The Dow at 18,000: Contradictions mount in world economy

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As the year draws to a close, there is an ever-widening gap between what is taking place in financial markets and the state of the underlying real economy. Wall Street has reached record highs, with the Dow topping 18,000 this week, while the world economy remains largely in the grip of tightening recessionary conditions. This disparity portends the eruption of economic and social contradictions.

Throughout this year, financial markets have followed a basic pattern: periods of sudden turbulence followed by a new surge. The most serious was the bond market "flash crash" of October 15, when conditions emerged resembling those following the collapse of Lehman Brothers in September 2008.

But at every point, financial markets have been revived with the promise that the supply of cheap money from central banks would continue. At the same time, stagnation and outright recession continue across much of the world.

While there are signs of a modest up-tick in US growth, the European economy has yet to reach the levels it attained as long ago as 2007, with no sign of recovery in the immediate future. Japan is in recession, despite the stimulus measures unleashed by "Abenomics," and the Chinese economy is slowing amid mounting fears that it is ripe for a financial crisis.

But financial markets power on. The plunge in the value of the Russian rouble over the past two weeks could have been the start of further instability, but after the US Federal Reserve made it clear that there would be no sudden increase in interest rates, the Dow Jones Industrial Average surged ahead, bringing its rise over the past year to 1,000 points.

The rouble collapse is a product of two processes: the precipitous fall in the price of oil, down more than 50 percent since June, and the use of sanctions by the US and the European Union against Russia, which have led to it being cut off from financial markets in what amounts to economic warfare.

Undoubtedly, there is also a large element of manipulation, directed in the first instance against Russia, in the fall of oil prices. But more broadly, the oil price plunge reflects deepening recessionary trends that stand directly at odds with the rise in the financial markets.

Oil is only one of the major industrial commodities that have experienced a significant decline this year. The price of iron ore has dropped by almost 50 percent and is at its lowest level in five years. The price of wheat, a key agricultural commodity, is down by 20 percent.

The overall decline in economic growth, and particularly its key driver, investment spending, is indicated by the fact that this year commodities are on track to be the worst performing major asset class for the third consecutive year. The Bloomberg Commodity index has fallen 14 percent this year and is at a five-year low.

It is not just the fall in commodity prices that points to deepening slump, but also the actions of the major producers. On Monday, the Saudi oil minister, Ali al-Naimi, said in an interview that the OPEC oil cartel would not cut production to maintain prices even if oil went as low as $20 per barrel. "It is not in the interest of OPEC producers to cut their production," he declared, "whatever the price is. Whether it goes down to $20, $40, $50, $60, it is irrelevant."

This statement represents a major shift in OPEC strategy, which has been based on regulating supply to maintain a certain price range. However, in the present conditions of falling demand and increased supply, not least because of the development of shale oil in the US,

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OPEC is adopting a new strategy based on maintaining a given market share, arguing that cutting production to boost prices will benefit only its competitors.

Maintaining production in the face of falling demand means forcing down the price in order to send higher-cost producers, shale oil producers and deep-water drillers, to the wall.

The same process is taking place in the iron ore mining industry, where BHP Billiton, Rio and other lower cost producers are maintaining or even increasing production levels in the face of falling prices.

These actions are in response to the continuous downward pressure in the world economy and reflect the calculation that any strategy for survival must be based on waging a war to the finish, rather than an expectation of a genuine and extended upturn sometime in the near future.

The divergence between the real economy and the financial markets is rooted in the economic breakdown that began with the financial crisis of September 2008. After mobilising trillions of dollars to prevent a complete meltdown of the financial system, central banks, with the US Fed taking the lead, have continued to pump money into the sclerotic arteries of the financial system in order to maintain it.

Nothing like it has been seen in history, as even a brief review of the amounts involved makes clear. From its founding in 1913, it took the Fed 94 years to expand its balance sheet to $900 billion, where it stood on the eve of the financial crisis. Just six weeks after the collapse of Lehman Brothers, it had doubled in size.

By the end of the year, it had tripled. It now stands at more than $4 trillion.

Where the Fed has gone, others have followed, including the Bank of Japan and the Bank of England, with the result that the combined balance sheet of central banks now totals $16 trillion, or three times the level before the crisis.

This massive injection of money has not gone to increase production, boost wages or generate jobs, but to boost the financial markets. The combined valuation of global equity markets is now around $75 trillion, compared to the low of $25 trillion in March 2009. This has brought a vast increase in social inequality, as the banks, speculators and financial operatives have increased their wealth through asset inflation, while the real wages of working people have either stagnated or declined.

The growth of fabulous wealth at the heights of society, the result of speculation and parasitism, together with worsening conditions for the overwhelming majority, signifies a build-up of enormous tensions that will erupt in social and political struggles.

At the same time, the conditions are being created for another financial crisis that could set these struggles in motion. The actions of the central banks in fuelling the insatiable demands of finance have created a massive financial asset bubble that threatens to burst if the supply of cheap cash is turned off or reduced.

As a recent report by the credit strategy department at Deutsche Bank put it: “The problem for central bankers is that they have inflated certain asset prices to levels where, if they reined in their actions too much, then they would likely see adverse market moves and a loss of confidence in the system.” The report concluded that those in charge of monetary and economic policy were nowhere nearer to finding a solution than they were in 2008–2009.

The reason is that there is no solution under the profit system. There is no return to “normal.” There is only the ever-growing threat of economic destruction through a global collapse, coupled with the impoverishment of the working class, and, at the same time, an increasingly ferocious conflict between corporate and financial giants for resources, markets and profits, leading to a new world war.

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