Recession risk on the rise

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6 February 2016

In accordance with the perverse logic that governs the stock market, where bad news for the real economy is regarded as good news for financial speculation, Wall Street's Dow Jones index fell by more than 200 points on Friday on the back of the US jobs report.

While the report showed job growth of 151,000, below expectations and well below the 262,000 increase in December, it brought the official unemployment rate down to 4.9 percent and therefore was not sufficiently bad to ensure that the Fed takes further interest rate increases off the table for the foreseeable future. Consequently, the market went down.

However, the report, showing that 9.9 percent of the workforce is either unemployed or working part-time while desiring full-time employment, did not reflect a series of layoff announcements over the past month.

The outplacement agency Challenger, Gray & Christmas reported that employers announced 75,115 job cuts last month, up from a 15-year low of 23,622 in December. The announcement came in the wake of a series of economic reports indicating a significant slowing of the US economy, with economists and financial analysts estimating a 20 percent chance of recession, the risk of which was considered negligible only a few weeks ago.

Overall gross domestic product grew at an annual rate of only 0.7 percent in the December quarter. The Commerce Department has reported that new orders for manufactured goods fell by 2.9 percent in December, the largest drop in a year.

Writing in the *Financial Times* this week, market columnist John Authers noted that the "greatest concerns [over recession in the US] surround industrial production and manufacturing." He continued, "Industrial production fell in 10 months out of 12 last year—a figure that has always, since 1919, been associated with a recession."

Significantly, in view of the claims that manufacturing is not the important indicator it once was and consumer spending is the key driver of the economy, large job cuts are taking place in retailing. Major firms have announced plans to cut 22,246 jobs, the most since January 2009, with Walmart planning to close 269 stores worldwide.

Energy companies, hit by lower oil prices, plan to cut 20,246 jobs, up from 1,682 in December.

The Institute for Supply Management's purchasing managers' index for manufacturing came in at 48.2 for January, below the 50-line that separates contraction from expansion, the fourth successive month it has been in negative territory. The ISM index for non-manufacturing fell to 53.5 in January from 55.8 in December, well below economists' expectations of a 55.1 reading.

In a further indication of the distance of the political establishment from the real situation facing the mass of the population, President Obama hailed the job figures and the fact that the unemployment rate of 4.9 percent was half the 10 percent level in the immediate aftermath of the financial crisis. The "durable" US economy had continued to grow and was "the strongest in the world," he declared, adding that Americans should "feel good about the progress we've made."

In his remarks, Obama pointed to challenging headwinds in the global economy, but did not dwell on them as he sought to counter what he called the "doom and despair" of Republican stump speeches in the lead-up to the New Hampshire presidential primary on Tuesday.

But even as he spoke, those "headwinds" were getting stronger. In US financial markets, the yield on ten-year Treasury bonds has fallen back below 2 percent, generally an indication of coming recession. The fall in yields has been particularly marked. In early December, Bloomberg reported that only two of the 73 analysts it polled predicted that the 10-year rate would go back below 2 percent.

This is part of a global trend. In Europe and Japan, government bonds worth nearly $6 trillion are now so high in price—indicating a lack of confidence in the real economy as investors seek safe havens—that buyers would make a loss if they held the bonds to maturity.

"If major government bond markets are right," the *Financial Times* noted, "the global economy is sliding towards recession."

Bill Gross, known as the bond market king when he headed the world's biggest bond trading firm, PIMCO, warned this week of "shades of 2007," when the US Fed failed to see the emerging financial crisis. Low interest rates and massive central bank intervention had failed to generate economic growth and were beginning to endanger bond investors, he said. After several decades of zero percent rates, the Japanese economy had failed to respond and the US economy had averaged only 2 percent growth since the end of the recession in 2009.

Another indication of worsening financial conditions was contained in a report from the Bank for International Settlements (BIS). It noted that the surge in lending to emerging markets, which played a significant role in holding up global growth after the financial crisis, had come to a halt.

The total stock of dollar-denominated credit in bonds and bank loans to emerging markets, including corporations, governments and households, but excluding banks, had fallen to $3.33 trillion at the end of September last year, down from the level of $3.36 trillion in June. This was the first decline since the first quarter of 2009, at the height of the financial crisis.

The head of research at the BIS, Hyun Song Shin, told the *Financial Times* that an investment boom creates a "virtuous circle" in which things can look better than they actually are, but which "can quickly go into reverse" and turn into a "vicious circle," especially where a high level of leveraging is involved.

With the onset of a "deleveraging cycle" in emerging markets, "all the weaknesses are suddenly being uncovered," he said.

"The issue is not just for emerging markets," he added. "It is spilling back into developed markets. The broader financial markets are recoiling from risk, and that spreads across all markets. The problem now is that the real economy is being affected."

International Monetary Fund Managing Director Christine Lagarde also pointed to growing financial dangers. In a speech this week, she called for the existing financial "safety net" to be strengthened to prepare for a crisis in commodity-exporting countries, which were coming under "severe stress." The IMF is already in talks with Azerbaijan over a bailout of $4 billion, Nigeria is seeking a $4 billion loan to cover its budget deficit, and other countries may not be far behind in seeking assistance.

Last month, the Institute of International Finance said there had been a net capital outflow of $735 billion from emerging markets in 2015, the first such occurrence since 1988. Contracting liquidity in these markets presented a greater threat to global growth than either the slowdown in China or falling oil prices, it warned.