Towards a Global Economic Slowdown: Stock Market Slide, Declining GDP, Rising Unemployment

By Mike Whitney
Global Research, June 05, 2012
Counterpunch 4 June 2012
Region: Asia, Europe, USA
Theme: Global Economy

> -"Every major part of the global economy is slowing, and slowing rapidly….Right now, we seem to be in a synchronized global slowdown, and that is very worrisome."
>
> – Mohamed El-Erian, Pimco

Growing troubles in the eurozone, a slowdown in China and a jobs report that was weaker than the most-pessimistic forecast, sent stocks plunging on Friday. The Dow Jones Industrial Average lost 275 points on the day while the S&P 500 and the NASDAQ followed the DJIA into the red. All the gains of 2012 have now been erased leaving all the major indices in negative territory.

The global selloff was preceded on Thursday by a revision of first quarter GDP which was slashed from 2.2 percent to 1.9 percent. The US economy is neither growing nor adding jobs. The signs of stagnation–which have spread from manufacturing, to consumer confidence, to GDP, and now to jobs– has ended all talk of a "recovery" and dampened Obama's prospects for re-election in November.

Payrolls increased by just 69,000 in May, far below the 150,000 that analysts had expected. The unemployment rate rose to 8.2 percent from 8.1 percent while revised estimates show that fewer jobs were created in the last 3 months than originally stated. The grim report suggests that the Obama economic recovery has run out of steam just as many economists had predicted. Obama's unwillingness to follow the advice of top economics advisor, Christina Romer–who recommended a $1.8 trillion stimulus package, instead of the $787 billion that the administration settled on–has probably cost him the election. Obama's future depends on the condition of the economy, and the economy stinks.

In Europe, troubles in Spain and Greece have touched-off a bank run that's pushed yields on risk-free assets, like US Treasuries and German bund, to record lows. The German 2-year bund (Schatz) dipped into negative territory on Friday while yields on the benchmark 10-year Treasury declined to 1.44 percent. The yield on the Swiss 10-year has plunged to an astonishing 0.48% is "the lowest ever recorded anywhere."

Jittery investors are now lending money to the US and German governments' knowing they'll get less back in return. (in inflation adjusted terms.) This is the very definition of panic. And their fear is not without foundation, after all, Europe's wholesale funding market is broken, Spain's banking system is undercapitalized and teetering, the bank runs are intensifying, and policymakers are unable to agree on a course of action. Political paralysis has made a bad situation worse. Here's a chart that shows the amount of liquidity the ECB has given to Greece, Spain and Italy via the Target2 program. Target fill the hole that's been created by capital flight. This is what [a modern-day bank run] looks like.

The European Commission and the ECB have been unable to stop the bank runs because there is no euro-wide deposit insurance. So, when depositors begin to doubt their country's future in the EZ, they withdraw their savings and move it to a safer location, like Germany. Here's more from Reuters:

> "Spaniards alarmed by the dire state of their banks moved money abroad in March at a faster rate than at any time since records began in 1990, official figures showed.
>
> The 66.2 billion euros net capital flight occurred before the nationalisation of Spain's fourth biggest lender, Bankia in May due to massive losses from a burst property bubble….
>
> The European Central Bank stepped up pressure on Thursday for a joint guarantee on bank deposits across the euro zone, saying Europe needed new tools to fight bank runs as the bloc's debt crisis drives investors to flee risk." (Reuters)

The eurozone is not sufficiently integrated, fiscally or politically, to deal with the problems it now faces. It does not have a centralized bond market that collectivizes the debts of the member states in order to keep borrowing costs low. Nor is there a mechanism for fiscal transfers to help level the playing field so that account imbalances do not become unmanageable and destructive. EZ managers have rejected the traditional methods for integration and, instead, settled on punitive austerity measures that are designed to purge large deficits through internal devaluation. The process has created record unemployment, severe recession, and widespread social unrest. Still, Brussels persists with the same policy ignoring the fact that it has only deepened the crisis.

