Systemic Breakdown? Financial Bubbles Creating Conditions for New Crash

By Nick Beams

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It is a sure sign of the systemic breakdown of the global capitalist system that the very measures put in place to try to prevent a crisis are creating the conditions for a financial meltdown beyond even the scale of 2008.

For almost five years the world's major central banks have pumped an estimated $7 trillion into financial markets with the stated aim of trying to spark an economic recovery. Economic data from around the world indicate that it has been a manifest failure.

The statistics on price levels are among the most significant. These show that rather than prices increasing—a sign of recovery in so-called "normal" conditions—deflationary pressures are intensifying.

In the US, consumer prices fell by 0.4 percent in May, the biggest decline since late 2008, following a 0.2 percent decline in April. In Europe, excluding food and energy costs, consumer prices in the 17-member euro zone rose by just 1 percent in April from a year earlier.

The downtrend has far-reaching implications. Confronted with falling prices for their products, major firms and corporations seek to make profits not by investing and expanding production, as they would seek to do if a recovery were underway, but by savage cost-cutting coupled with financial speculation. The consequent cuts in pay and jobs lead to a reduction in consumer demand, further fueling the deflationary trend.

Other economic data highlight this process. Last month, US industrial production fell by 0.5 percent, compared to a projected decline of 0.2 percent, prompting predictions that results for the second quarter would be even worse than the last quarter of 2012, when the US economy showed virtually no expansion.

In the euro zone, unemployment has risen for the 23rd consecutive month and now stands at 12.1 per cent, a 1.1 percent increase over the level a year ago. The euro zone economy contracted by 0.2 percent in the first quarter, meaning the current contraction has lasted longer than that experienced in 2008-2009.

Since the onset of the breakdown in 2008, the prospect has been held out that China could provide the basis for the long-term expansion of the global economy. But while industrial production and retail sales both showed a significant rise last month, pointing to economic growth of about 7.5 percent this year, these hopes are being dashed.

In a recent article pointing to the absence of “a strong source of demand growth” anywhere in the global economy, the *Financial Times* noted that “worries” about the Chinese economy were “widespread.” In the long term it was clear that the double-digit growth of the past decade was a thing of the past, while in the short term, despite an expansion of credit the rise in GDP produced by this lending was near its lowest level for a decade.

In contrast to the trends in the real economy, financial markets are experiencing an unprecedented boom. The Dow Jones Industrial Average is up by 15 percent since the Fed launched its third round of quantitative easing last September. In Japan, the Nikkei index has climbed 44 percent since last December and the election of the Abe government, which demanded that the Bank of Japan boost the money supply. In the UK, the FTSE index has gained 20 percent in the last six months on the back of quantitative easing by the Bank of England, despite the fact that the British “recovery” is weaker even than that experienced in the Great Depression, while European stock markets have gained 30 percent since last July.

These increases are being fuelled entirely by the trillions of dollars being pumped into the financial system by the major central banks.

But rather than expressing a “recovery,” the booming share markets are a fever chart of the deepening crisis of the capitalist system. Never in the history of world capitalism has there been such a divergence of financial markets from underlying economic processes.

The unprecedented rise in global markets has sparked concerns that the conditions are being created for a crash. As *Financial Times* columnist Gillian Tett noted, “[W]hile the flood of central bank liquidity is enabling the system to absorb small shocks, it is also masking a host of internal contradictions and fragilities that could surface if a shock hits” with the “potential for… future violent instability rising apace.”

While any rational analysis points to the fact that the present conditions are preparing the way for a disaster, the frenzy of speculation continues according to its own mad logic. As the then-chief executive of the US banking giant Citigroup, Chuck Prince, famously remarked in July 2007: “As long as the music is playing, though, you’ve got to get up and dance.” Little more than a year later, the global financial system plunged into its worst crisis since the 1930s.

Today the situation is potentially even more explosive than five years ago. This is because, unlike 2008, the central banks, having bought up trillions of dollars worth of government and other financial assets, are key market players themselves, and so will be directly impacted by a collapse of financial markets.

Increasingly, they are being caught in a trap of their own making. Withdrawal of the financial stimulus measures threatens to collapse the bubble. At the same time, the pumping out of still more money draws them deeper into the mire.

Last week, economists at the International Monetary Fund published an analysis warning that ending easy money policies could result in the central banks suffering severe losses as interest rates spiked and bond prices fell. The Federal Reserve could experience a loss equivalent to as much as 4 percent of GDP ($628 billion), the Bank of Japan could lose 7.5 percent of GDP, and the Bank of England almost 6 percent.

In other words, a new financial shock could call the stability of the central banks themselves into question. Unlike the situation in 2008-2009, they would be unable to mount a rescue operation.

The deepening global crisis of capitalism has the most far-reaching political implications.

The past five years have seen the pumping of hundreds of billions of dollars into the coffers of the banks and speculators, and the financial elite that benefits from their activities, while the impoverishment of ever broader sections of the population has continued unabated.

These measures, far from producing an economic "recovery," have prepared the way for even bigger disasters.