Another global financial crisis in the making, Bank for International Settlements warns

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The Swiss-based Bank for International Settlements has stated that the current policies of central banks and monetary authorities could lead to another financial crisis, potentially bigger than that of 2008.

The warning is contained in the latest annual report of the bank, sometimes referred to as the central bankers' bank, issued yesterday.

The report expressed concerns that the present low-interest rate regime, initiated to try to overcome the effects of the 2008 crash, has pushed financial markets to new highs while lowering the rate premium for many risky loans.

The BIS noted that markets had been "exuberant over the past year," particularly in advanced economies. They were "dancing mainly to the tune of central bank decisions," with volatility reaching historical lows and "market participants ... hardly pricing in any risks."

"Overall, it is hard to avoid the sense of a puzzling disconnect between the markets' buoyancy and underlying economic developments globally," the bank stated.

The "disconnect" is most clearly expressed in the United States, where the Federal Reserve's policy of pumping trillions of dollars into financial markets has seen stock market indexes reach record highs, while the underlying economy stagnates and reverses. Last week, it was revealed that the US economy contracted almost 3 percent in the first quarter of 2014, but stock markets climbed even further in the belief that the on-going stagnation would lead to the provision of still more ultra-cheap money.

The BIS noted that despite an increase in economic growth, the world economy had not shaken off its dependence on monetary stimulus. Regardless of the euphoria in financial markets, investment remained "weak." On a global scale, the total debt of private non-financial sectors had risen by 30 percent since the global financial crisis, pushing up the ratio of this debt to global output.

Moreover, a concentration on short-term growth figures ran the risk of ignoring the long-term dangers created by present monetary policies.

"Focusing our attention on the shorter-term output fluctuations is akin to staring at the ripples on the ocean while losing sight of the more threatening underlying waves," the BIS head of economics Claudio Borio warned in a press briefing on the report.

The report stated that when viewed through the "financial cycle lens," the current configuration of macroeconomic and financial developments raised a "number of risks."

In countries that had been experiencing "outsized financial booms," the risk was that "these will turn to bust and possibly inflict financial distress." Indicators that had proved accurate in the past, such as the behaviour of credit and property prices, were exhibiting "worrying signs." Though the BIS did not name the US, it is the leading example of a country with an 'outsized financial boom.'

There were also dangers in so-called emerging market economies because of the disparity between the size of these markets and huge global investor portfolios, which the report likened to the effect of an "elephant in a paddling pool." It was "far from reassuring" that flows to these countries had increased "on the back of an aggressive search for yield," meaning they could reverse rapidly.

The report said that data indicating a sound financial position, together with so-called macro-prudential measures by financial authorities designed to try to prevent the build-up of risks, did not provide reassurance. "Time and again," it noted, "in both

advanced and emerging market economies, seemingly strong balance sheets have turned out to mask unsuspected vulnerabilities that surface only after the financial boom has given way to bust."

The BIS warned that any crisis in emerging markets would have a major impact on the more advanced economies. Since the Asian financial crisis of 1997, the share of emerging market economies had risen to around one third of global gross domestic product and their weight in the international financial system had increased.

"The ramifications would be particularly serious if China, home to an outsize financial boom, were to falter. Especially at risk would be the commodity-exporting countries that have seen strong credit and asset price increases and where post-crisis terms of trade gains have shored up high debt and property prices."

The BIS did not specifically name Australia but the description matches its economy exactly. Other commodity exporting countries that would suffer a major impact include Brazil and South Africa.

According to the report, it was "somewhat unsettling" to see growth patterns similar to those that preceded the crisis of 2008. Property prices in Britain had been "unusually buoyant," while segments of the corporate lending market in the US were "even frothier than they were before the crisis."

While it did not name the US Federal Reserve, the BIS report criticised its policy of quantitative easing on two fronts. While the benefits of "unusually easy money" policies may appear quite tangible in the short term, especially if assessed on the basis of the response of financial markets, "the costs ... will become apparent only over time and with hindsight. This has happened often enough in the past."

The BIS then took aim at the Fed's policy of informing financial markets of its intentions. "Seeking to prepare markets by being clear about intentions may inadvertently result in participants taking more assurance than the central bank wishes to convey. This can encourage further risk-taking, sowing the seeds of an even sharper reaction."

In other words, the very policies being implemented, supposedly with the aim of preventing a financial crisis, may well be creating the conditions for one. The report noted that any policy model which relied too much on the increase of debt, as "financial booms sprinkle the fairy dust of illusory riches" over time "sows the seeds of its own demise."

The BIS report is the latest in a series of warnings that the present financial boom is sowing the seeds for another crisis. It has a significant degree of credibility because the bank was one of the few official bodies that pointed to the unsustainable financial conditions leading up to the crisis of 2007–2008.

But the BIS, as with all the other economic authorities in the global capitalist economy, has no policies that can bring about a return to what were once considered "normal" patterns of economic growth.

Its central criticism of the easy money policies of the Fed and other central banks is that they have diverted attention from what it insists are necessary "structural reforms," especially in labour markets. In other words, what is needed to pump life-blood back into the sclerotic arteries of the global capitalist system is an intensification of the offensive against the working class that began after 2008.