Bank for International Settlements warns of build-up of global debt

Nick Beams
8 March 2016

The governing council of the European Central Bank (ECB) will meet this Thursday where it is expected to expand its quantitative easing program through an extension of its asset-purchasing program and possibly lower interest rates further into negative territory.

But there are growing doubts about the efficacy of these policies amid ongoing euro zone deflation and worries that they are dangerously backfiring.

Since ECB president Mario Draghi promised in 2012 to “do whatever it takes,” the ECB has pumped billions of euros into the financial system without halting deflation or stimulating the real economy. Its only impact has been to fuel further speculation in financial markets.

In a note issued Monday, the chief economist at Société Générale, Michala Marcussen, summed up the general sentiment in financial markets. She expected a further cut in the deposit rate and an extension of long-term refinancing operations and added: “Our main concern is that, whilst the bank will continue to signal its willingness to do whatever it takes, its ability to provide further significant stimulus is becoming more limited.”

There are growing concerns that, not only is the policy ineffective, it is creating the conditions for a further financial crisis. In its quarterly review issued on Sunday, the Bank for International Settlements (BIS), sometimes referred to as the central bankers’ bank but whose main role is an informational service, noted that the “uneasy calm,” to which it had pointed in December, had “given way to turbulence.”

Introducing the review, Claudio Borio, the head of monetary and economic research, said previously the BIS had highlighted that “the tension between the markets’ tranquillity and underlying economic vulnerabilities had to be resolved at some point. In the recent quarter, we may have been witnessing the beginning of its resolution.”

Borio then reviewed the two most significant developments of the past three months. First, there was the stock market turbulence in January when equities experienced one of their worst starts to the year in history. This was followed by the “briefer but perhaps more worrying episode in the first half of February” which focused on the “health of global banks” as their valuations plunged to new lows. The “main source of anxiety,” especially after the Bank of Japan’s decision to shift to negative interest rates at the end of January, was “the vision of a future with even lower interest rates, well beyond the horizon, that would cripple banks’ margins, profitability and resilience.”

A research paper published as part of the review warned it was difficult to predict how individuals and financial institutions would operate if interest rates stayed below zero for a long period of time and whether the mechanisms by which central bank moves are transmitted to the rest of the economy would “continue to operate as in the past.”

So far the banks had not passed on the cost of negative interest rates, under which they are charged for money deposited with the central bank, and it is by no means certain what the long-term consequences would be. “The viability of the banks’ business model as financial intermediaries may be brought into question,” the review said.

Pointing to a “certain composure” that had returned to markets since the turbulence of the first two months, Borio said it was necessary to look beyond the markets’ oscillations between hope and fear to the “deeper forces at work.”

“Once we do so, the clues are not hard to find. Against the backdrop of a long-term, crisis-exacerbated decline in productivity growth, the stock of global debt has continued to rise and the room for policy manoeuvre has continued to narrow," he said.

In other words, while debt has continued to mount, the underlying economy has grown very slowly and in some cases stagnated. In the euro zone, for example, output is still yet to return to the levels reached prior to the 2008 crisis, while investment, which is the driving force of real growth, remains at around 25 percent below its previous trend.

According to Borio, debt was at the root of the events of 2008 and since then it had continued to grow in relation to global gross domestic product. Dollar-denominated debt owed by emerging market economies has played a prominent role, doubling from 2009 to some $3.3 trillion. Now there was evidence it was being reduced with the emergence of a "worrying vicious cycle between US dollar appreciation and tightening financial conditions for firms or countries that have heavily borrowed in dollars."

Summing up the significance of financial market turbulence, he said "we may not be seeing isolated bolts from the blue but the signs of a gathering storm that has been building for a long time." The report indicated that "central banks have been overburdened for far too long" and the confidence of financial institutions "in central banks' healing powers—probably for the first time—has been faltering."

The latest analysis of the BIS, which has been a long-time critic of the rationale behind quantitative easing—that problems resulting from the growth of debt can be alleviated by creating still more debt—underscores the bankruptcy of all bourgeois policy in the face of the deepening contradictions of the global capitalist order.

The quantitative easing program has done nothing to promote economic growth. Its main consequence has been to transfer untold wealth into the hands of the parasitic financial elites, worsening the social conditions of the working class and widening social inequality, while at the same time creating the conditions for another financial meltdown.

But the program advanced by its critics in the BIS—the purging of debt and the intensification of attacks on the working class through so-called "structural reforms"—amounts to nothing less than a prescription for a return to the conditions of the 1930s.

This political and economic fact of life has far-reaching implications for the international working class. It increasingly demonstrates that it is confronted not with a conjunctural downturn, from which there will be some "recovery," by one or another means, but a breakdown of the entire capitalist economic order, for which it must advance its own solution based on an active political struggle for an international socialist program.