

Mounting warnings of a global recession

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The world economy is showing signs of significantly lower growth, if not an outright recession, with the warning lights flashing in both financial markets and the real economy.

In the past week the yield on US 10-year Treasury bonds has fallen sharply and on some occasions has dropped below the rate on shorter-term Treasuries. This is significant because under “normal” circumstances rates on longer-term bonds are higher than those obtained on short-term debt. The “inversion of the yield curve” points to rising financial uncertainty as investors seek greater security and is regarded as an indicator of recession.

Other interest rates, most notably on German bonds that like US Treasuries are regarded as a safe haven, have also fallen and in some cases are in negative territory. On Wednesday the German government issued €2.4 billion of 10-year bonds with an interest rate of minus 0.05 percent. The issue was oversubscribed 2.6 times meaning they could have raised €6.3 trillion.

The growing nervousness in financial markets is also indicated in a report from Bloomberg earlier this week which said the amount of global bonds with a negative yield had gone over \$10 trillion.

Negative yield occurs when the price of the bond rises so high due to investors seeking security that if it were held to maturity it would produce a loss on the investment.

The immediate starting point of this shift was the indication from the US Federal Reserve following the meeting of its Federal Open Market Committee (FOMC) earlier this month that it was contemplating no interest rate increases this year—a sharp reversal from the position at the end of last year when at least two interest rates were anticipated for 2019.

The switch by the Fed started in January with the issuing of a “dovish” statement in interest rates in response to a sharp downturn in US stock markets for December when they experienced the worst outcome for that month since 1931.

The statement following this month’s FOMC meeting

made clear the Fed was not simply engaged in a temporary reversal of its previous agenda. It was a virtual admission there was not going to be any winding back of its massive asset purchases under the program of quantitative easing which saw its balance sheet expand from around \$800 billion before the financial crisis to \$4.5 trillion.

The Fed had started winding back its holdings by \$50 billion a month and Fed chairman Jerome Powell indicated at the end of last year this policy would proceed into the future as if on “auto pilot.” This brought furious opposition from key sections of the financial markets which maintained the Fed’s policy was adversely affecting their operations.

At last week’s meeting the wind-down was effectively shelved. Powell said the Fed would slow the reduction of Treasury holdings to \$15 billion a month starting in May and expected to conclude the wind-down at the end of September. This meant that the Fed’s balance sheet would be around \$3.5 trillion, or 17 percent of GDP compared to around 6 percent before the 2008 meltdown.

The most significant feature of the Fed’s decision is what it indicates about the future of the US and global economy. It underscores the fact that more than 10 years after the global financial crash any return to what was once considered “normal” monetary policy is further away than ever and the global economy and financial system are completely dependent on the provision of ultra-cheap money from the major central banks.

Commenting on the latest move by the FOMC, *Wall Street Journal* writer Greg Ip noted that the US economy was expected to grow this year and that official unemployment remains low. “What’s worrying is that maintaining these conditions requires such expansive monetary policy. It suggests that powerful underlying forces such as slow-growing populations and diminished investment opportunities continue to weigh on economic growth and inflation around the world.”

He pointed out that if the US economy stumbled again, the Fed would not have much ammunition to respond

because at most it could cut interest rates a little more than two percentage points “less than half what’s required in most recessions.”

Recent reports suggest that the next Fed move on rates could be down rather than up.

Shortly after the Fed’s decision, another shock came in the form of data from Europe on the underlying state of the euro zone economy. The purchasing managers’ index for euro zone manufacturing fell to 47.7 in March from 49.4 in February, with a level under 50 indicating a contraction. In Germany, the euro zone’s key economy, the index for the factory sector slumped to 44.7 in March, down from 47.6 in February, to hit its lowest reading in 79 months.

On Wednesday at a conference in Frankfurt, European Central Bank President Mario Draghi provided an update on the state of the euro zone economy following the decision by the ECB earlier this month to reverse its policy of slight monetary tightening and undertake new stimulus measures.

He said last year saw a “loss of growth momentum” that had extended into 2019. The main factor at work is the slowing demand from external markets, indicating a slowing of the global economy. Weakness in world trade had continued and “global goods import growth in January reached its lowest level since the Great Recession, on the back of rising uncertainty about trade disputes and a slowdown in emerging market economies, especially China.”

Industrial production fell by 4.2 percent in December before recovering somewhat in January but indicators, such as new export orders, that have historically been closely associated with industrial production remained in “negative territory.”

Draghi noted that both extra- and intra-euro area slowed steeply last year and that such a simultaneous downturn “has not occurred since the start of the global financial crisis.”

Draghi tried to put the best face on an increasingly worsening situation saying that so far the decline in external demand had not spilled over into domestic demand but the risks had risen in the past few months.

He concluded his remarks with the assurance that the ECB was ready to respond to future risks and “we are not short of instruments to deliver on our mandate.”

This claim was the subject of a scathing response by Ashoka Mody, a former deputy-director of the International Monetary Fund’s Research and European Departments and now a professor at Princeton University,

which was reported in the UK-based *Telegraph*.

“What instruments?” he asked. “Aside from its jumble of words the ECB has nothing else to offer.”

Mody said the ECB was riven by “national conflicts,” always acted too late, with delays and half-measures which were the antithesis of risk management.

So far the official position in the US is that the economy will continue to grow this year. The Fed has revised down its forecast from 2.3 percent last December to 2.1 percent but, according to Powell, it still remains in a “good place” although growth had slowed from “solid rate” in the fourth quarter of 2018.

Earlier this month, *New York Times* columnist David Leonhardt provided some insights into the longer-term situation pointing out the strength of US economic expansion was exaggerated.

“Here’s the truth: There is no boom. The economy has been mired in an extended funk since the financial crisis ended in 2010. GDP growth still has not reached 3 percent in any year, and 3 percent isn’t a very high bar.”

He wrote that if experts’ predictions on the growth of the US economy had actually eventuated then it would be 6 percent larger than it is today producing \$1.3 trillion more in goods and services.

One of the reasons he noted was that major companies, despite all the money that was available were holding back. A report released earlier this week pointed to one of the reasons why. Companies in the S&P 500 spent a record \$806 billion buying back their own shares in 2018, beating the figure for 2017 by almost 56 percent and shattering the previous record of \$589 billion set in 2007.

These figures underscore the fact that the chief effect of the various stimulus measures introduced by central banks and governments—the program of quantitative easing and the Trump corporate tax cuts—has been to further fuel parasitism and speculation, while signs of recession indicate that a new crisis is in the making.



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