

A sharp warning on the state of the global economy

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In its annual report, the Bank for International Settlements (BIS), the umbrella organisation for central banks, has painted a picture of a world economy and financial system, increasingly fractured, full of contradiction, conflicts and vulnerabilities, amid a long-term global slowdown.

The report contrasted markedly with the relatively upbeat report presented year ago.

According to this year's assessment: "The prospects for the global economy have become much more uncertain and unpredictable in recent months, marking a notable departure from the relative optimism of the previous year when a soft landing was in sight. Trade disruptions now threaten to reshape the global landscape, as long-standing political and economic relations are being questioned." So read the opening sentences of chapter one of the report issued on Sunday.

The immediate focus is on US trade policy and the disruption of the Trump tariffs, with their "unknown eventual scope and impact." These have "elevated measures of economic uncertainty to levels typically associated with crises and sparked high volatility in financial markets."

Even before the Trump economic war, however, the world was "already grappling with significant vulnerabilities."

These are rooted in the very foundations of the global economy which the report noted in the introduction "is facing long-standing and emerging challenges. Productivity growth has been trending down in many advanced economies for decades and more recently in several emerging market economies, acting as a drag on overall economic growth."

Economies have become more vulnerable to inflation because of ageing populations and emerging labour shortages with trade fragmentation which "could further reduce supply flexibility."

On top of this, "high public debt in several jurisdictions makes the financial system vulnerable to interest rate rises, while reducing governments' ability to respond to adverse developments."

The use of the word "several" represents a significant

underestimation of the situation as the growing debt crisis is concentrated in the major economies.

The US has a debt of \$36 trillion, rising at what is universally characterised as an "unsustainable" rate. In the UK, which experienced a major crisis in 2022, there have been warnings of a bond market sell-off because of the high levels of debt. European countries, particularly France and Italy, are weighed down in debt, while the Japanese prime minister has likened the government's financial position to that of Greece in the 2010s.

The report said that while higher public debt levels are "sustainable in the presence of strong income growth and low interest rates, current and future conditions look less than favourable."

Again, that is something of an understatement for as the report itself continued, "economic growth is expected to remain subdued for the foreseeable future" and interest rates "may not return to the low levels observed in the pre-pandemic decade."

These mounting problems are compounded by major changes in financial markets flowing from the rise of private credit—so-called non-bank financial institutions (NBFIs). Their increased use in the financing of public debt "has heightened liquidity risks in bond markets, raising the potential for financial stability risks to emerge outside the traditional banking systems."

Elaborating on these risks, the report noted that "a growing share of long-term credit to small or medium-sized and highly indebted companies is provided by private credit funds," which are in turn funded by pension funds and insurance companies. The connections in this form of funding are "notoriously opaque."

The overall result is that "financial conditions as well as financial stability risks are increasingly influenced by players outside the traditional banking system." But the banks are ultimately involved because of the support they provide to the private markets.

The financial crisis of 2008, the report said, was primarily a banking crisis with mortgage markets at its core. But today

the landscape has “government bond markets at its centre and asset managers of various stripes as the key intermediaries.”

This is particularly the case in the repo, or repurchase, market where hedge funds use government bonds as collateral in very short-term borrowing from banks to finance highly leveraged trades.

“By using government securities as collateral in the repo markets to borrow cash for additional securities, these strategies boost returns but are also vulnerable to adverse shocks in funding, cash or derivative markets. This vulnerability has increased further as financing terms have become increasingly lax.”

Creditors, the report found, have “stopped imposing any meaningful restraint on hedge fund leverage.”

This leaves the broader market more vulnerable to disruptions because “even slight increases in haircuts [losses] can trigger forced selling and amplify financial instability”. That was evident both in the market turmoil in March 2020, at the start of the pandemic and in turbulence of April this year.

In response to the unexpected size of Trump’s “reciprocal tariffs” on “liberation day,” April 2, interest rates on government bonds spiked. But contrary to what normally takes place, the US dollar fell in international currency markets and for some days the market mantra was “sell America.”

The report pointed to the complex effects of tariff hikes in the conditions which now prevail.

“The global economy is not a collection of islands; it consists of a dense web of interconnections among suppliers, customers, consumers and the financial intermediaries that knit them together. Activity straddles the border, so that traded goods undergo many rounds of value added before finding their eventual customers.”

And the disruption of supply chains would again lead to “upside surprises in inflation.”

The issue of inflation raises before the BIS and all central banks—the guardians of the interests of finance capital—one of the issues of greatest concern, namely the response of the working class.

The report itself used carefully guarded language saying that “households ... may show less tolerance for real wage declines following the sharp rise in living costs after the pandemic.”

In his remarks on the report, BIS managing director Agustin Carstens was a little more direct.

“If evidence of de-anchoring [a code word for a rise in workers’ wages struggles because of the expectation of further price hikes] emerges, central banks must respond forcefully to inflationary shocks.”

That means interest rates must be lifted even if that pushes the economy into recession. In fact, the BIS report looked on such a development positively in regards to inflation, saying a global slowdown could be a mitigating factor in its development.

The BIS also bared its class teeth when it came to deal with the general slowdown and the growing fiscal crisis, reflected in the escalation of government debt.

It insisted that so-called “structural reforms” were the key to addressing the persistent challenges of low economic and productivity growth experienced by many economies in recent decades” and that such reforms were the only means to overcome this.

“Neither expansionary monetary policy nor expansionary fiscal policy can act as a lasting driver of long-term growth.”

In the capitalist economy, where “productivity” is ultimately based on the rate at which surplus value, the basis of profit, can be extracted from the working class, “structural reform” comes down to the reduction of the labour share of national income and the worsening of working conditions.

The same class dynamic was seen in BIS’s prescriptions for the reduction of government debt which it identified as the source of financial instability.

It said countries facing “large fiscal deficits and limited fiscal space must pursue fiscal consolidation.” But it ruled out achieving that by increased taxation on corporations and the wealthy saying that “relying heavily on tax-based consolidation could hinder growth further.”

Under conditions where all governments are increasing spending on the military to their highest levels in the post-war period, “fiscal consolidation” means deepening attacks on social services such as health, education and pensions, which in turn impacts on the working class, well beyond the levels already carried out.

The BIS report is a warning both as to the depth and growing intensity of the crisis of the global capitalist economy and the response of the ruling class and its state agencies to it.



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