The EZ troubles are not difficult to grasp or remedy, in fact, former economic advisor to Barack Obama, Austan Goolsbee explained the problem in an article in Thursday's Wall Street Journal. Here's an excerpt:

> "At root, the euro-zone problem remains the locking together of very different economies into a monetary union without a way to adjust….Normally, exchange-rate adjustments would reduce this gap…. But without an exchange-rate safety valve you need an alternate way to rebalance economies. Moving, inflating, struggling, or subsidizing are your only choices…(Either) Southern Europe can struggle through the problem—grinding down wages through high unemployment and structural labor-market reforms ….(or) Northern Europe could decide…, that it is willing to permanently subsidize euro-zone countries with low productivity growth. That could be through explicit subsidies or through bailouts and broad-based guarantees." –A Fiscal Union Won't Fix the Euro Crisis –The only practical choices are more geographic mobility, inflation, or subsidies" Austan Goolsbee, Wall Street Journal)

There it is in a nutshell. The problem is not particularly hard to understand or to fix, but if it's ignored or if deficit zealots (like Angela Merkel) feel as though they can apply their own nonsensical remedies (austerity), then the bank runs will gain pace, a wider panic will ensue, and the monetary union will be torn apart, which is what's happening now.

Goolsbee's article also provides an interesting breakdown of how fiscal transfers work in the US:

> "Last year, the Economist compiled census data from 1990 to 2009 for all 50 U.S. states on the amount of federal spending in each state minus the amount the state's residents pay in federal taxes. Over 20 years, states like Minnesota and Delaware annually paid in about 10% more of their state GDP than they got back. On the other side, for the last 20 years New Mexico, Mississippi and West Virginia have received annual subsidies of more than 12% of state GDP. While not a perfect measure of subsidy, it conveys the basic point well. These are big. Greece's entire 2011 deficit, for example, was 9.1% of GDP."

The reason the US is able to successfully use one currency–despite the fact that some states are more productive and competitive than others– is because the weaker states are subsidized via Pentagon contracts, unemployment benefits, federal infrastructure programs, food stamps etc. These "fiscal transfers" are necessary to make the US-currency union work. The same rule applies to Europe, but EU leaders reject the idea saying that fiscal transfers are tantamount to "financing other governments" which is banned under the Stability and Growth Pact. This is idiocy in the extreme. The fact is, economists and experts have repeatedly explained what needs to be done to make the EZ a viable currency union, but EZ leaders refuse to make the changes. Their obstinance has thrust the 17-member monetary union to brink of annihilation.

In China, the evidence of a slowdown is also beginning to mount. The recession in the eurozone has taken a toll on Chinese exports which has hurt manufacturing and retail sales. (China's PMI slipped to 50.4 from 53.3 a month earlier.) As the slump in the eurozone deepens, China's economy will cool even more forcing policymakers to lower reserve requirements while boosting stimulus to increase investment by the state-owned enterprises. The recent signs of capital flight from China has experts worried that the boom-times may be over and that China may be headed for a hard landing. Here's a clip from economist Tim Duy on the topic:

> "…the exodus of cash could indicate that the Chinese story is coming to a close – and that will have significant consequences for the global economy. It is another signal that emerging markets will not be supporting global demand anytime soon. I think .. this story is slipping under the radar while we all have our eyes focused on the farce in Europe. But it could be the real game changer in the global economy." ("Capital flees China", Tim Duy, economists view)

China's industrial production and electricity use are falling fast, while the number of non-performing loans has ballooned to new highs in the last year. Efforts to stimulate the economy have also fallen short as businesses continue to reduce their borrowing to see if demand picks up later in the year. New bank loans have dropped 8% y-o-y, while consumer credit has slowed to a trickle. Here's more from the Wall Street Journal:

> "The lack of confidence is due to the overhang from the last blowout. All of that investment in industrial capacity and real estate is now coming on line. Companies and local governments are finding it difficult to make their new assets generate enough revenue to service the debt. Inventories are piling up,

> and China is seeing capital flight for the first time in decades….
>
> The worry is that China has gone more than a decade without a painful slowdown. During that time, the government held down interest rates at artificially low levels to encourage investment. Such conditions often precede particularly long and painful contractions." ("China Is Stimulused Out", Wall Street Journal)

China, the US, and the eurozone are all running out of gas at the same time. If shares continue to tumble as they have in May, the Federal Reserve will resume its Quantitative Easing (QE3) program to prop up stock prices. But liquidity injections alone will not provide the jolt the real economy needs to increase activity, add jobs or grow. Absent another round of fiscal stimulus, the economy will continue to drift sideways or dip back into recession.

Mike Whitney *lives in Washington state. He is a contributor to Hopeless: Barack Obama and the Politics of Illusion (AK Press). Hopeless is also available in a Kindle edition. He can be reached at fergiewhitney@msn.com.*

The original source of this article is Counterpunch

Articles by: **Mike Whitney**