Amidst slowdown in global economy

Europe threatened with deflationary spiral

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New data released this week on the German economy has intensified fears that Europe's euro zone is slipping into its third recession in six years and may have entered a downward deflationary spiral of the type that led to the Great Depression of the 1930s.

According to the IFO Business Climate Index for October, German business confidence has fallen to its lowest point since August of 2012. The October survey showed confidence falling to 103.2 this month as compared to 104.7 for September. The new reading was lower than economists' forecast of 104.3. It was the sixth straight monthly decline.

The dismal business confidence figure follows a series of reports showing that Europe's biggest economy is contracting. German industrial production fell 4 percent between July and August. Factory orders and exports in August saw their steepest plunge since 2009. The country's gross domestic product shrank in the April-June quarter. Its inflation rate is just 0.8 percent, far below the target set by the Bundesbank and the European Central Bank (ECB).

Earlier this month, the German government cut its 2014 economic growth forecast to 1.2 percent from 1.8 percent, and its 2015 projection to 1.3 percent from 2 percent. Following the release of the new IFO report on Monday, Germany's Chamber of Commerce slashed its growth forecast for 2015 to 0.8 percent.

"The outlook for the German economy deteriorated once again," said IFO President Hans-Werner Sinn in a news release. Joerg Kraemer, chief economist at Commerzbank AG in Frankfurt, was quoted by Bloomberg News as saying, "The latest numbers from the industrial sector are very worrisome. The third quarter was probably worse than expected. The economy may have stagnated at best."

Germany, the industrial powerhouse of Europe, was supposed to be the engine that would pull the continent out of its economic malaise. Instead, its highly export-dependent economy is being undermined by a global slowdown in demand, including from China, its third largest market, the so-called "emerging economies" such as Brazil, and the rest of Europe. The government's own policies—economic sanctions against Russia over the Ukraine crisis, war in the Middle East, and relentless austerity throughout Europe—are contributing to Germany's slump.

Germany's downturn is part of a general crisis in the 18-nation euro zone. Growth in the region came to halt in the second quarter and its overall inflation rate, at 0.3 percent, is hovering on the edge of outright deflation.

These conditions prevail despite massive infusions of cash into the financial markets by the central banks of the US, Europe and Japan. The ECB, in a desperate attempt to stave off outright deflation, has slashed its benchmark interest rate to 0.05 percent and launched a modified version of the US Federal Reserve's "quantitative easing" program, under which the central bank essentially prints money to buy bonds.

In another sign of the worsening crisis, the Swedish central bank on Tuesday unexpectedly cut its benchmark interest rate to zero. The Riksbank also slashed its growth projection for 2015.

Sweden, which has the highest unemployment rate in Scandinavia, has seen falling prices in 16 of the past 24 months. The country's inflation rate has remained below the Riksbank's 2 percent target for almost three years. After a year of zero inflation in 2013, the Riksbank has predicted a minus 0.2 percent inflation rate this year.

The current (October 25-31) issue of the British *Economist* magazine focuses on the deflationary crisis in Europe and its disastrous global implications. In a lead editorial headlined "The world's biggest economic problem: Deflation in the euro zone is all too close and extremely dangerous," the magazine notes that Europe's slump is part of a global tendency. It cites the fact that China is now growing more slowly than at any time since 2009.

To back up its warnings on the danger of a deflationary spiral—in which falling prices create a vicious cycle of bankruptcies and layoffs leading to more bankruptcies and layoffs—the *Economist* notes that inflation rates are well below central bank targets in the US and China as well as Europe. Of the 46 countries whose central banks target inflation, the magazine writes, 30 are below their target.

In Europe itself, prices are falling in eight countries. In Italy, Spain and Greece, inflation is below zero.

The *Economist* goes on to note that the International Monetary Fund has estimated the odds of deflation in the euro zone, defined as two quarters of falling prices in a 12-month span, at 30 percent for the coming year.

"As debt burdens soar from Italy to Greece," writes the magazine, "investors will take fright, populist politicians will gain ground, and—sooner rather than later—the euro will collapse."

The *Economist*, speaking in behalf of British capitalism and the City of London, flays German Chancellor Angela Merkel for her opposition to any backing off on austerity and prescribes more cash for the financial markets combined with so-called "structural reforms" of the European economies—a euphemism for the destruction of job protections, pensions and what remains of the European welfare state.

Other British newspapers have weighed in behind the *Economist*. The *Telegraph* in an article Monday decried the ECB's failure to include the risk of deflation in its just-completed "stress test" of European banks. The newspaper noted that prices have fallen over the past six months in roughly half of the euro zone and the "proportion of goods in [its] price basket has jumped to 31 percent."

The *Financial Times* on Tuesday quoted George Magnus, senior economic adviser at UBS bank, as saying, "Not only is deflation a clear and present danger, it's already happening in some countries."

The deflationary trend in Europe is increasingly impacting the already fragile US economy. Several indexes released Tuesday point to a weakening of economic activity.

The Commerce Department reported that orders for durable goods—products such as heavy machinery designed to last more than three years—fell 1.3 percent in September from the prior month. It followed a record 18.3 percent decline in August and belied the forecasts of economists, who had predicted a 0.7 percent increase.

A category of durable goods called "core capital goods," which is used to measure business investment, fell 1.7 percent last month, its biggest drop since January.

In a separate report, the Institute of Supply Management reported that its gauge of manufacturing declined to 56.6 in September from 59 in August.

A survey of home prices showed a continuing slowdown in the housing market. The S&P/Case Shiller composite index of 20 metropolitan areas gained 5.6 percent in August over the previous year, the slowest year-on-year increase in nearly two years. On a seasonally adjusted monthly basis, prices in the 20 cities fell 0.1 percent for the month.

The housing figures follow an earlier report that spending at US retailers declined in September, the first drop since January.

The *Wall Street Journal* quoted Cliff Waldman, an economist with the Manufacturers Alliance for Productivity and Innovation, saying, "The darkening world economic and geopolitical picture is having an impact."

The infusion of trillions of dollars of virtually free credit into the banks and financial markets by the US Federal Reserve and other central banks has failed to resolve the capitalist breakdown that began with the Wall Street crash of September 2008. The conditions of the vast majority of the planet's inhabitants continue to worsen.

The banks and corporations have not used their windfall to invest in production and create jobs for the unemployed. They have either hoarded the money, used it to buy back their own stock to drive up its price, or engaged in other parasitical activities. The real economy remains virtually moribund.

The unprecedented monetary stimulus—combined with ruthless austerity against the working class—has benefited the financial aristocracy, increasing its vast wealth and its share of the world's resources. At the same time, it has fostered new forms of speculation and all of the fraudulent and criminal activities that accompany it. The same tendencies that triggered the crash of 2008 are again at work, leading inevitably to a new financial collapse.

In an article Monday on the emergence of a new market in "asset-backed securities" based on sub-prime auto loans—a mirror of the sub-prime home mortgage Ponzi scheme that collapsed six years ago—the *Financial Times* noted that issuance of junk-rated corporate bonds has hit a new record high.