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Deflation, Stagnation and Vast Money-Printing Operation Fueling Tensions, Creating Conditions for Another Global Financial Crisis

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Further evidence emerged last week that the pumping of money into the financial system by the world's major central banks is doing virtually nothing to promote global economic growth. Instead, there are mounting warnings that the vast money-printing operation is creating the conditions for another global financial crisis.

Amidst the general stagnation, moreover, tensions between the major economic powers are intensifying.

The *Financial Times* noted on Friday that "disappointing growth figures" for Europe and Japan had "dashed hopes that a global economic recovery would gather pace in the second half of the year."

Growth in Germany, the main economy of the euro zone, increased by only 0.3 percent in the three months to the end of September, while the French economy shrank by 0.1 percent, after growing by 0.5 percent in the previous quarter.

In Japan, the initial boost given to the economy by so-called Abenomics—the push by the Bank of Japan to double the country's money supply—appears to be running out of steam. The rate of growth halved in the third quarter, falling to an annualised rate of 1.9 percent after hitting 3.8 percent in the second quarter, mainly due to a fall in consumption, which dropped from 0.6 percent growth to 0.1 percent, and a decline in exports, which contracted by 0.6 percent.

In the face of slower growth, the US Federal Reserve's policy of "quantitative easing" is likely to continue. In her testimony before the Senate Banking Committee, Janet Yellen, nominated by President Obama to take over from Ben Bernanke as Federal Reserve (Fed) chairman in January, said the American economy and the US labour market were performing "far short of their potential" and had to improve before the Fed would reduce monetary stimulus.

The official reason advanced by the Fed and other central banks for the provision of ultra-cheap money to the banks and financial institutions is that it is needed to boost the economy. The real reason, however, is that low inflation rates, and even deflation, cause major problems for large holders of debt, especially financial institutions. With low levels of inflation and falling prices, the real value of debt and debt repayments starts to rise under conditions of economic stagnation.

This prospect was clearly on the mind of European Central Bank (ECB) chief Mario Draghi when he announced a surprise cut in the ECB refinancing rate from 0.5 percent to 0.25 percent earlier this month. Draghi said the economic outlook had changed abruptly over previous weeks and the euro zone faced a “broad-based and prolonged” situation in which inflation was running well below the target rate of around 2 percent.

Draghi said the ECB was “technically ready” to reduce the interest rate to below zero if necessary. Falling inflation is adding to the debt burden in a number of euro zone countries. It has been estimated, for example, that for every 1 percent fall in the inflation rate, Italy has to cut government spending by a further 1.3 percent of gross domestic product (GDP). Despite the austerity measures of the past two years, Italian government debt has increased from 119 percent of GDP to 133 percent. Spain, Greece and Portugal are in a similar situation.

Announcing the interest rate decision, Draghi claimed that the governing council of the bank was “wholly in agreement about the need to act,” differing only on the question of timing. This assertion is belied by the fact that representatives of Germany, the Netherlands and Austria on the ECB board voted against the move.

There are accusations that Draghi has been operating in the interests of Italy and other countries, including France, which have been demanding action to bring down the value of the euro in order to boost exports. While all central bankers deny that rate cuts are aimed at reducing currency values, in line with commitments by members of the G-20 to refrain from competitive devaluations, the rate cuts threaten to ignite a currency war.

Central banks in a number of countries have cut rates in the recent period. Earlier this month, the Czech National Bank took action to drive down the value of the koruna against the euro, pledging to keep selling the currency “for as long as needed” to boost growth. The Australian and New Zealand central banks would like to see the value of their currencies decline—Reserve Bank of Australia governor Glenn Stevens has said the value of the Australian dollar is “uncomfortably high”—but are fearful that rate cuts will lead to the growth of a bubble in housing markets.

In the United States, there are fears that the Fed’s ultra-cheap monetary policy could be leading to another crisis. There are warnings that the activities of real estate investment trusts, which borrow short-term to invest long-term in packages of mortgage bonds, could be a source of financial instability if interest rates start to rise. In its Global Financial Stability Report published in October, the International Monetary Fund warned of “sizeable disruptions in secondary mortgage markets” that could have “macroeconomic implications”—i.e., a destabilising impact on the US financial system.

The ongoing stagnation in the world economy, with no end in sight, is leading to a ferocious struggle for markets and rising tensions between the major economic powers. Laurent Freixe, the executive vice-president of Nestlé, the world’s largest food company, has pointed to the buildup of “deflationary tensions.” He recently said, “There is no growth in the marketplace, so everyone is fighting for a share of a shrinking pie.”

These tensions have been manifested in a number of areas. Earlier this month, The US Treasury criticised Germany for the deflationary impact on the world economy of its continued drive for export surpluses, bringing a sharp retort from the German side.

There are also widening divisions within the euro zone. In the wake of the split on the ECB governing council, the president of the European Commission, José Barroso, announced an inquiry into whether Germany's current account surplus was harming the European economy.

While he insisted that the "in-depth review" was not intended to criticise the competitiveness of German industry, the decision brought a sharp response from all major German parties. A spokesman for the ruling Christian Democratic Union said German exports were a "cornerstone of our prosperity." Representatives of the Greens and the Social Democratic Party made similar statements. Bundesbank president Jens Weidman, one of those who voted against the ECB interest rate cut, said, "You cannot strengthen Europe by weakening Germany."

Rising economic tensions, deflation, currency wars, the slowdown in economic growth and contracting markets, coupled with fears of a new financial crisis provoked by the policies of the Fed and other central banks, all point to the fact that there is no "economic recovery" in sight, and that the breakdown of the world capitalist economy, set off in 2008, is accelerating.

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