. In reality, such terms--bull and bear markets--fail to even come close to explaining what has taken place. World capitalism is not simply experiencing some market turmoil. Rather, the crisis in the markets is only the most dramatic expression of a sea-change in the world economy, as an examination of the different components of the global crisis makes clear.

In Japan, the latest plunge on the Nikkei has been set off by criticisms of the proposed bailout of the Long Term Credit Bank of Japan by the government. The government of Prime Minister Keizo Obuchi has pledged to pump around \$3 billion into the LTCB in order to merge it with the Sumitomo bank.

The government's so-called "soft landing" approach to the banking crisis has come under fire from the opposition Democratic Party. Reflecting the demands of international financial markets that

"restructuring" Japan's financial system requires that major banks be allowed to go to the wall, it is threatening to block legislation in the parliament.

But with the total bad debt in the Japanese banking system now estimated to be as much as \$1,000 billion, there are fears that the collapse of one major bank could set off a chain reaction of corporate and banking failures, leading to a collapse of the national financial system and sparking a global financial collapse and depression.

A comment by Hiroshi Ota, business editor of the *Yomiuri Shimbun*, replying to critics of the "soft landing" policy, gave an indication of the air of panic now gripping Japanese financial circles.

"What does the 'hard landing' that they advocate actually mean?" he demanded. "Does it mean that, weakened by the collapse of the biggest economic bubble in history ... big banks should end up at the mercy of international speculators and possibly be thrown out of business. That would trigger a depression--not just for Japan but for the world."

He pointed out that when the Hokkaido Takushoku Bank was allowed to fail last December, it "rocked" the economy of the Hokkaido island and that "failure of the national banking system would mean a national collapse."

"In the case of big Japanese banks that engage in international operations, highly risky derivatives transactions amount to an average of 100 trillion yen (\$7 billion) per bank. Thus, the sudden failure of such a bank would throw the international financial system into chaos and cause an international depression."

The Russian default has already sent shock waves through the international financial system. Under the debt restructuring plan announced by acting Prime Minister Chernomyrdin earlier this week, international investors will receive no more than 30 cents in the dollar on their Treasury bills and possibly much less.

According to the latest calculations, international banks have already suffered losses of around \$50 billion on their Russian investments. International financier George Soros has confirmed that his hedge fund alone has lost around \$2 billion. German banks and financial firms, which have more than \$30 billion in outstanding loans, stand to be among the hardest hit.

American banking houses are also affected. The Republic New York Corp has announced that losses on investments in Russia have wiped out its third quarter profits after writing down the value of its Russian debt to 15 cents in the dollar.

Other banks with significant investments in Russia include Chase Manhattan, Citicorp, Bankers Trust, BankAmerica and JP Morgan. Credit Suisse First Boston has already disclosed losses of at least \$254 million.

And the losses could extend, as the slump in the value of the rouble continues. Russian gold and foreign currency reserves, which only two weeks ago were estimated at around \$17.4 billion, are now down to \$13.4 billion. The Russian central bank, which has spent more than \$8.8 billion since July, said it had now given up trying to support the rouble.

Under the devaluation, the rouble was set at around 9.50 to the dollar. But this has now become a fiction. The Russian central bank suspended all trading in foreign currencies on Thursday as demand for dollars exceeded supply by \$290 million. In exchange offices, the rate went as low as 13 roubles to the dollar.

The Russian crisis has had an immediate impact in Latin American markets, as investment houses and fund managers sell off assets to try and cover losses in the Russian market.

Shares on the Sao Paulo market fell by almost 10 percent on Thursday, bringing the decline since the start of the month to more than 38 percent. The Argentine share index plunged by 10.6 percent.

The underlying recessionary trend in the world capitalist economy is revealed in the fall in world commodity prices. The Commodity Research Bureau index fell to below 200 this week, for the first time since 1993. It is expected to decline even further in the coming period, as the supply of commodities such as oil, nickel and aluminium increases, particularly from Russia.

The all-items commodity index prepared by the *Economist* magazine has fallen by 30 percent since May 1997, with oil prices dropping from almost \$22 last September to below \$13 today. Russia has been the hardest hit, but other affected oil-exporting countries include Indonesia, Nigeria and Venezuela.

Dramatic falls in two of the world's major commodity-based currencies, the Canadian and Australian dollars, further underscores the recessionary outlook. Both currencies have hit all time lows, with the Australian dollar down to just over 55 cents from its level of around 74 cents just over a year ago.

The slide into global slump was also evidenced by economic statistics coming out of Asia. In Malaysia, the central bank announced that the country's gross domestic product had contracted by 6.8 percent in the June quarter, following a 2.8 percent decline in March, as the country entered its first recession in 13 years.

In Korea, where the official unemployment rate has jumped from 2 percent to more than 7 percent in a year, the central bank reported that the economy--the 11th largest in the world--declined by 6.6 percent in the second quarter. The Philippines and Hong Kong are also expected to report that they have officially entered a recession, defined as two successive quarters of contraction.

Already the contraction in East Asia is taking on the proportions of the Great Depression and it is expected to worsen because of the growing debt crisis. Non-performing loans of domestic banks are estimated at more than 40 percent of GDP in Korea and Thailand, and more than 30 percent in Indonesia and Malaysia. On top of this, there is an unpayable external debt calculated at \$30 billion for Korea, \$22 billion for Indonesia and \$13 billion for Thailand.

But the biggest potential time bomb for world capitalism is ticking away in the United States. Since the Asian crisis began to unfold a year ago, the world economy has been increasingly sustained by the continued growth in the US economy, resulting from the stock market bubble.

The latest national accounts figures showed that while consumer spending in June rose by 0.6 percent, incomes increased by only 0.2 percent. The savings rate for the June quarter was just 0.6 percent.

These figures are part of a general trend. The combined deficit of the US personal and corporate sectors has been running at around 3 percent per year, indicating that the expansion of the US economy has been largely financed by a build-up of debt.

The implications of this situation were the subject of an article published on Wednesday by *Financial Times* columnist Martin Wolf entitled "Threats of depression." Citing recent research which showed that consumer spending has been increasingly sustained by the rise in share market values, he pointed to calculations by Goldman Sachs that a 20 percent decline in global equities would shrink global GDP by as much as 1 percent in the second year, representing "a shock as large as the Asian crisis."

Other research by two British analysts, Wolf wrote, showed that a 50 percent decline in the US stock market, which would merely bring US price/earnings ratios back to their historic average, would reduce US GDP by almost 7 percent in the second year. Even if interest rates were reduced to 4 percent, the contraction of GDP would still be 5 percent.

The article's conclusion revealed the state of extreme perplexity now gripping media and financial circles in the face of the gathering world crisis.

"Much now depends," Wolf wrote, "on the indefinite maintenance of historically extraordinary stock market valuations in the midst of an increasingly global deflation. The world economy is being held up by its stock-market boot-straps. It is no longer a question of asking whether this can last, but of praying for it to do so."

The events of the past few days indicate that the boot-straps may well have already snapped.

See Also:

Russian crisis shakes global markets

[25 August 1998]

Japan could trigger global crisis

Markets unimpressed by Obuchi's speech

[11 August 1998]

A Marxist analysis of the Asian meltdown

A lecture by Nick Beams

[March-April 1998]



To contact the WSWs and the
Socialist Equality Party visit:

wsws.org/contact