

Deepening contradictions within the global economy

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When Wall Street suffered its biggest ever one-day fall of almost 23 percent on October 19, 1987, the newly-installed chairman of the US Federal Reserve Alan Greenspan initiated a policy which was to become the hallmark response of central banks to financial and economic turbulence.

The Fed, he declared, “affirmed today its readiness to serve as a source of liquidity to support the economic and financial system.” It is a policy which has been followed assiduously over the past quarter century. When the first cracks in the credit-fueled boom appeared with the Asian crisis of 1997 and the collapse of Long Term Capital Management and the Russian debt default in 1998, the Fed was on hand to pump in more cheap credit. This gave rise to the dot.com bubble of 2000-2001. When that collapsed, it was followed by the housing sub-prime bubble, which burst in the global financial crisis of 2008.

The response to the near meltdown of the global financial system was to extend even further the very policies that had given rise to the crisis. The US government bailed out the banks and the Fed initiated its program of ultra-low interest rates and quantitative easing (QE), pumping some \$4 trillion into the financial system. It was joined by other major central banks, including the Bank of England, the Bank of Japan and the European Central Bank, all of which started their own versions of QE. They were followed by China, as its government launched a half-trillion dollar stimulus package and financial authorities began a massive expansion of credit which, by some estimates, amounted to the equivalent of the entire financial system of the United States.

The official rationale for the QE measures was that they were needed to promote economic growth. It was claimed that the provision of cheap money in the major economies and the lowering of returns on safe government-backed financial assets would lower the yield on financial assets and propel investors along the so-called yield curve—pushing them to invest in the real economy which would eventually lead to a return to economic growth after the most serious downturn in the global economy since the Great Depression of the 1930s.

The official policy was always a fiction. Far from promoting real economic growth, it has led only to the creation of another financial bubble based on parasitism, that is, on the accumulation of fabulous wealth through speculation. Investment levels remain well below what they were before the crisis—in the case of Europe down by at least 25 percent—while real growth has not returned to its pre-crisis path. World trade growth, a key indicator of the

health of the global economy, has markedly slowed and real wages have stagnated. At the same time, social inequality has increased to historically unprecedented levels, indicated by the fact that some 62 billionaires now own as much as half of the world’s population.

There are now clear signs that the latest bubble is on the way to bursting, with implications which go far beyond those which have preceded it. This is because, unlike previous occasions when the central banks were on the sidelines of financial markets, they are now key players, having expanded their balance sheets with massive debts.

For a period it can appear that the central banks are able to function as a kind of modern-day alchemist, somehow creating wealth out of thin air. But in the final analysis, financial markets are rooted in the real economy and it is here that concerns are growing.

As the governor of the Reserve Bank of Australia, Glenn Stevens, noted in a recent speech in New York, the “really critical question” is what are the prospects for sustained growth in the future? He said: “The real economy needs to generate decent returns in the real capital stock that are then matched (risk-adjusted) by the yield on financial assets. The financial assets are, in the end, just paper claims on that flow of real returns—directly in the case of private sector obligations and indirectly for government obligations, which rely on being able to tax growing private incomes. If the real economy can’t perform to provide real returns to capital, there is nothing to back higher yields on financial assets.”

Stevens made his comments in the wake of the spring meetings of the International Monetary Fund at which it had again lowered its forecast for global growth, warned of increasing spillover effects from financial turbulence in China and other emerging markets and issued another call for major governments to provide stimulus to economic growth—a call which has no prospect of being enacted.

Meanwhile, every day brings new evidence of mounting economic problems. Official data from the US late last month showed that the economy grew at an annualised rate of only 0.5 percent in the first quarter of 2016, with non-residential investment, a key economic driver, falling and weak exports.

These developments were “concerning,” the *Financial Times* noted, “because they suggest a fundamental lack of momentum in US growth, not just the temporary effect of the financial market

turmoil ... at the beginning of the year.”

Apple, the world’s largest company by market capitalisation, has reported its first quarterly sales decline in 13 years. But Apple is just an expression of a more general trend. US companies have reported profit declines for the third quarter in a row.

