

# Global Financial Asset Deflation Underway: Prelude to Next 'Great Recession'?

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Theme: [Global Economy](#)

*This morning, Monday, March 9, financial asset markets continue to implode: US stocks are further collapsing -6% (Dow down 1650, Nasdaq >500 mid-day). Ditto Asian and Europe stock markets -6%. They were already declining sharply last week due to coronavirus induced supply chain shocks (reducing production) and expanding demand shocks (consumer spending contraction in select industries like travel, hotels, entertainment)—all of which are being forecast by investors to whack corporate earnings in 2Q20 big time.*

*But imposed on the equities market crash of the past 2 weeks now is the acceleration of the global oil price deflation that erupted yesterday as the Saudis deal with Russia last year to cut production and prop up prices fell apart. Collapsing oil & commodities futures prices are now feeding back up equities and other financial asset prices. Financial price deflation spreading, including to currency exchange rates. Money capital fleeing everywhere into 'safe havens' (gold, Treasuries, Yen). Historic decline of US Treasuries now below 1% (30 yr.) and .5% (10 yr).*

Will the financial asset markets deflation soon spill over to the credit system (especially corporate bonds) and accelerate the decline of real economies worldwide in turn? Are traditional monetary & fiscal policy tools now less effective compared to 2008-09? If so, why? Is the global economy on the precipice of another 'great recession'?

## Financial Asset Markets Imploding

So we have oil futures market prices—i.e. another financial asset market—collapsing now and impacting the stock markets. In other words, a feedback contagion underway on stocks market prices in turn. Feedback is occurring as well on other industrial commodity futures prices that are following oil futures prices downward in tandem. But that's not all the financial contagion and deflation underway.

The freefall in financial assets (stocks, oil, commodities) is also translating into currency exchange price deflation in turn, especially in emerging market economies in Latin America, Africa, Asia highly dependent on commodity sales with which to earn needed foreign exchange with which to finance their past debt (e.g. case of Argentina whose negotiations with IMF on how to restructure their debt will now break down, I predict).

Currency exchange rates are in sharp decline everywhere as a result. For emerging market economies that means money capital is more rapidly flowing out of their economy, toward safe havens globally like the US dollar, US Treasury bonds, gold, and the Japanese Yen currency.

In short, stocks, oil-commodity futures, and forex currency markets are all imploding and

increasingly feeding back on each other in a general deflating downward spiral. This is a classic 'cross-contagion effect' that occurs in financial asset market crashes. And crashing financial markets eventually have the effect of contracting the real economy in turn, by freezing up what's called the credit markets. Businesses can't roll over their loans and refi their corporate bonds. Banks stop lending. The rest of the real economy then contracts sharply. It starts in the financial markets, spreads to credit markets (corporate junk bonds, BBB corporate bonds, then top grade bonds).

### Coronavirus Effect as Precipitating Cause

But it even earlier begins in a slowing real US and global economy that precedes the markets crash. The global economy was already weakening seriously in 2019. The US economy at year end 2019 was also weak, held up only by household consumption. Business investment had already contracted nine months in a row in 2019 and inventories built up too much. And, of course, the Trump trade war took its toll throughout 2018-19.

Then came the Coronavirus which shut down supply chains in China, and then in So. Korea and Japan in turn. That then began impacting Europe, already weakened by the trade war (especially Germany) and Brexit concerns. The supply chain economic impact of the virus developed into a consumer demand economic impact as well, as travel spending was reduced (airlines, cruise ships, hotels, resorts, etc.) and now, in latest development, other areas of consumer spending too. Both supply chain (production cutbacks) and demand (consumption cutbacks) are interpreted by investors as leading soon to a big fall in corporate earnings—which translates in turn into stock price collapse we see now underway. Investors have decided the 11 year growth cycle is over. They're cashing in and taking their money and running to the sidelines, moving it from stocks to cash or Treasuries or gold or other near liquid financial assets.

So the Coronavirus event is really a 'precipitating cause' of the current markets crash. The real economy weakness was already there. The virus just accelerated and exacerbated the process big time. (see my 2010 book, 'Epic Recession' for explanation how financial causation comes in different forms as precipitating causes, enabling causes, and fundamental causes. Book reviews are on my website). Again, worth repeating: global and US economies were weakening noticeably in late 2019. The virus further impacted supply chains (production) and demand (consumption), reduced corporate earnings in the near term and thereby simply pushed stock markets over the cliff.

