Will there be another financial crisis?

By: Jamal Harwood*

There has been much speculation recently about when another crisis will hit the world's major economies. This is natural. The recovery from the last crisis, if it can be called recovery was poor, with economies barely growing at 2% if at all, and what growth was achieved happened largely by money printing (QE). Furthermore, budget deficits in the US and Europe are growing. Further money printing will be necessary unless governments can constrain spending, which they have consistently failed to do. Additionally, interest rates have been rising and this adds to budget deficits through the higher interest payments on the debt. The US pays 25% of its tax receipts on servicing debt (the UK is 26% with others worse – Ireland is 50%). Since the last crisis, global debt (government, corporate and personal) has continued to balloon and now is greater than $250 Trillion dollars – 5 times the size of the world's economies, China's debt is $34 Trillion (public and private).

The politicians and bankers have been talking up the economy in the US. Yet, the economy is on the verge of recession. The stock market had its worst month in 90 years with declines of more than 20%. In the 2008 crisis the stock market declined by more than 50%. The US administration was sufficiently concerned that Treasury Secretary Steven Mnuchin telephoned the 6 major US banks on the 24th of December, and the "plunge protection team" has been steadily buying the US stock market and indices since then, to ward off further drops in the market. A sustained drop in the stock market will cause serious problems because confidence in the economy is so closely tied to it, along with Pension funds, local government, bank assets and major corporations. The plunge protection team is an anomaly where the government intervenes using public money in the supposed "free market".

The Federal Reserve has also signalled that they will stop increasing short term interest rates. They have increased them on the basis that the economy is strong and the unusual policy (for them) of imposing zero interest rates - which was the emergency measure of the last crisis – was now over. But it's taken 10 years for the crisis to abate, and now they will reduce them again to try and ward off the next crisis! And how long will it be until the Quantitative Easing (QE – money printing from nothing) resumes in full force, particularly with the large budget deficits that Trump is maintaining.

The US dollar has been dominant as the global reserve currency, but increasingly the Chinese, Russians and others have been stockpiling gold, and using their own currencies where once the dollar was virtually the only international trade currency. They are in no position yet to challenge US dollar hegemony but nevertheless are positioning themselves. The dollar has been used in the creation of the record US debt position of $21 Trillion, money that has been used to pump up the stock, bond, and real estate bubbles (all at record high levels). Successive administrations have turned on the money printing presses to create the elusive wealth effect (people's assets like their home goes up in value so they spend more in the economy). But when these bubbles burst, as the stock market appears to be, and real estate is also dropping, the effect is disastrous.

Inflation is rising and long term rates will have to rise in response – according to Capitalist markets. This will in turn affect the bond markets (when interest rates rise, bond prices drop). Pressure on interest rates also come from the realisation that budget deficits are not going away and growth is an illusion. Higher rates mean larger deficits, and the cycle get worse with more money printing and bigger deficits, the central banks are losing control.

The source of the next catalyst for crisis could be from Europe. While the US has done $2.4 Trillion of QE the EU has done $3 Trillion in QE and its economies are lagging. Despite zero interest rates recovery has been poor. Italy is facing rising interest rates on their sovereign bonds, and this should not have happened in the EU era. Common budget rules were not adhered to and many of their banks are now in distressed condition. The infamous PIIGS (Portugal, Italy, Ireland, Greece and Spain) all remain in perilous condition, particularly their banking systems. Ireland has the equivalent of $100,000 debt for every person, and has much concern over the final outcome of Brexit. It is no surprise that there has been a rise in populism, and growing unrest against establishment political parties and their leaders.

Unrest in the populations

Recently Adair Turner from the House of Lords in London who heads the low pay commission said:

"Everybody knows that capitalism is not egalitarian, but the broad promise has been that, over a ten year period, you can be pretty confident that a rising tide raises all boats and everybody feels somewhat better off, and that's gone wrong,"

He pointed to a toxic mix of stagnant productivity, falling real wages and rising inequality.

"The combination of that is a lot of people do not feel the system is delivering for them. This is a big challenge for economists".

Consumer confidence is dropping and the wealth continues to accumulate into the hands of the few. Yet, they depend upon the general public to spend more and borrow more, and they aren't. Economies are fragile – they need growth.

Capitalist economies depend on confidence. But confidence is a word which is a large part of the expression "confidence trick" or "con job". Their markets are propped up by government intervention, their money is paper with nothing backing it, printing more at the whim of politicians, and they change their rules like they change their shirts.

It's really just a question of when not if we have another crisis.

﴿أَلا إِنَّهُمْ هُمُ الْمُفْسِدُونَ وَلَكِن لاَّ يَشْعُرُونَ﴾

"Unquestionably, it is they who are the corrupters, but they perceive [it] not." [TMQ 2:12]

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