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A decade of speculation

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Abstract

The power of finance ensured that, other than for an initial fiscal push to salvage financial institutions, monetary measures in the form of quantitative easing, involving the infusion of large volumes of cheap liquidity, were the principal response to the 2008 global financial crisis. The effects of the generalised and prolonged dependence on such measures have been a substantial increase in vulnerability, at the centre of which is a huge build-up of private – especially corporate – debt, and unwarranted and unsustainable asset price inflation in both developed country and 'emerging economy' markets. A consequence of these processes is a massive increase in income and wealth inequality across the world, which limits the level of effective demand and growth.

JEL Codes: E44, E52, E58, G01, G15

Keywords

Asset markets, financial fragility, macroeconomic policy, private debt, quantitative easing

Introduction

The 2008–2009 global financial crisis (GFC) has had massive external effects and is in various forms still with us. While analyses of the fundamental factors that led to the crisis vary, there is consensus that the combination of an excessive overhang of debt in corporate and household balance sheets, and unsustainable asset price inflation in equity and housing

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and real estate markets, was the proximate determinant of both the intensity of the crisis and the manner in which it unfolded. In fact, many observers initially interpreted what was really a system-wide crisis as a more limited phenomenon that primarily afflicted the sub-prime mortgage market and the asset backed securities that were built on it.

Given the role of a toxic mix of excessive debt and speculation in triggering the crisis, post-crisis discussions focussed on the need to regulate or do away with structural features that prevented the early detection and correction of such trends. However, since this would require striking at the root of deregulated and unbridled finance, from the very beginning efforts were underway, led by the champions of finance and financial players themselves, to deflect the debate in other directions.

The intensity of the real economy crisis resulting from the financial crisis helped. In the initial phases of the crisis, the need to save the financial system and stall the slide into recession focused attention solely on those tasks. A combination of fiscal and monetary stimuli was deployed for the purpose, although fiscal spending in the advanced economies was directed more at recapitalising banks rather than addressing mortgage foreclosures or reviving demand. Furthermore, the initial fiscal stimulus that occurred across G20 countries was essentially short-lived, especially in the advanced economies. Consequently, the financial system benefitted in two ways. First, it received financing from the budget, through measures such as the Troubled Asset Relief Programme (TARP) in the USA that allowed financial institutions to partly retrench questionable assets and partly issue new equity to increase their common tangible equity ratios and declare solvency. Second, it received financing at near zero interest rates from the central banks against the assets that had no open market buyers and were therefore worthless when marked to market. That finance could be used to invest in new low yielding assets, which, however, offered good net returns because of the low or absent cost of capital. However, once finance had found its feet once again and went on to record profits based on such carry trades; governments were prevented from continuing with proactive fiscal policies on the grounds that this would lead to unsustainable public debt levels.

In the event, by the time government could focus attention on real economy revival, the only instruments they could leverage were monetary policies in the form of low and even negative interest rates and 'quantitative easing' or massive liquidity infusion through the purchase of bonds. The US Fed (Federal Reserve Bank), for example, saw the size of assets on its balance sheet bloat from around USD800 billion to more than USD4 trillion, the counterpart of which were the liabilities that drowned the system in liquidity.

Thus, the rescue effort launched after the crisis went through two phases. In the first phase, in order to prevent the recession from becoming a modern-day repeat of the 1930s Depression, governments opted for debt-financed spending in the form of a fiscal stimulus to revive demand on the one hand, and funds infusion for financial sector recapitalisation on the other. This did have a salutary effect on growth, quickly retrieving economies from the depths of the recession. But once this was done, governments succumbed to the pressure not to use debt-financed fiscal spending as a means of stimulating a recovery, instead focussing on monetary policy measures, such as liquidity infusion and interest rate reduction, to combat recession and spur recovery. Indeed, because of the dominance of the ideology of fiscal prudence at all costs, governments in advanced countries and most emerging markets have in general resolutely abided by a conservative fiscal agenda and refused to return to the proactive fiscal policies adopted in the immediate aftermath of the crisis.

The result of this shift from dependence on fiscal policy to reliance on the monetary lever was that some of the buoyancy induced by the initial fiscal stimulus was lost. Output growth fell from its peak and settled at a new normal that, though not a recession, was too weak to be a robust recovery. Monetary policy proved to be less effective in reviving growth, the recovery was weak and halting and the road to recovery prolonged.

