Storm clouds gather over world economy

By Nick Beams
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The annual International Monetary Fund (IMF) and World Bank meetings concluded in Washington over the weekend in the midst of a deepening economic and financial crisis, with no prospect of a recovery in the world economy.

The euro zone seems set to enter its third recession since the global financial crisis erupted in 2008, and there are fears that the policies being pursued by the world’s major central banks are creating the conditions for another crash.

The IMF and World Bank meetings were held following the release of data showing that Germany could be moving into a recession. Industrial production dropped 4 percent from July, the biggest decline since January 2009. New orders for September fell at their fastest pace since 2009, according to a survey of purchasing managers.

Output of investment goods slumped 8.8 percent in August, intermediate goods were down 1.9 percent, consumer goods fell 0.4 percent, and construction dropped by 2 percent. Only energy output increased, by 0.3 percent.

The IMF cut its forecast for German growth for 2014 from 1.9 to 1.4 percent and downgraded its 2015 prediction from 1.7 to 1.5 percent. Even these predictions are likely to be too optimistic, since Germany’s economy shrank in the second quarter of this year. Germany, which depends highly on exports, is being hit by stagnation across Europe, its largest single market, as well as recession in Brazil, another key market, and the marked slowdown in Chinese growth.

The world slump, growing uncertainties over the direction of central bank policies and increasing geo-political tensions in Ukraine and the Middle East are all combining to create volatile conditions in financial markets.

Trading on Wall Street opened this week with the S&P 500 Index experiencing its worst three-day loss since 2011, led by falls in airline shares as a result of the Ebola crisis and declines in energy stocks as the price of oil hit its lowest point in four years. Monday’s losses came after a week in which $1.5 trillion was wiped off the value of global equities.

Fears of another financial crisis prompted US and British financial officials to organise a war game yesterday in which they sought to ascertain whether lessons had been learned from the 2008 crisis. Reporting on the war game on Sunday, Larry Elliott, the Guardian economics correspondent, summed up the atmosphere at the IMF meeting.

“The Fund’s annual meeting was like a gathering of international diplomats at the League of Nations in the 1930s. Those attending were desperate to avoid another war but were unsure how to do so. They see dark forces gathering but lack the weapons or the will to tackle them effectively.”

Elliott pointed out that the IMF and central bankers are well aware that pumping money into the financial system has not boosted the real economy through expanded investment and increased production, but led only to increased financial risk-taking. At the same time, they fear that lifting interest rates to halt speculation will push their economies into recession, and so they “cross their fingers and hope for the best.”

The IMF, he continued, knows something is going “badly wrong in Europe, but was powerless to do anything about it.”

Clear evidence of the gathering slump is provided by the sharp declines in commodity prices. Oil prices are reported to be in “free fall,” with benchmark Brent Crude down 24 percent since the middle of the year. The International Energy Agency says oil prices have been “weighed down by abundant supplies” and weakening demand.

The price of iron ore, a key indicator of investment
because of steel’s role in construction, has dropped by 41 percent this year to its lowest level for five years. The Bloomberg industrial metals index is down 37 percent from its highest point after the financial crisis and 50 percent below the levels reached in 2007.

The price of gold is 38 percent off the high it reached in 2011. Agricultural product prices, another key indicator, are also sharply down. Corn prices are 22 percent lower than they were in June, wheat is down by 16 percent over the same period, and soybean prices have fallen 28 percent to their lowest level in four years.

The growing slump is compounded by uncertainty and confusion in financial markets. Last week, the US Federal Reserve Board released the minutes from the September meeting of its policy-making committee, revealing that “some participants expressed concern that the persistent shortfall of economic growth and inflation in the euro area could lead to a further appreciation of the dollar and have adverse effects on the US external sector.” The Fed’s vice-president, Stanley Fisher, has said that the central bank will monitor the impact of the dollar’s strength on the level of global demand for US goods and services.

The minutes raised questions over how far and how fast the Fed will seek to raise interest rates to more normal levels. The risk of turbulence results from the fact that while the Fed is ostensibly on an ill-defined path back to higher rates, the European Central Bank (ECB) and the Bank of Japan are pushing rates down. This creates the conditions for so-called carry trades, where investors borrow at lower rates in international markets and then invest in US assets, pushing up the value of the dollar and impacting US exports.

The uncertainty over the direction of Fed policy has contributed to a sharp rise in the VIX volatility index, which tracks movements on US share markets. It has increased by 21 percent over the past week, following months of what was described as an “eerie calm.”

The problems in financial markets are exacerbated by differences in the policies of the major economic powers, which emerged into the open at a seminar organised during the IMF meeting.

Centering his fire on Germany, former US Treasury Secretary Lawrence Summers, who last year warned of the prospect of “secular stagnation” for the world economy, criticised Europe’s “dismal” economic performance, comparing it to the two-decades-long stagnation in Japan and the Great Depression of the 1930s.

German Finance Minister Wolfgang Schäuble struck back, dismissing the suggestion that the crisis was the outcome of European policy failings. “America was the cause of the crisis, to be frank,” he said.

The US, as well as the IMF, wants the ECB to extend its asset-buying program to the purchase of government bonds in order to increase financial stimulus. But ECB President Mario Draghi has said the ECB is close to the limit of what it can do. In 2012, Draghi managed to avert a financial crisis originating in Spain, Greece, Portugal and other highly indebted euro zone countries by declaring that the ECB would do “whatever it takes.”

As six years of central bank interventions have demonstrated, however, injections of money cannot bring about increased investment and production in the real economy, which is where the crisis is now centered. The only beneficiaries are the banks, finance houses and ultra-wealthy speculators.

Moreover, there are deep divisions in the ECB itself. German representatives have already voted against the present round of asset purchases and are certain to stridently oppose any central bank move to buy up government bonds and extend quantitative easing.

The IMF discussions presented a picture of a ruling class in disarray. Divided over what to do and unable to advance a program to promote anything remotely resembling an economic recovery, the ruling elites are acutely aware they are sitting on a powder keg. They are united only by their fear that the worsening social conditions and deepening inequality produced by the breakdown of the economic order over which they preside will provoke an explosion of social struggles from below.

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