Global financial system may be heading for another 2008

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This week's decision by the US Federal Reserve to continue its $85 billion per month cash handout to the banks and finance houses, in the form of purchases of treasury bonds and mortgage-backed securities, and the likelihood that the policy will continue well into the new year, can only heighten concerns that the global financial system is heading for another crash, possibly on a scale bigger than 2008.

After raising the possibility earlier this year that it might begin to "taper" its $1 trillion a year asset-buying program, the Fed pulled back in response to pressure from the banks and financial corporations, reflected in falls in share and bond markets that followed the Fed's signals of a pullback. Since the Fed's decision in September not to reduce its asset purchases, bond markets have risen and US stock indices have reached new records.

The official reason advanced by the Fed for monetary stimulus is the need to boost the US economy. But the asset-buying program has done nothing to create jobs or boost investment.

Non-farm employment in the US remains 1.7 million below where it was at the end of 2007, and once the increase in the labour force is taken into account, the US labour market is some 8.5 million jobs below where it would be had there been a genuine recovery. Finance capital, which dominates all aspects of monetary and fiscal policy, including the policy agenda of the Fed, has been the only beneficiary, with corporate profits now at their highest proportion of US gross domestic product in history.

The Fed's continued supply of ultra-cheap money to the financial system has brought warnings—some of them from economists within the finance houses themselves—that the conditions are being created for another crash.

William White, formerly chief economist at the Bank for International Settlements, who was one of the few to warn of the dangerous conditions that led to the collapse of Lehman Brothers in September 2008, said recently that the present situation was "like 2007 all over again, but even worse."

"All the previous imbalances are still there," he said. "Total public and private debt levels are 30 percent higher as a share of GDP in the advanced economies than they were then, and we have added a whole new problem with bubbles in emerging markets that are ending in a boom-bust cycle."

He warned that the world had become addicted to easy money, with rates falling with each cycle and crisis and little ammunition left if the system buckled again.

One of the consequences of the cheap money program has been to promote a flow of money into Asia and other so-called emerging markets.

These economies now require an inflow of around $1.5 trillion per annum in external funds just to meet their financial needs. As much as 50 percent of Indonesian rupiah government bonds are held in foreign hands, with the figure for Malaysia and the Philippines at 40 percent.

If the Fed does begin to taper, thereby lifting interest rates in the United States, this money could flood back to the US, threatening a financial collapse. There was a preview of what could happen over the summer, when Asian and other emerging market currencies began tumbling because of fears that the US would begin tapering.

The fear is that such a movement could set off a repeat of the Asian financial crisis of 1997-98, which heavily impacted South Korea, Indonesia, Thailand and Malaysia, among others.

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The global consequences would be far more serious than at that time. This is because the onset of recessionary conditions in the major advanced capitalist economies since the crisis of 2008 has meant that emerging markets now account for as much as 70 percent of world economic growth.

The Bank for International Settlements has pointed to the "deflationary shock" resulting from a crisis in Asia, warning of a risk of "blow-back effects to major economies."

A recent report by economists at JPMorgan Chase stated that "the current episode of excess liquidity, which began in May 2012, appears to have been the most extreme ever in terms of its magnitude."

The latest surge went far beyond the three previous major episodes, 1993-94, 2001-2006, and the period October 2008 to September 2010. Liquidity was keeping markets afloat at present, but they would become vulnerable next year if it disappeared.

Speaking in Sydney yesterday, the London-based credit strategist at Citigroup, Matt King, claimed central bankers were in denial about the creation of asset bubbles. It was as if the central bankers, having no policies to foster economic growth, had decided to create a new housing price bubble.

There are also concerns in Europe that deflationary pressures are going to worsen the debt position of a number of countries, particularly Italy and Spain, following figures which showed that all key measures of euro zone inflation fell markedly in October.

Societe Generale strategist Albert Edwards has warned that if there is an unexpected recession, Europe will slide into outright deflation. "The risk is a trade shock from Asia," he wrote. "That is when markets will start to panic."

The deflationary trends recall the situation in the 1930s when a vicious cycle was set up as falling prices meant that debts began to rise in real terms, leading to further economic contraction. The Bruegel think tank in Brussels has said that deflation could push both Spain and Italy into what it calls a "runaway debt trajectory." The latest figures show that Italy's consumer price index rate fell by 0.3 percent in September and October despite tax increases that should have increased it.

Worsening global economic and financial conditions are fuelling increased tensions among the major capitalist powers.

In its twice-yearly review of currencies and economic policies, the US Treasury Department for the first time singled out Germany for major criticism in a "key finding." It pointed to countries with "large and persistent" current account surpluses in the euro area, noting that Germany's surplus was now bigger than that of China.

It charged that Germany's "anemic pace of domestic demand growth and dependence on exports have hampered rebalancing at a time when many other euro-area countries have been under severe pressure to curb demand and compress imports in order to promote adjustment. The net result has been a deflationary bias for the euro area, as well as for the world economy."

This brought an angry riposte. The German finance ministry issued a statement that its current account surplus was "no cause for concern, neither for Germany, the euro zone, or the global economy." A finance ministry spokesman said there were "no imbalances in Germany that needed correction."

The abrasive exchange highlights the fact that the supposed "unity" between the major powers following the events of 2008 has all but disintegrated, as each major power pursues its own agenda: everyone for himself and the devil take the hindmost.

The US Fed shovels out money to boost its banks, regardless of the consequences. Germany imposes poverty in the rest of Europe in support of its banks and major corporations. Japan follows the Fed in expanding its monetary base in order to cut the value of the yen and improve its competitive position against its Asian rivals.

Growing financial instability and mounting antagonisms between the major powers are creating the conditions for another major crisis, with disastrous consequences. The only way forward is the unified struggle of the international working class to take political power, end the stranglehold of the banks and corporations on the world's economic resources, and establish a rationally planned socialist economy.

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