Signs of emerging crisis in economy and financial system

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As Wall Street continues to surge to record highs—Apple has doubled its market capitalization from $1 trillion to $2 trillion in just two years and the S&P 500 index has surged 50 percent since the mid-March crash—there are clear indications of a crisis building up both in the real economy and the financial system.

Last week, the *Financial Times* reported that while the market was at a record high, "corporate distress" in the US had never been worse with "large corporate bankruptcy filings" running at a record pace and set to exceed levels reached in the aftermath of the financial crisis of 2008.

As of August 17, a record 45 companies, each with assets of more than $1 billion, had filed for Chapter 11 bankruptcy, compared with 38 in the same period in 2009 and more than double the figure of 19 in the comparable period last year.

It reported that in total 157 companies with assets of more than $50 million have filed for bankruptcy with a lot more expected to follow.

Ben Schlafman, the chief operating officer at New Generation Research, which tracks bankruptcy filings, told the newspaper: "We are in the first innings of this bankruptcy cycle. It will spread far across industries as we get deeper into the crisis.

"It pains me to say it, but bankruptcy is a growth industry in America."

The Labor Secretary in the Clinton administration, Robert Reich, said cutting off the $600 per week federal unemployment benefit will push tens of millions into poverty or close to it.

"They won't have the money to buy billions of dollars worth of goods and services. As a result the entire economy will suffer. Small businesses will continue to suffer the most because they are already precarious."

Goldman Sachs has said it expects that of the 22 million workers cut from payrolls in the first wave of the pandemic almost a quarter will be permanently axed. In a research note published on Friday and reported on Bloomberg, Goldman Sachs economist Joseph Briggs said that while there was a return to work from temporary layoffs, "other patterns suggest that rehiring prospects for temporarily laid-off workers started to deteriorate in July" and some 2 million workers could remain unemployed well into next year.

Reporting on the situation in Britain, the *Financial Times* said that accounting, law and investment banking firms were "preparing for a fresh wave of distress in the autumn" when government loan schemes to run out.

Leading insolvency barrister Mark Phillips said: "There are a series of crises looming. The full wave of insolvencies hasn't even started yet."

Financial and accounting firms have been involved in efforts to aid companies in restructuring their debt and raise capital to avoid a collapse.

"But the winding down of state support schemes is expected to trigger a large number of insolvency proceedings, as many of these companies run out of cash," the FT said.

In the major industrial centres of Europe there are fears that after what was described as bounce back from the sharp economic contraction in the spring, the recovery is now starting to slow.

There was a 22.5 percent rise in industrial production across the euro zone in May and June, but this was not enough to compensate for the 28 percent fall in the first two months of the pandemic. Germany's central bank has reported that euro zone manufacturers are still only operating at 72 percent capacity in July compared to their long-term average of 80 percent.

The car-making industry, which forms a vital component of the German economy, has been hard hit, with predictions that global car sales will fall to 69 million this year compared to 88 million in 2019. The head of Audi has said he does not expect the levels of car production to return to their pre-crisis levels at least until 2022 or 2023.

But even these predictions could be knocked awry in the face of what is clearly a resurgence of the pandemic. In the US, it continues to rage out of control while in Europe there are sharp rises in the number of infections due to the return to work drive of governments amid the push to reopen schools.

Last Friday alone, Spain reported 8000 new COVID-19 infections, with the infection rate rising across the region. In Germany the Robert Koch Institute, the country's main public health organisation said infections had risen sharply in all of the country's 16 regions in seven days, describing the situation as "alarming."

Infections have surged again in South Korea, one of the world's major industrial and manufacturing centres with an additional 397 cases reported on Sunday, the highest number since the beginning of March.

"Cases are rising in 17 cities and provinces across the nation, and we are now at the verge of a massive nationwide outbreak," the head of the country's Center for Disease Control and Prevention, Jung Eun-kyeong, told a news briefing on Sunday.

Amid this wave of disease and economic devastation, markets have continued to rise. But there are growing fears that the conditions are building up for a major financial crisis. The market rise has driven the surge in technology stocks, which form a large component of the S&P 500 index and, above all, the supply of cheap money from the Fed.

One indication of the effect of the intervention by the Fed, which has pumped around $3 trillion into the financial system, is the lowering of the yield on US Treasury bonds as a result of the central bank's purchases of government debt.

The yield on the 10-year Treasury bond, a benchmark for both US and global financial markets, is now around 0.6 percent, a full percentage point below its level in February. With the yield on government debt now bringing a negative return when inflation is taken into account, this has fuelled a turn to the stock market, gold and corporate debt. This search for a positive return has sparked what has been termed an "everything rally."

But the rise of the market rests on very shaky foundations as evidenced last week when the minutes of the Fed's July meeting were published, sending a tremor through Wall Street.

Contrary to many expectations in the market, they showed that the Fed had still not determined into "forward guidance" policy, that is, firm guarantees that there will be no tightening of monetary policy into the indefinite future, including a commitment to purchase bonds to set a cap on bond yields.

With the US government to issue more bonds to finance its debt, this measure is regarded in some quarters as necessary to insure that the increased supply of bonds does not lead to a fall in their price and a consequent rise in interest rates.

Commenting on the massive disconnect between the underlying economy and the stock market, an article in Bloomberg noted that "any number of looming threats could bring the historic rally in US equities to a screeching halt." They could include conflict over the re-opening of schools, the November election, the conflicts with China or the effects of US monetary policy.

Then there is the issue of the massive increase in corporate debt—more than $1.6 trillion over the past few months. Such is the extent of the debt mountain that Bloomberg reported that an analysis conducted by its intelligence unit revealed that the average below investment-grade firm (or junk-rated company) had debt levels relative to earnings so high in the middle of the year that they would have triggered warnings from bank regulators had they occurred a few years ago.

However, it noted, regulators had dropped those warnings which a few years ago had applied only to a few but which today "could apply to many more."

Gold has also been part of the "everything rally"—a rise sparked by the search for profit as its price reaches record heights and underlying uncertainty about the stability of the global monetary system as trillions of dollars are created at the press of a computer button by central banks.

While it has been on the rise, the gold price is highly volatile and so sudden downward movement is another factor that could trigger a collapse of the global financial house of cards.