World economy “sleepwalking” to another financial crisis, warns former Bank of England chief

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A stark warning was made by the former Bank of England (BoE) governor, Mervyn King, who was BoE governor during the 2008 crisis, that the global financial system was heading for a devastating financial crisis. In a lecture delivered during the semi-annual meeting of the International Monetary Fund last week, he said there had been no fundamental questioning of the ideas that had led to the collapse a decade ago.

“Another economic and financial crisis would be devastating to the legitimacy of a democratic market system,” King said. “By sticking to the new orthodoxy of monetary policy and pretending that we have made the banking system safe, we are sleepwalking towards that crisis.”

King warned that the US would suffer a “financial Armageddon” if the Federal Reserve were not able to combat another crisis, given that the world was in a low growth trap. Recovery from the crisis of 2008-9, he declared, was weaker than that following the Great Depression.

At its meeting, the IMF said the world was experiencing a synchronised growth slowdown, concentrated in the major economies. That warning was underscored even before the discussions were over.

On Friday, it was announced that China’s economy had grown by 6 percent in the third quarter of this year, its slowest pace in 30 years. The main factors were the trade war with the US, slowing manufacturing and shrinking investment opportunities.

Releasing the latest figures, which came in below analysts’ expectations, the National Statistics Bureau said that, generally speaking, the national economy “maintained overall stability” in the first three quarters. “However, we must be aware that given the complicated and severe economic conditions both at home and abroad, the slowing global economic growth, and increasing external instabilities and uncertainties, the economy is under mounting downward pressure.”

The impact of the US trade war was reflected in a 3.2 percent fall in Chinese exports for the year. But trade tensions are by no means the only problem. Investment is also weakening, with growth in construction activity—a key driver of the economy—down to 4.7 percent year-on-year in the third quarter, from a rate of 5.5 percent in the second quarter.

Chinese growth looks to be heading towards 6 percent or even below, continuing a persistent downward trend, and now well below the rate of 8 percent the government had previously designated as the level necessary to maintain “social stability.”

As the *Financial Times* noted in its report on the latest data: “The debate over the past five years, as growth has shown signs of slowing, is whether China and its political system can shoulder the pressures associated with a cooling economy. These include higher unemployment, distressed banks and waning prospects for many people in less developed regions that have yet to benefit from the country’s growth from the decades-long opening up of the economy.”

In another expression of the global slowdown, the German government has revised down its forecast for growth in the world’s fourth largest economy for next year, from 1.5 percent to 1 percent, and projected only 0.5 percent growth for 2019. The German economy shrank by 0.1 percent in the second quarter and there could be a similar contraction in the third, placing it in a “technical recession,” defined as two consecutive quarters of contraction.

At the conclusion of its meeting, the IMF’s International Monetary and Financial Committee (IMFC) issued a communiqué underscoring the worsening global outlook. It said the world economy was expected to grow by about 3 percent this year, but the pace had continued to weaken since April. While growth was projected to pick up next year, the outlook was “highly uncertain and subject to elevated

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downside risks."

"These include trade tensions, policy uncertainty, and geopolitical risks, against a backdrop of limited policy space, high and rising debt levels, and heightened financial vulnerabilities. Other longstanding challenges also persist," the IMFC statement said.

This was followed by what can only be described as a series of empty declarations on the need to use "all appropriate tools" to promote growth and "enhance resilience," coupled with a call to resolve trade tensions and strengthen international co-operation—commitments destined to remain in name only.

As King's remarks exemplified, the real situation was far more accurately described by comments and discussions outside the formal deliberations and statements.

The *Financial Times* reported that, in their official statements, finance ministers and central bankers "held off raising fears that a global recession is coming—but in private, international and national officials are not so certain."

It said the World Bank's chief economist, Pinelopi Goldberg, came closest to articulating fears that, in the face of a recessionary downturn, policymakers would not have the means to counter it.

"Policy is supposed to remove instability, instead it is suppressing old certainties," she said. "No one knows what tomorrow will bring."

The worsening economic and financial situation, and the growing perplexity of the world's policymakers over how to deal with it, were revealed during an hour-long panel discussion sponsored by the US business channel CNBC during the course of the IMF gathering.

IMF managing director Kristalina Georgieva opened her contribution to the discussion urging policymakers to undertake measures to boost the world economy. She asked for a show of hands in the audience from those who intended to follow the fund's recommendations.

As the *Wall Street Journal* pointedly reported: "Not many hands went up."

During the discussion, Georgieva set out what she called the "bad news" for the world economy. In the advanced economies, productivity growth had levelled off and "doesn't want to move at all" and could not generate growth.

Referring to the situation in financial markets, where some $15 trillion worth of bonds— around one quarter—were trading with negative yields, she indicated the consequences of low growth. "Weird things" were happening because the normal pathway to genuine yield was not opening in advanced economies.

Technological change was taking place, "yet it does not generate growth."

Ray Dalio, the head of Bridgewater, one of the largest hedge funds in the world, said the economic environment had entered a "big sag" with parallels to the situation in the 1930s.

He indicated that a further easing of monetary policy by the world's central banks would make little difference, because it had reached its limits. Dalio has previously indicated he believes there will be a third stage of monetary policy—following the cutting of interest rates and quantitative easing—in which central banks will have to monetize government debt. That is, governments will have to increase their debts, which will be financed directly by the central banks, including the possibility that they will also have to directly hand money to consumers.

Europe, Dalio said, was at the limit of present policies, together with Japan, and the US did not have much room to continue.

The world was now experiencing the biggest wealth gap since the 1930s. "In the United States, the top one tenth of 1 percent of the population has a net worth that is approximately equal to the bottom 90 percent."

This was creating political tensions, which rendered problematic any coordinated policy to deal with the worsening situation in the global economy. Dalio's prescription was for moderate political leaders, who put aside national interests, to take charge. But that was becoming more difficult, because of what he called the rise of "populism" of the right and the left, recalling the 1930s.

Zhu Min, a former deputy managing director at the IMF, and now chairman of the National Institute of Financial Research at Tsinghua University, said the real challenge was not just a recession as classically defined, whether growth was above zero or below. Because interest rates were so low, inflation was low and growth so low "the whole landscape can collapse. I think that's the real risk."

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