After Brexit, mounting warnings of global slump and financial panic

By Andre Damon
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The global economic fallout of Thursday's referendum by Britain to leave the European Union continued over the weekend amid growing warnings that the ongoing market sell-off, which wiped $2.5 trillion from the values of world equities markets Friday, is only the most visible manifestation of a much deeper crisis of the global economy.

Over the past month, both the International Monetary Fund and Federal Reserve chairwoman Janet Yellen have warned in effect that the US and world economy face conditions comparable to what some economists have called "secular stagnation," characterized by a long-term reduction in growth rates.

On Sunday, the Bank for International Settlements (BIS), sometimes referred to as the "central bankers' bank," added its voice to this chorus. It warned of deep-rooted problems in the global economy.

The report, which was drafted prior to Thursday's referendum, said the world economy was "threatened by a 'risky trinity': debt levels that are too high, productivity growth that is too low, and room for policy manoeuvre that is too narrow." It cast doubt on the ability to continue to combat crises with monetary policy.

These warnings came as virtually every global central bank issued a statement saying it would either begin or was ready to implement a further expansion of liquidity measures in response to the share selloff. Markets are increasingly betting that the Federal Reserve will halt, or even reverse, its announced plans to begin raising interest rates.

In the latest such measure, the Japanese government of Prime Minister Shinzo Abe and the Bank of Japan, announced the provision of additional funds to the financial system. This fueled a small stock market rally in early trading Monday, despite continued turbulence in global currency and other equity markets and the on-going sell-off of the British pound, which fell two percent.

The BIS warned that the response of global central banks to the crisis that erupted in 2008 had been dominated by the creation of asset bubbles through low interest rate policies. These conditions have weakened productive investment, fueled a global expansion of debt, making it near impossible for central banks to respond in an effective manner to the eruption of new crises.

"The global economy cannot afford to rely any longer on the debt-fueled growth model that has brought it to the current juncture," warned the report, adding "we badly need policies that we will not once again regret when the future becomes today."

The report, on technical grounds, rejected the use of the term "secular stagnation," a concept developed in the 1930s to describe the Great Depression and used by former Treasury Secretary Lawrence Summers to refer to the current crisis. But the content of its analysis amounted in effect to the same thing.

"The crisis appears to have permanently reduced the level of output," it said, adding, "given the almost unprecedented breadth and depth of the recent crisis, it would be unrealistic to think that output could regain its pre-crisis trend."

The report pointed to the "persistent and otherwise puzzling" global slowdown in productivity growth. It tellingly attributed the slowdown to the effect of a massive series of booms and busts that have characterized the global economy in recent years as it has become increasingly dominated by financialization and speculative mania, fueled by virtually unlimited cash from global central banks.

The BIS warned that these policies facilitated "the persistence of exceptionally low interest rates, increasingly negative even in nominal terms.” The growth of negative interest rates, promoted by central banks seeking to reassure the markets, is a risk with “a long fuse, with the damage less immediately apparent and growing gradually over time. Such rates tend to depress risk premiums and stretch asset valuations, making them more vulnerable to a reversal by encouraging financial risk-taking.”

This refers to a situation where, because interest rates are pushed down on relatively secure assets, speculators have to undertake increasingly risky bets to secure the same rate of return as they did in the past.

In other words, all the actions taken by global central banks since the 2008 crisis, and stretching back as far as the US Federal Reserve’s response to the 1987 stock market crash, have only exacerbated the cancerous growth of financial parasitism. This is the “fuse” that triggered what the BIS calls the “Great Financial Crisis” of 2008, and threatens to blow up again.

The report pointed to the continuation of extraordinarily accommodative monetary policy, leading to an even further build-up of debt trading at negative yields, a phenomenon the BIS first warned about in last year’s annual report. In that period, “Inflation adjusted policy rates have edged deeper below zero, continuing the longest postwar period in negative territory.” It added that “the Bank of Japan has joined the ECB, Sweden’s Riksbank, Denmark’s Nationalbank and the Swiss National Bank in adopting negative nominal policy rates.

As a result, “at the end of May, close to $8 trillion in sovereign debt, including at long maturities, was trading at negative yields—a new record.”

Due to the continuous infusions of cash into world markets, “monetary policymakers have found it harder to push inflation back in line with objectives,” leading to economic slump. It added, “In the process, financial markets have grown increasingly dependent on central banks’ support and the room for policy manoeuvre has narrowed.” These facts are already “shaking public confidence in policymaking.”

Tellingly, however, the BIS had no solution to the ongoing crisis besides further austerity measures. It called for slashing government debt while improving the “quality of public spending… notably by shifting the balance away from… transfers.” In other words, too much is being spent on social services—such as Social Security, Medicare, and Medicaid in the United States—and not enough is being subsidizing business activity.

In reality, these types of fiscal austerity measures and labor market restructuring called for by the BIS have been brought forward in every major economy in response to the 2008 crisis. These range from the United States, where state education spending has been slashed by 25 percent, to Greece, Spain, Portugal, and, most recently, in France, with the implementation of the El Komri labor reforms by the Hollande government.

These policies have transferred ever-more wealth to the financial elite, who have proceeded to use their cash hoards for speculation and financial parasitism, fueling a vicious cycle of economic stagnation, rising inequality and financial crisis, in turn inflaming international antagonisms and the growth of protectionism.