### Mutual Feedback Effects: Real & Financial Economies

But financial crashes have the effect of feeding back into the real economy as well, causing it to contract further in turn. What starts as a weakening of the real economy that translates into financial markets crashing, in turn feeds back into a further weakening of the real economy. Mainstream economists don't understand this 'mutual feedback effect'; don't understand the various causal relationships between financial asset cycles and real investment cycles. (For my explanation of this relationship there's my 2016 book, 'Systemic Fragility in the Global Economy' and specifically chapters on the need to distinguish between financial asset investing and real investing and how late capitalism's financial structure has changed such that the inter-causal effects of financial-real investment have deepened and intensified.) Financial crashes accelerate and deepen the contraction of the real economy. Recessions turn into 'Great Recessions' as in 2008-09. They may even turn into bona fide 'Depressions' as in the 1930s should the banking system not get bailed out

quickly.

### Corporate Bonds & Credit Markets Next?

The feedback effect of the current financial asset price deflation—now underway in stocks, commodity futures, forex, (and derivatives)—on the real economy will soon emerge as the financial markets deflation affects the various credit markets. The key credit market is the corporate bond market. Bond markets are far more important to capitalism than equity-stock markets. The credit markets to watch now are the corporate junk bonds (sometimes called high yield corporates). Junk bonds are debt issued to companies that have been performing poorly for years. They are kept alive by banks helping them issue their bonds at high interest rates. Investors demand a high rate because the companies may not survive. In good times they do. But when markets and economies turn down, companies over loaded with junk financing typically default—i.e. can't pay the interest or principal on their bonds. They go under. The investors that bought their risky bonds are then left holding their debt that becomes near worthless. The US junk bond market today is 'worth' more than \$2 trillion. At least a third of that is oil & energy (fracking) companies. A large part of their bonds must be rolled over, refinanced, in 2021. But many of them will not be able to refinance. Why? Because global oil prices have just collapsed to \$30 a barrel, perhaps falling further to \$20 a barrel. At that price, the oil-energy junk bond laden companies will not be able to refinance. They will default. That will spread fear and contagion to other sectors of the \$2 trillion junk bond sector—especially big box and other retail companies (e.g. JC Penneys, etc.) that also loaded up on junk financing in recent years. Investors will disgorge themselves of junk bonds in general.

The fear of a crash in junk bonds will almost certainly spread to other corporate bonds, first to what's called BBB grade corporates. That's another \$3 trillion market. But most of BBBs are really also junk that's been improperly reclassified as BBB, the lowest (unsafe) level of corporate Investment grade bonds (the safest). So at least \$5 trillion in corporate credit is at risk for potential default. If even a part defaults, it will send shock waves throughout the corporate economy that will have very serious implications—for both the financial and real economies, US and global, which are increasingly fragile.

### Is Another 'Great Recession' on the Horizon?

For example, Japan is already in recession as of late last year. Now it's contracting, reportedly, by 7% more. Europe was stagnant at best, with Italy and Germany slipping into recession before the virus hit. So. Korea and Australia are in recession now, as other economies in Asia and Latin America are now contracting as well. China economy reportedly will come to a halt in terms of GDP this quarter, or even contract, according to some sources. Meanwhile, Goldman Sachs forecasts the US economy growth will stall to 0% in the second quarter 2020.

So a collapse in risky corporate bonds will occur overlaid on this already weak real economic scenario. Should that happen, then the recession could easily morph into another 'great recession' as in 2008-09; maybe even worse if the banking system freezes up and central banks cannot bail them out quickly enough. Or if banks in a major economy elsewhere experience a crash—as in India or even Europe or Japan where more than \$10 trillion in non-performing bank loans exist—and the contagion spreads rapidly to banking systems elsewhere

Which leads to the question can central banks now do so? After the 2008-09 crash, the Fed bailed out the US banks by 2010. But it kept interest rates near zero under Obama for six more years. Banks could still get free money from the Fed at 0.15% interest. (The Fed then paid them 0.25% if they left the money with the Fed). The Fed bailed out other financial companies to the tune of \$5 trillion more as it bought up bad loans and Treasuries from investors at above then market rates. That is, it subsidized them. And did so for six more years. All this free money flowed, mostly into financial markets in the US and worldwide, creating the stock bubbles that are now imploding. So the Fed and other central banks went on a binge subsidizing banks for years, and in the process broke their own interest rate tool needed for instances like the present crisis. The Fed tried desperately to raise interest rates in 2017-18 so it could have a cushion for times like this. But it then capitulated to Trump and began reducing interest rates again in 2019-as it had under Obama for six years.

