Economic data show gathering global slump

Nick Beams
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The latest economic statistics from Europe, Japan and China point to deepening recessionary trends in the global economy.

The eurozone economy is still below the level it reached six years ago on the eve of the global financial crisis, China manufacturing output is slowing and there are growing concerns that "Abenomics," supposedly aimed at stimulating the Japanese economy through monetary policy, is running out of steam.

When the European Central Bank (ECB) meets in Frankfurt on Thursday it will be under pressure from financial markets to introduce some form of "quantitative easing" based on the purchase of financial assets. Last month, confronted with a situation in which eurozone inflation was just 0.4 percent—one fifth of the bank's target rate—ECB president Mario Draghi told a central bank conference in Jackson Hole that it would employ "all available means needed to ensure price stability."

Low inflation or outright deflation is regarded as one of the biggest sources of instability for the financial system because it increases the real burden of debt, both private and government.

Draghi also indicated that he believed there was scope for a relaxation of austerity programs and for government spending to play a role in promoting economic growth, coupled with "structural reforms" to further attack the social conditions of the working class.

However, his remarks created something of a storm, with German Chancellor Angela Merkel and Finance Minister Wolfgang Schäuble reportedly seeking a clarification from the ECB president.

In an interview with Bloomberg, Schäuble said "structural reforms" were needed, which were not up to the ECB to implement. Monetary policy could only buy time. He also discounted further action to combat deflation, saying the ECB did not have the instruments to carry it out. Interest rates were at an historical low, he said. Rather than liquidity in markets being too low, it was even too high.

Manufacturing data released on Monday underscored the worsening situation across the eurozone, with activity at its lowest level for more than a year during August. While the headline purchasing manager's index was 50.7, above the 50 mark which divides growth from contraction, it was down from 51.8 the month before.

The French manufacturing sector contracted at the fastest rate since May last year, while Italy went from expansion to stagnation.

Gross domestic product figures show the same trend. The German economy, which accounts for almost 30 percent of eurozone output, contracted in the second three months of the year, and the 18-member eurozone bloc failed to grow at all. Italy is now in its third recession since the financial crisis erupted in 2008–2009.

The problem goes deeper than even these figures indicate. It is now estimated that the eurozone economy is operating at 20 percent below its trend growth rate. According to US Nobel laureate economist Joseph Stiglitz: "There is a risk of depression lasting years, leaving even Japan's lost decade in the shade."

The days when China could be considered the saviour of the world economy have well and truly gone, as recent data has underscored. Last month, the Chinese government's official purchasing managers' index (PMI) fell for the first time since February, down from a two-year high in July of 51.7 to 51.1. The slowdown in manufacturing followed the release of figures which showed a contraction of lending in July and a fall in property prices.

Commenting on the manufacturing figures, the *Financial Times* noted: "China's economy has been slowing for several years, but a sharp correction in real estate markets in recent months has led to concern that

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the slowdown could turn into a more severe slump."

The Chinese government has responded to problems in the real estate market with a series of measures described as a "mini-stimulus." But the fall in the PMI indicates that these measures may not be working. According to the *Financial Times*, manufacturing weakness last month was "primarily the result of lacklustre domestic demand"—flying in the face of official government policy, which is supposedly aimed at boosting consumption spending.

In Japan, "Abenomics," based on government stimulus measures and a financial asset purchasing program by the Bank of Japan, was touted as the way out of the deflation which has gripped the economy since the 1990s. However, after correcting for the one-off effects of a consumption tax increase in April, the Japanese economy experienced virtually zero growth from mid-2013 to mid-2014.

Chetan Ahya, chief Japan economist at Morgan Stanley, told the *Financial Times*: "Abenomics is in trouble." Even though some indicators pointed upward following a decline in the second quarter, "the pace is too slow to warrant hope of a sharp rebound."

Taking a step back from the month to month data, and reviewing economic developments over a longer time frame, brings into focus the underlying significance of what is taking place. Over the past six years, central banks and monetary authorities have undertaken the greatest financial stimulus package seen in history.

The US Fed alone has pumped $4 trillion into financial markets. Chinese credit markets have expanded by an amount equal to the entire US banking system. Yet the world economy as a whole has not only failed to "recover," it has clearly entered a period of stagnation, if not outright recession.

At the same time, the measures undertaken have created the conditions for another financial crisis. While the real economy has barely grown, financial markets have reached record highs as a result of monetary stimulus. However, the conditions that have led to the financial bonanza are about to change in the coming months.

Next month, the US Fed is expected to bring its program of "quantitative easing" to a close and move toward an increase in interest rates, possibly starting in June next year. But in Europe and Japan, central banks are maintaining or even increasing financial stimulus measures.

This has prompted warnings that financial markets could be in for a period of instability as a result of this policy divide. For the past six years, all the world's major central banks have been following the same agenda.

Stephen Halmarick, the head of economic and market research at Colonial First State, Australia's largest asset manager, told the *Sydney Morning Herald* that in the next six to 12 months this would change "dramatically" as central banks moved in different directions, increasing "global volatility risks" substantially.

In other words, while the stimulus measures staved off a complete collapse of the financial system, they failed to boost the underlying economy and have set in place conditions for a further meltdown.

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