Interest rate hikes leading to recession, UN says

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8 October 2022

The United Nations has added its voice to the growing list of international organisations, including the World Bank and the World Trade Organisation, warning that interest rate hikes imposed by the US Federal Reserve are creating the conditions for a financial crisis and global recession.

In its annual report issued earlier this week, the United Nations Conference on Trade and Development (UNCTAD) said that after a "recovery" in 2021 "the world economy is in the midst of cascading and multiplying crises."

It said that with incomes still below 2019 levels in many major economies "growth is slowing everywhere."

The rise in interest rates and highly volatile bond markets meant that "debt-distressed countries, including over half of low-income countries and about a third of middle-income countries, are edging ever closer to default."

With one eye clearly focused on the class struggle, it said economic hardship, arising from a cost-of-living crisis in advanced and developing countries, compounded by the threat of new outbreaks of COVID-19, the effects of climate change, and cuts in government spending, "is already triggering social unrest that can quickly escalate into political instability and conflict."

Pointing to the effects of interest rates on the economy, the report said every percentage point rise in the Fed's key interest rate lowered economic output in rich countries by 0.5 percent and by 0.8 percent in poor countries over the next three years; and more drastic rises of 2 and 3 percentage points (such rises are already being implemented) would further depress the "already stalling economic recovery" in emerging economies.

Speaking on the report, UNCTAD secretary-general Rebeca Grynspan said: "There's still time to step back from the edge of recession." But the current course of action was hurting the most vulnerable, especially in developing countries and "risks tipping the world into a global recession."

The rate hikes, spearheaded by the Fed and carried out by central banks around the world, have been initiated in the name of fighting inflation. But they will do nothing to bring down prices which are the result of supply-side constrictions, speculation and profit-gouging by major corporations, details of which are contained in the report.

In an interview on the report, Richard Kozul-Wright, head of the UNCTAD team which prepared it, said: "Do you try to solve a supply-side problem with a demand-side solution? We think that's a very dangerous approach."

This is a misplaced analysis. The aim of central bank policy is not the reduction of inflation per se.

It is directed to inducing a major slowdown, a recession, if necessary, to suppress workers' wage demands as they seek to claw back the cuts in living standards they have already suffered—and the further cuts to come—arising from the largest price increases in four decades.

In other words, the policies being directed by the Fed are not the product of a misdiagnosis of the economic situation. Rather, they flow from a consciously worked-out class-war agenda resulting from the policies implemented by governments and central banks, at least since the global financial crisis of 2008.

The report gave short shrift to the claim that the price surge is simply the product of the war in Ukraine, noting that while this has "added to economic anxieties" the "most critical problems faced by the global economy predate the war."

The evidence suggested the inflation surge did not come from the loosening of fiscal policy or wages pressure "but instead derives largely from cost increases, particularly for energy, and sluggish supply response due to a prolong history of weak investment growth."

This is a direct result of the quantitative easing policies of the Fed and other central banks after the 2008 crisis, accelerated after the March 2020 meltdown of financial markets, which meant speculation and financial parasitism were on steroids due the provision of trillions of dollars of ultra-cheap money.

In what it called a "high profit environment, financial engineering became an instrument of rent-seeking behaviour, particularly among larger international corporations. Thanks to their market power they have often generated income from the manufacture of scarcity rather than the production of goods or delivery of services."

This has been combined with profit gouging. By mid-2022, the ratio of corporate profits to US GDP was 7 percent as opposed to 6.25 percent before the pandemic. With US GDP somewhere north of $20 trillion, this means that at least an additional $150 billion is flowing into the coffers of the corporations.

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According to the report, between 2020 and 2022 "an estimated 54 percent of the average price increase in the United States non-financial sector was attributable to higher profit margins, compared to only 11 percent in the previous 40 years."

Another key factor in pushing up prices, particularly energy and food, has been the increase in speculation, financed by low interest rates. "The quantitative easing of 2020 and 2021 led to more speculation and inflation in asset markets, from crypto currencies to oil, food and minerals."

Hedging has long been part of the commercial operation of commodity markets because of their volatile nature. But this has been completely overshadowed by speculation which is "one important factor in driving up energy, food and commodity prices."

Before 2002, non-commercial speculators comprised 20 percent of US oil futures markets. By 2009 this had risen to 50 percent with more recent estimates putting it as between 70 and 80 percent.

The report noted that since the financial crisis of 2008 financial entanglements have become increasingly global, with the result that "complex shocks, including outbreaks of financial panic or extreme price volatility, or a combination of external triggers, are a present danger."

It was prepared before the UK financial crisis, but there is no question that had it not been staved off, at least temporarily through the £65 billion intervention by the Bank of England into the bond market, it would have ripped through the global financial system, confirming this analysis.

"Monetary tightening," it continued, "poses additional risk to the real economy and the financial sector: given the high leverage of non-financial businesses, rising borrowing costs could cause a steep increase in non-performing loans and trigger a cascade of bankruptcies."

If regulations were considered politically unacceptable [that is, by the financial markets] and monetary authorities proved unable to stabilise inflation quickly, government authorities "might resort to additional fiscal tightening" which would "only help precipitate a sharper global recession."

The financial situation has been made more unstable by what UNCTAD calls the "universe of non-bank financial institutions and credit providers," known as the shadow banking system, largely unregulated, which, despite some efforts to contain it has "expanded in size, geography and diversity."

The share of global financial assets held at shadow banking institutions has risen from 42 percent in 2008 to close to 50 percent at the end of 2019. In the US, shadow banking organisations originate more than two-third of mortgages and the share of loans to businesses is almost equal to that held by banks. In 2021, shadow banks controlled $226.6 trillion of assets out of a total of $468.7 trillion.

The report correctly noted that: "The world is facing a systemic crisis and only systemic action can solve it."

But the limited reforms UNCTAD proposes, based on greater regulation and control, fall far short of that. Furthermore, recent history shows, and as set out in the report itself, even these measures will not be undertaken.

Reviewing that history, the report stated: "In the decade following the GFC [global financial crisis], an opportunity was missed to put the world on a more sustainable and inclusive growth path." But once the panic was over, it continued, central banks pumped in more money, non-bank financial institutions greatly expanded their portfolios, governments cut their spending, wages stagnated, and wealth and income inequality grew.

The "missed opportunity" was not due to lack of knowledge. Reports, for example by the US Senate in 2011, pointed to the enormous dangers in the operations of the financial system and its often-outright criminality.

Nor was there a political problem in the electorate. Following the GFC, which devastated the lives of millions of people in the US and around the world, there would have been massive public support for taking the entire financial system into public ownership. But even where blatant criminal activity was revealed, no charges were laid. The banks were declared too big to fail and the criminals too powerful to jail.

No action was taken because of the enormous power of finance capital over the political system, determining the actions of governments. Since then that power has only increased. The systemic crisis can only be overcome if it is tackled at its source, the profit system itself, though the fight of the working class for a socialist program under which the financial and corporate giants are taken into public ownership under democratic control.

The authors of the UNCTAD report certainly did not intend it, but the data they have provided make the unassailable case for this program.

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