The free money from the Fed artificially boosted stock prices. On top of this Trump added a further subsidization of banks and non-bank corporations, businesses, and investors with his \$4.5 trillion 10 year tax cuts passed January 2018. Most of that went as a windfall to corporate-business bottom lines. 23% of the 27% rise in corporate profits in 2018 is attributable to the windfall tax cuts. And where did that go? It too was redirected to stock and other financial markets, further inflating the bubbles. Here's the channel and proof: Fortune 500 corporations in the US alone spent \$1.2 trillion in both 2018 and 2019 in stock buybacks and dividend payouts to their shareholders. The stock buybacks inflated the stock markets, and most of the dividend payouts did as well. (Buybacks+dividends under Obama were nearly as generous, averaging more than \$800 billion a year for six years).

In other words, the 25% run up in US stock markets in 2017-19 under Trump was totally artificial, driven by the tax cuts and by the Fed capitulating to Trump and lowering rates again in 2019. Very little of the annual \$1.2 trillion went into the real US economy. For the past year real investment in structures, plant, equipment, etc. actually contracted for nine months in 2019, and is now contracting even faster in 2020.

Just as the Fed has busted its own interest rate monetary tool as it continually subsidized banks and businesses with low interest rates for years, the chronic corporate-investor tax cutting has busted fiscal policy responses to recession as well. Since 2001 the US has provided \$15 trillion in tax cuts, the vast majority of which have gone to corporations, banks, and wealthy investors. That has led to government deficits averaging more than \$1 trillion a year since 2008. And accelerated the US federal debt to more than \$22 trillion. Fiscal policy is now seriously constrained by the deficits and debt-just as monetary policy as interest rates is now constrained by virtually all Treasury bond rates below 1% in the US and negative rates in Europe and Japan.

Interest rate policy responses to today's emerging crisis is thus dead in the water. (As this writer predicted it would become in 2016 in the book, 'Central Bankers at the End of Their Rope: Monetary Policy and the Coming Depression'). After years of monetary policy used as a tool to subsidize banks, it is now ineffective as a tool to stabilize the economy. Ditto for fiscal policy as tax policy. Used by Obama and even more so by Trump to subsidize corporations, stock buybacks, and financial markets, it is confronted by massive annual US budget deficits and accelerating national debt.

The likely responses by politicians and policy makers to the current emerging financial crisis

and recessions in the real economy will be to cut taxes even further for businesses. It will have little effect, however. But will exacerbate levels of deficit and debt. That means the follow up will be to attack and reduce government spending, especially targeting social security, medicare, healthcare and education in 2021. Trump has already publicly indicated his intent to do so. On the Fed side, expect more injection of money directly into the economy and failing businesses by means of another major round of 'quantitative easing' (QE). That's coming soon. Ditto for Europe and Japan where negative rates already exist. Watch China too should its economy contract for the first time in 30 years. And watch India, where it's banking system is already fracturing due to causes totally separate from the virus effect. A banking crash in India is on the agenda. It could result in yet another financial blow to the global economy, adding to the current Saudi-produced oil price shock and the virus effect on supply chains and demand.

## Summary and Conclusions

In summary, the global capitalist economy is unraveling financially, and soon further in real terms. Massive job layoffs in coming months in the US are a growing possibility. That will drive the US economy deep in contraction as household consumption, the only area holding up the US economy in 2019, now joins the contraction. It remains to be seen how US monetary and fiscal policy can restore economic stability given its self-destruction by US politicians since 2008. Trump policies have been no different than Obama's-just more generous to corporate America and investors. Trump's policies are best described as 'Neoliberalism 2.0' or 'Neoliberal on steroids'. (see my just published 2020 book, 'The Scourge of Neoliberalism: US Economic Policy from Reagan to Trump').

The US and global economies are well on their way to a repeat of the 'great recession' (or worse) of 2008-09. Only this time traditional monetary-fiscal policy is much less effective. More radical policy responses will likely be developed to try to stabilize the capitalist economies both in USA and elsewhere (where problems are even more severe). Watch closely as the crisis on the financial side moves on from equity (stock), commodities, and forex financial markets into derivatives markets and credit markets-especially junk bond and other corporate bond markets. Watch as the Fed tries desperately to provide liquidity to business and markets via its Repo channel and QE since its traditional rate channels are now ineffective. And watch as US and global capitalist advanced economies try to coordinate new fiscal policy responses to the general dual crisis in financial and real economic sectors of global capital.

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*This article was originally published on the author's blog site, [Jack Rasmus](#).*

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