OECD cuts global growth forecast amid growing financial turbulence

By Nick Beams
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The Organisation for Economic Cooperation and Development has issued a downbeat assessment on the state of the world economy as it cut its forecast for global growth this year from 3.7 percent to 3.1 percent in its semi-annual report issued Wednesday.

The 34-member organisation, which covers the world's major economies, said that with big companies reluctant to spend money on new investment—plant, equipment and new technology—as they had in past periods of "recovery," the lack of demand was holding back employment, wages and consumption spending.

The OECD assessment is in line with statements from the International Monetary Fund, the World Bank and major economic think tanks, all of which point to the perilous state of investment spending.

In an editorial comment accompanying the report, OECD chief economist Catherine Mann noted that recovery from the financial crisis of 2008 had been unusually weak and the starting point for its latest assessment was "inauspicious."

"The first quarter of 2015 was the weakest global growth since the crisis. The United States experienced a particularly sharp dip [contracting by 0.7 percent in the first quarter this year], but a number of other advanced economies shrank during the quarter, and growth in China slowed down more than expected," she wrote.

Mann tried to put an optimistic gloss on the situation, saying the OECD saw the poor figures as largely the result of temporary factors.

"But even if we are right about the transitory nature of the latest bout of weak growth, the outlook is not satisfactory. Despite tailwinds and policy actions, real investment has been tepid and productivity growth disappointing," she added.

The slower rate of investment was explained by a lack of expected demand both at home and globally, with the consequent lack of investment spending in turn holding back employment, wages and consumption. "The world economy remains stuck in a low-level supply-demand equilibrium environment."

A jump was needed to achieve a high-level equilibrium but she was not able to point to any clear sign of that taking place. Even if investment picked up in line with the OECD's prediction of a 4 percent rise next year "this would still be insufficient to deliver the strong global growth in the near term needed to increase employment and reduce inequality."

The stagnation in the world economy and the persistence of contractionary trends is being accompanied by growing signs that conditions in financial markets are building toward another crisis.

This week has seen further turbulence on European bond markets. On Wednesday the yield on German 10-year bonds—Bunds—hit 0.897 percent, the highest since October last year, indicating a major fall in their price (yields move in inverse relation to prices) as speculators sold off their holdings. The turmoil was accompanied by a statement from European Central Bank president Mario Draghi, following a meeting of the ECB that markets had to "get used" to volatility in the era of ultra-low interest rates.

Yesterday the sell-off continued, with the yield on Bunds rising to close to 1 percent before finishing down 5 basis points for the day.

These sharp movements, coming in the wake of a series of financial storms—the sudden spike in yields last October and the rapid movement of the Bund last month among others—have given rise to concerns that with a sustained "rush for the exits" there will be insufficient liquidity in financial markets to accommodate all those who want to get out.

In a comment published this week, well-known New York-based global economist Nouriel Roubini pointed to a "liquidity time bomb" in financial markets. The longer central banks supply money at ultra-cheap rates the more they feed bubbles in equity, bonds and other asset markets. "As more investors pile into overvalued, increasingly illiquid assets such as bonds, the risk of a longer-term crash increases," he wrote.

Yesterday the International Monetary Fund added to concerns over the stability of financial markets when it issued advice to the US Federal Reserve not to begin lifting interest rates until some way into next year.

There are fears that a normalised interest rate policy would have major global consequences as investors pull money from so-called emerging markets in Latin America and Asia and return it to the US where it could bring a higher yield.

A preview of what could take place occurred in the middle of 2013 after hints by former Fed chairman Ben Bernanke that US central bank would start to ease off its purchases on financial assets gave rise to the so-called "taper tantrum."

The consequences of any decision to begin raising official rates from their present levels of between zero and 0.25 percent could have even more serious consequences, under conditions where European bond markets are looking increasingly unstable.

Speaking to reporters, IMF managing director Christine Lagarde said the conditions were not yet right for the Fed to begin to lift rates. She said that the Fed's expected move had been "carefully prepared and telegraphed" to financial markets but then added: "Nonetheless, regardless of the timing, higher US policy rates could still result in significant market volatility with financial stability consequences that go well beyond the US borders."

In other words, global markets are so addicted to the supply of ultra-cheap money by the world's central banks that even though they have been warned it could start to be turned off, they will go into an uncontrollable spasm when the decision is actually taken.

The authors of the report, upon which Lagarde based her remarks, warned that there were still "significant uncertainties as to the future resilience of economic growth" in the U.S.. "Raising rates too soon could trigger a greater-than-expected tightening of financial conditions or a bout of financial instability, causing the economy to stall," they said.

This would mean that the Fed would have to reverse its decision and move rates back down to zero with "potential costs to its credibility." Given the likelihood and severity of risks there was a strong case for delaying any decision to lift rates.

Another indication that the world's central bankers have no coherent set of policies and no idea as to how a more "normal" regime might be introduced, nor what its consequences might be, was revealed in extraordinary remarks delivered by the governor of Japan's central bank, Haruhiko Kuroda, Thursday.

Opening a two-day conference on monetary policy, he drew a parallel between the bank's program of quantitative easing and the story of Peter Pan. "I trust that many of you are familiar with the story of Peter Pan, in which it says, 'the moment you doubt whether you can fly, you cease forever to be able to do it'," he said.

Kuroda said what was needed was a "positive attitude and conviction" and every time central banks had been confronted with problems, "they have overcome the problems by conceiving new solutions."

In fact, as events in the US and Europe this week show, the central bankers' "fairy dust" solutions have only created the conditions for another global financial crisis, with potentially even more devastating consequences than that of 2008 for billions of working people the world over.