In the world’s second largest economy, China, there is a growing tide of warnings that debt levels, estimated to be at least 237 percent of gross domestic product, cannot be sustained and that there has to be a day of reckoning, either in the form of a financial crisis or the onset of a protracted period of low growth, with devastating consequences for the global economy. The latest GDP data showed growth of 6.7 percent for the first quarter, roughly in line with the government’s target. But this was only achieved by stimulus measures initiated by the government and the central bank in response to market turbulence and fears of lower growth at the start of the year and there are now signs that its impact is wearing off.

The official government purchasing managers’ index fell to 50.1 in April from 50.2 in March, well below the median forecast of 50.4 in a poll of economists conducted by the *Wall Street Journal*. The response to the lower number was summed up by one market analyst, who said it highlighted that “the stimulus package we saw in the first quarter has a limited time frame” and that the weakening PMI “shows the easy-credit policies are having far less efficacy in driving growth.”

The inherent limits of the QE programs of the central banks are being felt most sharply in Japan, the world’s third largest national economy, and the eurozone. At the end of January, the Bank of Japan initiated a policy of negative interest rates in the hope that this would provide a boost to inflation and lead to a fall in the value of the yen, improving the competitive position of Japanese firms in global markets. The opposite has happened. Instead of falling, the value of the yen is up 16 percent so far this year, with more increases expected as Japan is viewed as a safe haven amid global uncertainty.

Major Japanese firms are now revising down their profit estimates on the basis of calculations that instead of trading around 120 to the US dollar, the yen will rise to 105. Seiko Epson, the world’s third largest printer manufacturer, is forecasting a 26 percent drop in operating profit. The car producer Mazda has predicted a decline in operating profit of 25 percent because the value of the yen will wipe out all the gains it had expected to make from cost savings and new products.

More broadly, the negative interest rate regime, which now covers around one quarter of the global economy, is having a major impact on insurance firms and pension funds which invest heavily in long-term government bonds. According to calculations by Fitch, the \$10 trillion worth of negative-yielding government bonds are costing investors around \$24 billion annually, with the result that pension funds and insurance companies are struggling to meet their long-term commitments. One of the authors of the Fitch report described pension fund deficits as a “ticking time bomb.”

The latest data from the eurozone points to the failure of the European Central Bank’s monetary measures. On Tuesday, the European Commission again revised down its forecast for inflation for 2016 and 2017, despite what the *Financial Times* described as

“some of the most aggressive monetary policies in the eurozone’s history.” In March, the ECB set its deposit rate at negative 0.4 percent and offered banks even cheaper loans in a bid to spark lending.

The European Commission said inflation would rise by only 0.2 percent this year, down from its forecasts of 0.5 percent in February and 1 percent last November. This compares to the ECB’s official target of inflation close to, but below, 2 percent. The European Commission said that core inflation had “so far failed to show an upward trend” because of low growth levels and stagnant wages.

Deflation is having a major impact on company profits across the eurozone. Growth forecasts for European corporate profits have fallen to their lowest level since the global financial crisis, amid warnings that there is no end in sight. According to estimates by Bloomberg, profits for the third quarter of 2015 dropped 39 percent on a year-on-year basis and fell by 71 percent in the last three months of the year.

The head of global equities at Henderson Global Investors, Matthew Bessley, told the *Financial Times*: “The earnings outlook is very gloomy. I can’t see where the upside is coming from because there is no engine for growth in the world.”

In other words, the eurozone and the rest of the global economy is caught in a deflationary vortex akin to the stagnation of the 1930s, in which expansive monetary policies resemble pushing on a piece of string. The underlying cause is not the lack of cheap money but the lack of profitable investment outlets, which means that there is a permanent excess of savings over investment demand.

Just as the economics of the present period increasingly resemble those of the 1930s, so do the politics. The ruling classes of the major capitalist powers are responding as they did then: with beggar-thy-neighbour policies, in this case currency devaluations, a resort to economic nationalism, deepening attacks on the working class, the development of increasingly authoritarian forms of rule and the preparations for war.

At the same time, these developments are producing a growing radicalisation of the working class as the fundamental tendencies of the profit system become ever more clearly revealed. The deepening economic crisis is creating the conditions for the eruption of major social and class struggles in which the decisive question is the building of a new revolutionary leadership in the fight for the program of international socialism.



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