

The Next Financial Crisis is Not Far Off

By [Jayati Ghosh](#)

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We were told the world economy was back on track, but festering problems threaten to hit developing countries hard

It's been an difficult year globally. It began with much relief and congratulations all round, based on perceptions that the financial crisis had been handled effectively, that the Great Recession was over and that significant economies (especially in the developing world) were powering their way back to rapid growth. But it is ending on a much more tentative and even troubled note.

The rebounding of output barely touched unemployment, which remains at historically high levels in most countries. The sovereign debt problems in Europe are just an indication that the financial crisis is far from over, and will continue to reveal itself in new forms for quite some time to come. Meanwhile, the stingy and (so far, at least) visionless response of the stronger economies to the crises in peripheral Europe has condemned them to intensified contraction and ensured that the EU will generate little growth and much instability in the near future.

But those shaking their heads from a distance over difficulties in the eurozone should be considering the other financial problems that continue to fester and will raise their ugly heads soon enough: the persistent depression in housing and real estate markets in the US and other developed and some developing countries, which contributes to asset deflation; the many other bad debts that are piling up quietly, like student loans and consumer credit; the continued incentives for risky behaviour by banks that have benefited from large government support; renewed speculative activity in commodity markets, which has pushed up primary commodity prices to close to their peaks of 2008.

For developing countries, this last feature is probably one of the greatest concerns - creating the fear that once again we will witness a global food crisis, driven not so much by real supply and demand factors (which have not changed that much) but by speculative activity causing sharp spikes in oil and food prices that are then transmitted to consumers across the developing world. Regulation that might have controlled this speculation is still being formalised in the US and has yet to be drafted in Europe. Meanwhile, the poor will continue to be battered by rising oil and food prices.

Prospects look even gloomier because national economic policy making has shifted from coordination to conflict mode. Loose monetary policies in the US and Europe may have domestic goals in mind, but they contribute to the carry trade that sends hot money to developing countries and pushes up their exchange rates and domestic prices. Since most of them are still obsessed with exports as the engine of growth, they try to resist this. So

currency wars have already started, but in a subtle, shadow-boxing way. The gloves are not yet off, but they could be soon, because no one seems sure where the growth is supposed to come from.

For large parts of the world economy, things are going to get worse before they get better. And in places where they are supposedly getting better, they are going to get even more uncertain.

***Jayati Ghosh** is is one of the world's leading female economists. She is professor of Economics at Jawaharlal Nehru University, New Delhi, and the executive secretary of International Development Economics Associates (IDEAS). She is a regular columnist for several Indian journals and newspapers, a member of the National Knowledge Commission advising the Prime Minister of India and is closely involved with a range progressive organisations and social movements.*

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