Global economic stagnation fuels financial instability

Nick Beams
8 August 2016

Last week's decision by the Bank of England (BOE) to undertake what it called "an exceptional package of measures" to counter the impact of the UK vote to quit the European Union, coupled with poor US growth figures, underscores the worsening situation for the global economy.

The BOE moves, which included a reduction in the benchmark interest rate to a record-low 0.25 percent and the pumping of an additional £170 billion ($223 billion) into the financial system, were taken in response to its own estimate that UK growth in 2017 will be only 0.8 percent, a drastic downgrade from its previous forecast of 2.3 percent.

The cutting of the growth estimate reflected not just the impact of the Brexit decision, but also the worsening outlook for the world economy as a whole.

The downward revision was preceded by data from the US which showed that the world's largest economy grew at an annualised rate only 1.2 percent in the second quarter, following an expansion rate of only 0.8 percent in the first. The second quarter figure was well below predictions of a rise of 2.5 percent.

The grim figures for the first two quarters meant that average US growth was only 1 percent in the first half of 2016, compared to a rate of around 2 percent since the beginning of the supposed "recovery" from the 2007–2009 recession. Taking a longer term view, the stagnation in the US economy is the worst for any period since the Great Depression of the 1930s. Over the two terms of the Obama administration, growth has been only 15.5 percent, compared to the recovery from the recession of the late 1950s which saw the economy expand by 52 percent in the years 1961 to 1969.

An article published Sunday in the *New York Times* pointed to some of the longer-term trends reflected in what it called "the low-growth world." It was not a new phenomenon, but had been in evidence for the past 15 years. From 1947 to 2000, gross domestic product (GDP) in the US per person rose by an average of 2.2 percent a year. Since then, the average has been only 0.9 percent, with Europe and Japan growing at even slower rates.

The article noted that if projections by the Congressional Budget Office issued in 2005 for the following decade had been met, US GDP would have been $3.1 trillion, or 17 percent greater, than it actually was. Even if the effects of the 2007–2009 contraction were discounted, GDP would still have been lower by $1.7 trillion.

This indicates that the crisis of 2008 and the consequent deep recession were not singular events that threw the economy off course, but rather a dramatic expression of a deeper malaise, as can be seen from what has taken place subsequently.

The *Times* article provides statistics indicating the devastating impact of this global stagnation on working-class living standards. It states: "In the year 2000, per-person GDP—which generally tracks with the average American's income—was about $45,000. But if growth in the second half of the 20th century had been as weak as it has been since then, that number would have been only about $20,000.

"To make matters worse, fewer and fewer people are seeing the spoils of what growth there is. According to a new analysis by the McKinsey Global Institute, 81 percent of the United States population is in an income bracket with flat or declining income over the last decade. That number was 97 percent in Italy, 70 percent in Britain, and 63 percent in France."

The chief factor in the ongoing stagnation, both in the US and throughout the world's major economies, is the fall in investment. In the US, it declined by 9.7 percent in the second quarter, the third straight quarterly decline. In Europe, investment levels are estimated to be running about 25 percent below where they were before the

© World Socialist Web Site

financial crisis of 2008. The impact of the decline is reflected in the paltry growth rate in the euro zone—just 0.3 percent in the second quarter.

The decline in investment over the past eight years is an expression of an ongoing downturn in the rate of profit. While the average rate of profit remains positive, enabling major corporations to accumulate cash, these firms fear that further investment will not bring a positive return. Consequently, instead of using their cash balances for productive investment, they have been deploying them in financial operations, such as mergers and share buy-backs.

While such activities can benefit the bottom line of the individual firm, they signify the growth of parasitism from the standpoint of the economy as a whole.

These activities have been aided and abetted by the low interest rate and quantitative easing policies of the world's major central banks. But these actions are creating the conditions for another financial disaster.

The European Central Bank, for example, has sought to bolster the continent's banking system and financial elite through the injection of cash—currently running at a rate of €80 billion a month, or almost €1 trillion a year. But there are signs that its efforts may be reaching their limits because of the ongoing stagnation in the underlying real economy, upon which the financial system ultimately rests.

In the wake of the 2008 crash, European banks and financial authorities did not undertake a major restructuring operation, including the writing off of bad debts, fearing that such action would weaken their competitive position against US finance capital. They hoped that recovery in the European economy would enable them to overcome bad debt problems over time. But the failure of the European economy to grow—it has only recently reached the economic output levels attained in 2007—has further exacerbated the bad debt problem.

The crisis is most sharply expressed in Italy, where bad loans held by the banks are estimated at around €340 billion, but it extends throughout the European economy, not least to Germany, where Deutsche Bank is regarded as one of weakest of the major international banks.

Commenting in the *Financial Times* on last week's moves by the Bank of England, financial analyst Mohamed el-Erian was full of praise for the measures, but warned that they had to be followed by government action for them to have lasting effect. Among the measures he and others have advanced are policies to deal with bank and financial indebtedness, better overall demand management of the economy, greater international coordination and pro-growth reforms.

But there are no signs of any such integrated measures to boost the global economy. El-Erian warned that if politicians continued to "slip and dither, poor growth prospects will turn into actual recessions, and artificial financial stability will give way to destabilising volatility." Under such conditions, he continued, "central banks will go from being part of the potential solution to becoming part of an even bigger actual problem."

El-Erian did not go into details, but at the heart of his warning is the transformed relationship of the central banks to the world financial system. When the crisis broke in 2008, the central banks were standing on the outside of financial markets and therefore able to intervene as a stabilising factor. Today, they are actively involved, holding trillions of dollars worth of government and other financial debt. The US Fed alone has expanded its asset holdings by more than $4 trillion in the past eight years.

The intervention of the central banks has created an historically unprecedented situation in global bond markets. There is now $12 trillion worth of sovereign debt trading at negative yields, meaning that the price of these bonds has risen so sharply, driven by the search of big investors for a "safe haven," that an investor holding them to their maturity would actually incur a loss. The situation is so precariously balanced that any unexpected movement in financial markets, even a relatively small one, has the potential to have far-reaching consequences. Coming in the midst of worsening conditions in the real economy, the Bank of England decision can only add to this underlying instability.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site