

Political Instability and Global Slump Intensify Financial Turmoil

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The year has opened with turbulence on world financial markets, reflecting the interaction between deepening slump, heightened geo-political tensions and growing political instability in virtually every country.

The mounting problems in the global financial system are expressed most directly on Wall Street, its apex. US equity markets are on course to have their worst start to the year since 2008. That year culminated in the global financial crisis set off by the collapse of Lehman Brothers in September.

Yesterday, the Dow was down by 130 points—a decline of 0.8 percent—following a 331-point decline on Monday. The more broadly based S&P 500 index has likewise fallen over the past two days, with markets in Asia and Europe also sharply down. Tuesday saw a “flight to safety,” with soaring demand pushing the yield on US ten-year Treasury bonds below 2 percent.

The most immediate factor behind the fall on Wall Street was a further decline in the price of oil, with West Texas intermediate falling below \$50 per barrel and Brent, the global benchmark, approaching that level. Since June, the price of oil has declined by more than 50 percent.

The oil price decline is itself the outcome of two processes: the attempts by the US to inflict economic damage on Russia, as it imposes sanctions cutting Moscow off from financial markets and seeks to use plummeting oil prices as a club, and the deepening recessionary trends in the world economy.

Summing up the situation, *Financial Times* columnist John Plender wrote that the world “has been prey to the growing problem of deficient demand, leading to deflation,” while the US has been growing too slowly to provide a foundation for global growth.

“This is a fearful world in which geopolitical risk, competitive devaluation and protectionist pressure could bring a descent into intractable deflation and long-depressed yields in the absence of robust policy,” he warned.

However, there is no evidence of such a policy anywhere on the horizon.

The euro zone is on the edge of its third recession since the financial crisis of 2008, amid increasing deflationary pressures. Figures to be released later today are expected to show almost zero inflation, with some predicting that the number will be negative.

The eyes of financial markets are turned towards the meeting of the European Central Bank (ECB) Governing Council on January 22 in the hope that the central bank may embark on expanded quantitative easing, involving purchases of government debt, in an attempt to stem deflationary pressures.

But a survey conducted by the *Financial Times* of 32 euro economists found that while most expected the ECB to step up its intervention, few believed the move would revive the euro zone economy.

In the wake of the financial crisis of 2008, China provided a stimulus to global growth as the government embarked on a major spending program and expanded credit. But China now faces the prospect, for the first time since the recession of 2009, of a fall in its growth rate to below the 7 percent level considered necessary to maintain employment.

It has been reported that the Chinese government is considering another major stimulus package to try to arrest the slowdown, but any such measures will only add to concerns about the level of Chinese debt.

In addition to recessionary pressures reflected in the oil price decline—a slump that is reflected across a broad range of industrial commodities, including iron ore—another major factor impacting financial markets is the prospect of a financial and political crisis in Europe following the Greek elections on January 25.

Polls indicate that SYRIZA (Coalition of the Radical Left), which has called for “renegotiation” of the Greek debt bailout package, could obtain the most votes and be called on to form the next government.

A report published in the news magazine *Der Spiegel* over the weekend made it clear that the German government of Angela Merkel will not tolerate any renegotiation of Greek debt and is prepared for a Greek exit from the euro zone. While the *Spiegel* report cited government sources who said Germany would be able to “handle” a Greek exit, no one knows what the consequences would be.

The Greek election is only one expression of growing instability across Europe that could lead to the break-up of the common currency. This would have major political consequences because the measures taken to foster European integration, reaching back to the early 1950s and culminating in the common currency, were never simply about economics but were aimed at preventing the eruption of major power tensions that led to two world wars in the space of a generation.

Those tensions are once again clearly in evidence. The governing council of the ECB is wracked by deep divisions, with German representatives opposed to further extensions of quantitative easing, above all, the purchase of sovereign debt.

The Greek election is to be followed by elections in Spain and Portugal where there is intense hostility to government austerity programs that have produced conditions not seen since the Great Depression of the 1930s.

The deepening political malaise was reflected in a column published in yesterday's *Financial Times* by foreign policy correspondent Gideon Rachman, in which he pointed to the loss of confidence in the strength of “the three props on which the post-cold war order [had] been constructed: markets, democracy and American power.”

Faith in free markets had been shaken by the events of 2008 and the Great Recession that followed, and while American power had demonstrated its capacity to destroy regimes, it had failed to provide stability.

“Just as troubling,” Rachman wrote, “is an emerging loss of faith in the ability of established democracies to deliver competent government. In the US, respect for Congress is at near-record lows,” while in European states “the political system seems incapable of delivering reform or growth—and voters are flirting with extremist parties.”

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