Outgoing German finance minister warns of financial bubbles

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The outgoing German finance minister, Wolfgang Schäuble, has warned the policies of the world's major central banks have created the danger of a new financial crisis due to the formation of speculative bubbles in the system.

His concerns were voiced in an interview with the *Financial Times*, published on Monday, as he steps down from his position as the country's finance minister after eight years to take up the post of speaker in the German parliament.

Schäuble, who has been one of the chief architects of the austerity measures that have devastated the conditions of workers, pensioners and youth in Greece, along with other European countries, told the newspaper he objected to the term (austerity), saying it was an Anglo-Saxon way of describing a "solid financial policy."

"The IMF and others agree with us that we are in danger of encouraging new bubbles to form. We have no idea where the next crisis will happen but economists all over the world are concerned about the increased risks arising from the accumulation of more and more liquidity and the growth of public and private debt. And I myself am concerned about this too," he said.

These remarks are a telling admission on two counts. First, that another crisis will take place, with potentially even more devastating consequences than 2008, indicating that governments and central banks have done nothing to overcome the conditions that led to the meltdown a decade ago. And secondly, that they "have no idea" about how and when it might occur, much less have put in place measures to prevent it.

Schäuble, whose views reflect those of key sectors of German finance capital, also warned there were risks of stability in the euro zone as a result of large amounts of non-performing loans held by major banks.

His warnings of the dangers of a financial bubble echo those of the Deutsche bank chief John Cryan. In speech last month, Cryan warned of "signs of financial bubbles in more and more parts of the capital market where we wouldn't have expected them." He called for an end to the "era of cheap money," saying it was causing "ever greater upheavals."

As a result of their quantitative easing policies since 2008, the world's four major central banks—the US Federal Reserve, European Central Bank, Bank of Japan and Bank of England—now hold $14 trillion of financial assets. This compares with their holdings of $6 trillion before the financial crisis. The Fed has increased its holdings from around $800 billion to $4.5 trillion.

The Fed has ended quantitative easing and has announced that it will start to run down its asset holdings to the tune of $100 billion a month from the start of next year. But interest rates remain at historically low levels and the monthly reduction in holdings is small compared to the overall holdings. Announcing the decision last month, Fed chairwoman Janet Yellen emphasised she did not want to spark any "outsized" movement in financial markets as a result of the new policy.

With the current program due to expire in December, the ECB has yet to indicate how it will reduce its purchase of financial assets. At present it has €2.3 trillion on its balance sheet.

The official rationale for the ECB policy is that it was needed to lift inflation near but below 2 percent. However, there are indications that asset purchases may extend well into 2018, possibly at a lower rate, because inflation is still stuck at around 1.5 percent and may even go lower.

The minutes of the ECB September meeting, released earlier this month, indicated that the central bank could remain an active force in European bond markets longer than had been previously expected. According to the minutes, members of the EBC governing council expressed the wish “to keep monetary conditions across the 19-member area loose and cement the region’s economic recovery.”

The next meeting of the ECB scheduled for October 26 has been described by analysts at the finance corporation ING as “likely to be one of the greatest balancing acts” in the central bank’s history.

The ECB would have to announce some kind of tapering in the bond-purchasing program, while, at the same time, “it will have to try to avoid markets interpreting the announcement as overly hawkish, thereby leading to a premature tightening of financial conditions,” they wrote.

So far as its official policy is concerned, the ECB is caught in a contradiction. On the one hand, the limited economy recovery in the euro zone points to a cutback in the level of financial support it is providing. But on the other hand, the rise in the value of the euro is pushing inflation further below the bank’s target rate because of the cheapening of imports.

The main danger of a new financial bubble appears, at this point, to be in the stock markets. The US market continues to trade at record highs while markets in Japan and Europe have also lifted.

Last Thursday, the S&P 500 index closed at its sixth daily consecutive record, its longest streak of highs since 1997 during the dotcom boom. But despite warnings that stocks are historically overvalued—only during 1929 and the lead-up to the collapse of the dotcom bubble have valuations been higher, according to finance economist Robert Shiller—the market continues to rise.

The mood was summed up by one financial analyst, cited by the *Wall Street Journal*. He likened the situation to 1996 when the head of the Federal Reserve, Alan Greenspan, pointed to “irrational exuberance” yet the market kept rising for the next three years.

Last week the financial web site *MarketWatch* reported that the market appeared to be in a “melt-up stage” driven by excessive credit and by a “timid Fed” reluctant to raise interest rates.

It defined melt-up as a “dramatic and unexpected” rise in an asset class “driven in part by a stampede of investors who don’t want to miss out on the rise rather than by improvements in fundamentals.”

This brings to mind nothing so much as the famous comment of Citigroup CEO Chuck Prince who noted in July 2007: “When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you’ve got to get up and dance.”

While there were signs at that time of a major crisis in formation, the financial boom continued. But it led to the greatest economic and financial crisis since the Great Depression. Present conditions, in which rising markets are fuelled not by growth in the real economy, but by ultra-cheap money point in the same direction.