Currency turmoil signals new phase of global economic crisis

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Whatever the immediate outcome of the turbulence sweeping through the financial systems of so-called "emerging market" economies, it represents a turning point in the global economy as a whole. The roots of the crisis lie in policies of "quantitative easing"—the pumping of trillions of dollars into the world financial system by the US Federal Reserve and other central banks—initiated in response to the 2008 breakdown that was sparked by the collapse of US investment bank Lehman Brothers.

Much of this money flowed into "emerging markets," seeking higher profits as share prices in these countries boomed and the rates of return on other financial assets rose. But now the bubble has started to deflate and volatile capital is rushing for the exits, sending currency exchange rates plunging.

A series of central banks, including in South Africa, India, Brazil and Turkey, have raised interest rates significantly. But these actions have so far failed to stem the outflow.

As Neil Shearing, the chief emerging markets economist at Capital Economics, told the *Financial Times*: "The fact that currencies have continued to weaken even in countries that have started to raise interest rates raises the prospect of a new, and potentially more worrying phase of the recent turmoil in EM financial markets, in which beleaguered policy makers find themselves unable to defend their currencies."

The first signs of a potential crisis appeared last May and June after Chairman Ben Bernanke indicated that the Fed would soon begin to "taper" its $85 billion per month purchases of mortgage-backed securities and US Treasury bonds. His comments sent a shiver through "emerging markets" and capital flowed out.

Stability returned when the Fed pulled back from the "taper" in September. But with the decision to cut purchases by $10 billion in each of the past two months, the outward flow has resumed.

Seeking to put the best face on a bad situation, some commentators have tried to maintain that the financial turmoil reflects country-specific problems and has no global implications. According to US Treasury Secretary Jack Lew, the main problem is bad policy in a number of countries. "I will say that we're seeing a lot of differentiation in the marketplace and we're seeing the countries that have taken tough actions and managed well are having a different experience."

His remarks recall those of former Fed chairman Alan Greenspan during the Asian financial meltdown of 1997–98, when he insisted that the crisis did not stem from the operations of the capitalist "free market" itself, but was the outcome of what he called "crony capitalism" in Asia. But the Asian financial crisis led to the Russian default of 1998 and then to the collapse of the US investment fund Long Term Capital Management (LTCM), which was bailed out by the Fed with public funds. The demise of LTCM was itself an early warning of what was to come ten years later when the entire American financial system became insolvent.

The claim that the present turmoil is the outcome of "country-specific" problems ignores the fact that the massive inflow of capital into "emerging markets" in the five years since the crisis of 2008 is part of a much broader development.

The continued injection of money by the Fed—amounting to at least $1 trillion per year—combined with near-zero interest rates has created a situation where the global financial system has come to resemble an inverted pyramid, with financial assets rapidly expanding relative to the productive base of the world economy on which they ultimately rest.

This means that, in the final analysis, a large proportion of these assets have become “toxic,” having no real value, just as hundreds of billions of dollars of securities based on sub-prime housing loans were found to be worthless five years ago. In other words, the present turmoil is an early signal of a new financial crisis, potentially more destructive than that of 2008.

This can be seen from figures on the extent of the movement of volatile finance capital in the past period. According to the Institute for International Finance, emerging markets have attracted about $7 trillion since 2005, which has been invested in a mixture of manufacturing and service enterprises, mergers and acquisitions, and stocks and bonds. JPMorgan Chase estimates that outstanding “emerging market” bonds are now $10 trillion, compared to just $422 billion in 1993.

On top of the shift of capital sparked by the “taper,” another factor in the crisis is the economic slowdown in China. According to a survey published this week, Chinese manufacturers have been cutting jobs at the fastest rate since March 2009, the nadir of the downturn caused by the global financial crisis.

Chinese growth this year is expected to be the lowest for more than 20 years, and there are increasing concerns about the stability of the country’s financial system. This week, the $500 million China Credit Trust had to be bailed out to avert default on a financial product backed by loans to a failed coal mining company. The China Credit Trust is part of the shadow banking system in China that is believed to account for about one third of all new credit in the Chinese economy.

The “emerging markets” crisis has already exposed significant rifts in the G20 group of leading economies, which held a series of crisis summits to coordinate international policy in 2009 and 2010. Speaking in the wake of Wednesday’s Fed decision, in which there was no mention of the impact of the further tapering of asset purchases on the rest of the world, Indian Central Bank Governor Raghuram Rajan said emerging markets had helped pull the world out of the global financial crisis and should not be ignored now.

“International monetary cooperation has broken down,” he said. Industrialised countries had to play a part in restoring it, and “they can’t at this point wash their hands off and say, we’ll do what we need to and you do the adjustment.” He warned that if the industrialised countries insisted on developing countries going it alone, they “may not like the kinds of adjustments we will forced to do down the line.”

The significance of that remark is underscored by the fact that in the five years since September 2008, the “emerging markets,” including China, have been responsible for about three quarters of the increase in global output. In 1997–98, the outcome of the Asian financial crisis was a downturn as significant in its impact on the region as the Great Depression was in the advanced capitalist economies. Any repetition would rapidly bring deepening recession around the world.

For the international working class, the eruption of this crisis has major implications. In all of the “emerging markets,” the interest rate increases and other emergency measures will mean a stepped-up offensive—the slashing of jobs, wages and social conditions.

The currency crisis demonstrates once again the emptiness of the claims by the ruling elites and their pundits that “economic recovery” is underway. The global capitalist system has failed. The very policies that were supposed to induce an upturn have only enhanced the wealth of the multi-millionaires and billionaires, while creating the conditions for another financial meltdown.

The international working class must draw the lessons of this experience and respond with its own program: the political struggle on an international scale for the overthrow of the capitalist elites as the first step towards the development of a socialist economy.