World economy in freefall

Andre Damon
22 May 2009

Governments of the world's major economies announced staggering first-quarter contractions in the past few days, as real indicators of the economic crisis continue to worsen.

Mexico was the latest country to post a huge decline in the first quarter, announcing Wednesday that its economy shrank by 8.2 percent compared to a year ago. This is the steepest fall since the peso crisis of 1995 brought the country to the brink of insolvency and works out on an annualized basis to a 21.5 percent free fall.

This followed Tuesday’s announcement that the Japanese economy contracted 4 percent in the fourth quarter, the worst downturn since 1955, and a stunning 15.2 percent annualized contraction. The Japanese economy had shrunk by 3.8 percent in the previous quarter.

Last week Germany announced that its economy had also fallen by 4 percent in the first quarter, the sharpest contraction since the government began keeping quarter-to-quarter figures in 1970. Germany, whose export-led economy is heavily dependent on external demand, was only the worst-affected of the major eurozone economies, all of which registered significant declines.

Only Monday, Jean-Claude Trichet, president of the European Central Bank, had said on behalf the Organization for Economic Cooperation and Development that the downturn had reached an “inflection point.” Working largely from stock market performance and confidence figures, Trichet hinted that an upturn is right around the corner.

“In all cases we see a slowing down of the decrease in GDP. In certain cases you see already a picking up,” Trichet concluded. The latest batch of GDP figures certainly do not lend credibility to this prognosis.

Official figures released Friday indicated that the eurozone contracted by 2.5 percent in the first quarter, compared to 1.5 percent in the last quarter of 2008.

The figures involved are staggering. As the *Financial Times* Lex column pointed out: “If the German economy continues to shrink at this rate, it will be a fifth smaller by the end of the year, entirely reversing the decade and a half of growth since unification.”

The economies of Eastern Europe are being pulverized, with the latest statistics indicating that Slovakia, the newest EU member, saw its economy contract by 11.2 percent in the first three months of the year.

Mexico, Germany, and Japan are among the United States’ largest trading partners, together accounting for over half a trillion dollars in yearly trade with the US. Prior to the downturn, American imports neared three trillion dollars per year and constituted a major force in driving production abroad.

US merchandise imports fell by over 30 percent in the first quarter of 2009 compared with the same period a year ago, according to the *Wall Street Journal*. In 2006, the US had a current account deficit of over $800 billion, which has now narrowed to $500 billion. Rising unemployment, falling home values and mass foreclosures have prompted significant declines in the consumption of foreign goods, including cars and consumer products. Mexican auto production, much of which goes to the US market, has fallen by over 41 percent, according to the *Wall Street Journal*.

The downturn has shattered the complex web of international production, leaving producers in the global supply chain completely cut off from information on how much to produce.

“You actually had to pick a number with no knowledge whatsoever, because nobody knows anything,” said one electronics parts manufacturer interviewed by the *Wall Street Journal*. Following the announcement of the fall in Japanese output, Sony said that it would cut its global supplier network in half to compensate for reduced demand.

Foreign direct investment shrank by 15 percent last year, according to a report published Wednesday by the United Nations. Supachai Panitchpakdi, secretary-general of the UN Conference on Trade and Development (UNCTAD), said that the decline in foreign investment would be “far deeper” than last year's.

Meanwhile global stock market and financial profits have continued their rally. In the past three months, all major world stock indexes have sharply increased. The FTSE All-World index has risen by over 40 percent since March.

Over the past three months, the US NASDAQ has gained 16.88 percent, the European FTSE Eurofirst 18 percent, The Japanese Nikkei 24.91 percent, and the Taiwanese Hang Seng 35.44 percent. The Vanguard Financials index, meanwhile, has outperformed all of these, shooting up by 42 percent since March 6.

As the *Financial Times* pointed out in a column Thursday, the recovery of stock markets is linked to the trillions of dollars in cash that central banks around the world have pumped into circulation. “Markets are being swamped by a wall of money unleashed by governments and central banks, causing a re-run of the speculation that drove indices ever higher two years ago. At some point this must drain away...If the hope is artificial, the disappointment is likely to be real.”

The US alone is set to pump nearly $15 trillion into the financial system, according to a recent Deutsche Bank report. The major developed countries have taken similar initiatives, injecting untold trillions into finance while real economies suffer the greatest ravages since the 1930s.

The program of the Obama Administration—the impoverishment of working people through layoffs and restructuring, together with huge subsidies to finance—has, with certain caveats, become the modus operandi of the governments of all developed countries. In the counties with high external deficits, such as the US, Spain, and the UK, this has the effect of transferring contraction abroad.

But the surplus countries are responding no more rationally. Michael Pettis, a finance professor at Beijing’s Peking University, writes in Thursday's *Financial Times* that a number of Asian exporters, particularly China, are attempting to offset falling world demand by boosting industrial production.

“These investment-oriented policies raise consumption indirectly, by boosting production, and so although they temporarily boost growth, they cannot result in a sufficiently large increase in domestic net consumption to replace American buying. What is worse, in some cases these policies will sharply constrain future domestic consumption, just when it is needed most.”

In short, while the US elite wants to go back to huge profitability through the impoverishment of millions and a consequent reduction of the current account deficit, China seeks to restore profits through the buildup of unsustainable manufacturing capacity. These two policies are set on a collision course, but their mutual outcome will be the same: impoverishment of workers in the importing countries, huge unemployment, overcapacity and deepening economic crisis for the exporters.

These processes, developing within a world economy in free fall and alongside drastically rising unemployment, augur social upheavals all over the world.