# A Warning From the Bank for International Settlements (BIS): The Calm Before the Storm?

By Mike Whitney
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*The Bank for International Settlements (BIS) is worried that recent ructions in the equities markets could be a sign that another financial crisis is brewing. In a sobering report titled "Uneasy calm gives way to turbulence" the BIS states grimly: "We may not be seeing isolated bolts from the blue but the signs of a gathering storm that has been building for a long time."*

The authors of the report are particularly concerned that the plunge in stock prices and the slowdown in global growth are taking place at the same time that investor confidence in central banks is waning. The Bank Of Japan's announcement that it planned to introduce negative interest rates (aka–NIRP or negative interest rate policy) in late January illustrates this point. The BOJ hoped that by surprising the market, the policy would have greater impact on borrowing thus generating more growth. But, instead, the announcement set off a "second phase of turbulence" in stock and currency markets as nervous investors sold off risk assets and moved into safe haven bonds. The BOJ's action was seen by many as act of desperation by a policymaker that is rapidly losing control of the system. According to the BIS:

> "Underlying some of the turbulence of the past few months was a growing perception in financial markets that central banks might be running out of effective policy options."

This is a recurrent theme in the BIS report, the notion that global CBs have already used their most powerful weapons and are currently trying to muddle-by with untested, experimental policies like negative rates that slash bank profitability while having little impact on lending.

While the BIS report provides a good rundown of recent events in the financial markets, it fails to blame central banks for any of the problems for which they alone are responsible. The sluggish performance of the global economy, the massive debt overhang, and the erratic behavior of the stock market are all directly attributable to the cheap money policies coordinated and implemented by central banks following the Great Recession in 2008. It's hard to believe that the BIS's failure to insert this fact into its narrative was purely accidental.

But the real problem with the BIS report is not that it refuses to assign blame for the current condition of the markets and the economy, but that it deliberately misleads its readers about the facts. While it's true that China is facing slower growth, oil prices are plunging, emerging markets have been battered by capital flight, and yields on junk bonds are relentlessly rising, it's also true that central bank policy is not primarily designed to address these problems, but to ensure the continued profitability of its main constituents,  the big banks and mega-corporations. Keep in mind, the global economy has been sputtering for the last 6 years, but the BIS has only expressed alarm just recently.  Why? What's changed?

What's changed is profits are down, and when profits are down,  Wall Street and its corporate allies lean on the central banks to work the levers to improve conditions. Here's more on the so called "earnings recession" from an article in the *Wall Street Journal* titled "S&P 500 Earnings: Far Worse Than Advertised":

> "There's a big difference between companies' advertised performance in 2015 and how they actually did.
>
> How big? ….S&P earnings per share fell by 12.7%, according to S&P Dow Jones Indices. That is the sharpest decline since the financial crisis year of 2008. Plus, the reported earnings were 25% lower than the pro forma figures—the widest difference since 2008 when companies took a record amount of charges.
>
> The implication: Even after a brutal start to 2016, stocks may still be more expensive than they seem. Even worse, investors may be paying for earnings and growth that aren't anywhere near what they think. The result could be that share prices have even further to fall before they entice true value investors." ("S&P 500 Earnings: Far Worse Than Advertised", Wall Street Journal)

Profits are down and stocks are in trouble. Is it any wonder why the BIS is running around with its hair on fire?

Also, corporate earnings have dropped for two straight quarters which is a sign that the economy is headed for a slump. Take a look at this clip from CNBC:

> "Recessions have followed consecutive quarters of earnings declines 81 percent of the time, according to an analysis from JPMorgan Chase strategists, who said they combed through 115 years of records for their findings."(CNBC)

"81 percent" chance of a recession?

Yep.

This is what the BIS is worried about.  They could are less about China or the instability they've created with their zero rates and cheap money policies. Those things simply don't factor into their decision-making. It's all just fluff for the sheeple. Here's more from Jim Quinn at Burning Platform:

> "The increasing desperation of corporate CEOs is clear, as accounting gimmicks and attempts to manipulate earnings in 2015 has resulted in the 2nd largest discrepancy between reported results and GAAP results in history, only surpassed in 2008…..Based on fake reported earnings per share, the profits of the S&P 500 mega-corporations were essentially flat between 2014 and 2015…..earnings per share plunged by 12.7%, the largest decline since the memorable year of 2008….

With approximately $270 billion of "one time" add-backs to income used to deceive the public, the true valuation of the median S&P 500 stock is now the highest in history – higher than 1929, 2000, and 2007. Wall Street's latest con game, with the active participation of corporate CEO co-conspirators, is a last ditch effort to fend off the inevitable stock market crash….All economic indicators are flashing red for recession. Stocks are poised for a 40% decline faster than you can say Wall Street criminal banks." ("The Great Corporate Earnings Fraud", Burning Platform)

Get it? When the profitability of the world's biggest corporations are at stake, the central banks will move heaven and earth to lend a hand. This was the basic subtext of the discussions at the recent G-20 summit in Shanghai, China. The finance ministers and central bankers wracked their brains for two days to see if they could settle on new strategies for boosting earnings. In fact, the austerity-minded IMF even called on the G-20 to support a coordinated plan for fiscal stimulus to boost activity and decrease the risks to the equities markets. Unfortunately, finance ministers balked because fiscal stimulus puts upward pressure on wages and shifts more wealth to working stiffs. That's why the idea was shelved, because the oligarchs can't stand the idea that workers are getting a leg-up. What they want is a workforce that scrapes by on minimum wage and lives in constant fear of losing their job. The class war continues to be a top priority among the nations voracious CEOs and corporate bigwigs.

