

# Storm clouds massing over global economy and financial system

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The new year opens with dark clouds gathering over the financial system and the global economy, each containing potential storms which either separately, or in combination, could set off a major crisis.

In a US television interview aired on Sunday, the managing director of the International Monetary Fund, Kristalina Georgieva, warned that a third of the world economy would be hit with recession this year as it faced a “tougher” year than 2022.

She said half the European Union was likely to be in recession as inflationary pressures, rising interest rates imposed by central banks and the Ukraine war continued to be a drag on the global economy.

Another factor is the impact of the COVID catastrophe in China where, as a result of the demands of the imperialist powers, the Xi Jinping regime has dropped virtually all public health measures in line with the situation in the rest of the world.

Referring to the COVID spread in China, Georgieva said, “The impact on the region will be negative, the impact on global growth will be negative.”

This meant that rather than boosting global growth, as it has in the past, China would be a drag on production. “That has never happened before,” she said.

The slowing global economy will cause increased problems for financial markets already showing mounting instability as the consequences of the reversal of the ultra-easy monetary policies of the world’s central banks increasingly make themselves felt.

These measures—so-called “quantitative easing,” which intensified after the onset of the pandemic when trillions of dollars more were poured into the financial system to prevent its collapse—have now been ended in the name of “fighting inflation.”

The central objective is not to bring down prices but to suppress the global upsurge of the working class in response to the highest inflation in four decades. This is regarded by the guardians of finance capital as the greatest danger to the system over which they preside.

The tightening interest rate regime, spearheaded by the US Federal Reserve, has already had a major impact on stock markets.

According to calculations by the *Financial Times* (FT), global stocks and bonds lost \$30 trillion in 2022—equivalent to almost 30 percent of global GDP—the biggest loss in financial asset markets since the crisis of 2008.

In what were once considered to be “normal” times, when stocks went down government bonds provided something of a safe haven. But because stock markets and the price of bonds rose on the low interest rate regime, they have both been in sharp decline.

On Wall Street, the S&P 500 index finished the year down by 19 percent and the tech-heavy NASDAQ ended 33 percent lower in the worst result for both since the global financial crisis. US stock markets lost \$12 trillion in value last year of which five major tech-based stocks accounted for a quarter.

Bond markets were also hit by a major sell-off. The yield in the 10-year Treasury bond, a benchmark for global financial markets, rose from 1.5 percent to finish the year at 3.9 percent. (The price of bonds and their yield, or interest rate, have an inverse relationship.) It was the biggest annual increase according to records going back to the 1960s.

The overall result for the decline in the S&P is significant but may not be considered large, at least so far. However, some of the falls in the market value of major companies, particularly those boosted by low interest rates, indicate more is to come and that major losses have already been incurred.

Two of the leading companies in the tech sector, Apple and Microsoft, have fallen by 30 percent. The Google parent Alphabet is down by nearly 40 percent, while the Facebook owner Meta has plunged 64 percent and the chipmaker Nvidia has lost 50 percent.

The most spectacular fall has been in the share price of Elon Musk’s electric car maker Tesla. Since November 2021, when it hit its peak, some \$900 billion had been wiped off its market value.

Its decline has mirrored one of the other major events of the last year—the collapse of the crypto market, most sharply expressed in the \$32 billion crash of the FTX crypto exchange and the bringing of criminal charges against its founder Sam Bankman-Fried. Since start of 2022, the value of the crypto currency market is estimated to have fallen by \$1.7 trillion.

The parallel between Tesla and crypto is not accidental. Their business models have been similar in many respects. Just as crypto, so-called digital money bypassing central banks, was hyped as the wave of the future, so Musk's operations were boosted by claims of a new era. Both have depended on the inflow of cheap money in search of overnight speculative gains.

As is always the case, relatively small retail investors, drawn in by the hype, have been taken to the cleaners. But as the fall of Tesla indicates—a loss of more than \$800 billion in 2022 alone—big money has also been involved and the trend has accelerated.

In what the FT described as a “gruesome December,” more than 40 percent was wiped off the value of Tesla shares leaving them two thirds lower than they were in late September. Some of this fall was no doubt due to Musk's takeover of Twitter, into which he has poured billions. But the underlying trend is clear—the demise of the share values of companies dependent on cheap money.

If the storms were confined to speculative areas of the market, they could perhaps be dismissed as “frothy” movements.

But one of the biggest of the recent period involved a supposedly stable area of the financial system—pension funds. The September-October crisis in the UK—only brought under control because of an intervention by the Bank of England (BoE)—threatened a financial crash of the £1.5 trillion British pension funding system.

The movement in the yields on 30-year UK government bonds on a single day, September 28 when the BoE decided to intervene, was larger than took place in most years.

Subsequent investigation has revealed that the crisis was not the outcome of peculiarities of the British pension system. Rather it was the expression of broader trends—the attempts by funds to meet their financial obligations by investing in riskier assets because the return on safe government bonds was so low under the previous low-interest rate regime.

This development promoted a warning from the Organisation for Economic Development (OECD) at the end of last month. Pension funds had to be “extremely careful” when searching for higher yields by investing in illiquid assets which cannot be readily turned into cash if the need arises.

When the financial system is operating smoothly, they have no need for cash. But if a sharp turn takes place, such as a rise in interest rates, cash becomes essential.

Speaking on the OECD findings, Pablo Antolin, of the organisation's Financial Affairs Division, said there was a need for pension funds to invest in more illiquid assets, but “we also have to be extremely careful because liquidity issues are very important in the management of investment strategies.”

The developing crisis goes across the board. As an FT editorial on the end of the cheap money era noted, higher interest rates would bring “casualties” and, given the uncertainty, market turmoil would continue.

“The combination is likely to shake out overbought assets and increase defaults. If rates rise further defaults will become more likely. That will not just be in developing and emerging economies, where distress is already visible. Highly leveraged ventures will be under pressure in high-income countries too.”

The implications for the working class of this deepening crisis are revealed not only in the repeated statements from the major central banks that in lifting interest rates their target is “tight” labour markets but in the actions of major corporations.

The chief US economist at RBC Capital Markets, Tom Porcelli, told the FT that with a weakening global economy, companies would try to protect their profit margins by “going after labour.”

His assessment was shared by Carl Riccadonna, chief US economist at BNP Paribas as he pointed to job cuts in the technology sector.

“As you face margin compression [reduced profit rates] and you try to defend against that, you're reducing overtime, you're freezing wages, freezing hiring, or even outright layoffs,” he said.



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