The "failed" G-20 summit was clearly a turning point for the markets. Now that the central banks are out of ammo, the only hope to keep stock prices artificially high rested on Keynesian fiscal stimulus injected directly into the real economy. That hope was extinguished at the meetings. The prospect that equities can continue to climb higher in the face of shrinking profits, tighter credit, slower growth and bigger corporate debtloads is unrealistic to say the least. Just check out this excerpt from a recent article at Bloomberg:

> "Companies still have a little time before they must pay down the bulk of $9.5 trillion of debt maturing in the next five years….But it's not getting any easier for these corporations to borrow, at least not in the U.S. In fact, many of these obligations are becoming harder and more expensive to repay at a time when companies face a historic pile of bonds and loans coming due.
>
> It's not terribly surprising that companies have a bigger debt load to pay down. They borrowed trillions of dollars on the heels of unprecedented stimulus efforts started by the Federal Reserve at the end of 2008 during the worst financial crisis since the Depression. They kept piling on the leverage as central banks around the world doubled down on low-rate policies and kept purchasing assets to encourage investors to buy riskier securities…."("Scaling the $9.5 trillion debt wall, Bloomberg)


Chart: [macronomy.blogspot.com](macronomy.blogspot.com)

What the author is saying is that central bank policy seduced corporations into borrowing tons of money that they frittered-away on stock buybacks and dividends, neither of which create the revenue streams necessary to repay their debts. So rather than build their companies for the future, (Business investment is at record lows) corporations have been behaving the same way the Wall Street banks acted before the Crash of '08. They've been borrowing trillions from Mom and Pop investors via the bond market, goosing their share prices through stock buybacks, increasing executive compensation, and dumping the money in offshore accounts. Now the bill is coming due, and they don't have the money to repay the debt or the earnings-potential to avoid default. Something's gotta give.

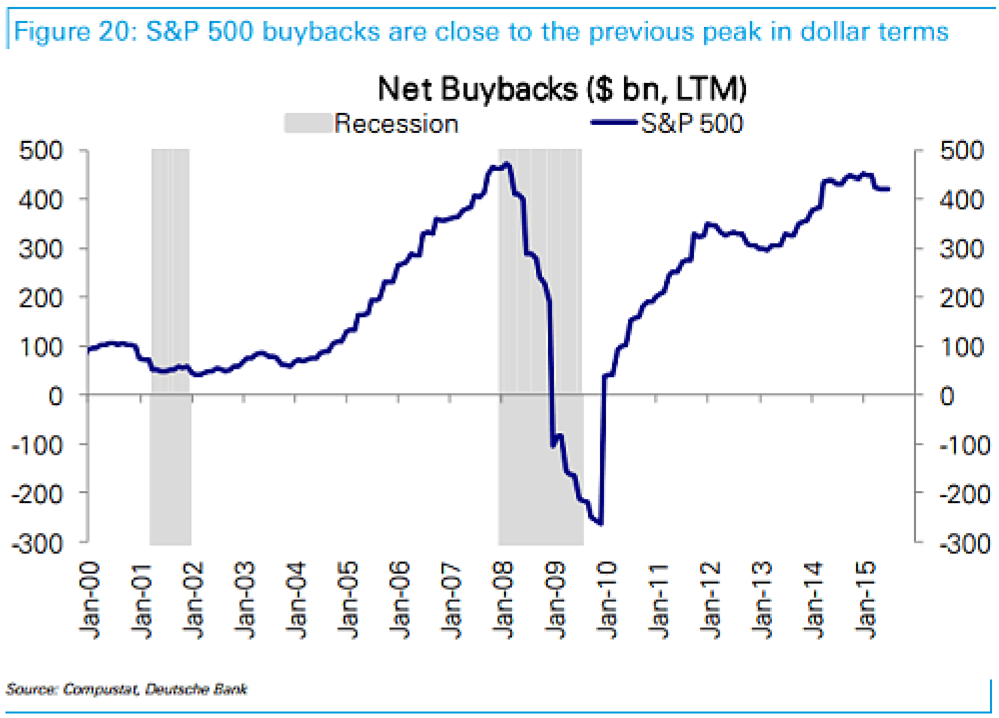

Chart: Burning Platform

Corporate red ink is one of many reasons why the BIS thinks "We may not be seeing isolated bolts from the blue but the signs of a gathering storm that has been building for a long time." Like the gigantic asset-price bubble in stocks, it's a sign that the economy and the markets are headed for a long and painful period of adjustment.

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