In this article, we trace how while the initial use of the fiscal lever did lead to a V-shaped recovery, the subsequent exclusive reliance on monetary policy saw the growth rate fall and settle at a 'new normal' that bordered on stagnation. We also critically reflect on how the availability of cheap liquidity allowed finance to expand credit and invest in asset markets in developed and developing countries, resulting in the resumption of unsustainable debt accumulation and asset market price inflation. We argue that since depressed demand kept the prices of goods and services under control, monetary policy remained loose despite its role in fuelling asset market speculation. In the event, the global economy finds itself overcome by vulnerabilities similar to those that prevailed prior to the financial crisis of a decade earlier.

What this effectively meant was that over time, policy debates in the core advanced economies moved away from the initial focus on tighter regulation of financial activities that would prevent such damaging consequences in future. Instead, in the name of addressing the Great Recession, policies designed for 'recovery' have increasingly contributed to re-creating the conditions that had preceded the crisis, albeit in slightly modified form.

The article is organised as follows: Section 'Stuttering recovery' reviews the lacklustre recovery process; section 'Unconventional monetary policy' critically assesses the consequences of lax monetary policy and failure to regulate finance; section 'Boom reversal?' examines the possibility of another crisis, while section 'Implications for developing countries' assesses the implications for developing countries; section 'Conclusion: Inequality, instability and insecurity' contains concluding remarks.

Stuttering recovery

The recovery itself is more a prediction than a reality. In January 2018, the International Monetary Fund (IMF) attempted to buoy optimistic sentiments by pointing to a dispersed recovery:

> Some 120 economies, accounting for three quarters of world GDP, have seen a pickup in growth in year-on-year terms in 2017, the broadest synchronized global growth upsurge since 2010. Among advanced economies, growth in the third quarter of 2017 was higher than projected in the fall, notably in Germany, Japan, Korea, and the United States. Key emerging market and developing economies, including Brazil, China, and South Africa, also posted third-quarter growth stronger than the fall forecasts. (IMF, 2018a)

Though there were many sightings of the green shoots of recovery beforehand, such optimism faded with the waning of upside evidence. The end-of-decade celebrations too were shrouded with uncertainty. While more cautious observers pointed to the end of

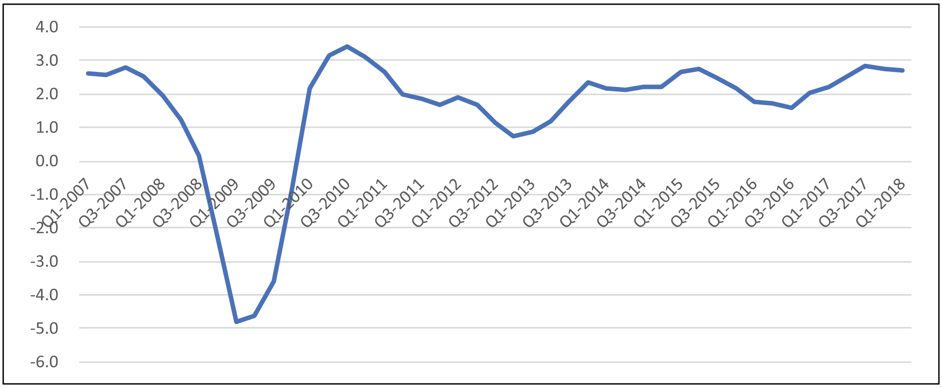

Figure 1. OECD growth trends since the 2007–2008 crisis.
Source: OECD 2018. OECD: Organisation for Economic Cooperation and Development.

intense depression in Europe and Japan and early evidence of a recovery in the USA, they saw potential downside risks as well. The optimists, on the other hand, saw the recovery as being robust because it was more synchronised, with simultaneous upturns in the USA, Europe, Japan and the emerging market economies.

However, such optimistic assessments are based on limited evidence that is by no means robust. As Figure 1 shows, if we examine the Organisation for Economic Co-operation and Development (OECD) as a group (combined evidence from which must reflect the synchronised upturn), the recovery between the third quarter of 2016 and the third quarter of 2017 merely replicated previous post-crisis trends that had been reversed. Thus, the growth rate declined in the last quarter of 2017 and first quarter of 2018. Indeed, even the third quarter figure was not very much higher than that in the second quarter of 2015, and much lower than the peak recorded at the end of the immediate post-crisis recovery in the third quarter of 2010. These trends were replicated with even less robust recovery in the G7, despite the fact that the USA – supposedly the focus of the recovery – has a much higher weight in this group (Figure 2).

Even in the USA, the year-on-year growth rate in first quarter of 2018 was close to two percentage points below that recorded in the first quarter of 2015. Upbeat assessments of US performance routinely quote the sharp fall in the unemployment rates from 10% in the midst of the crisis to lower than 4% currently, even though the evidence is clear that definitions that include the significantly underemployed in the employed figures and 'discouraged workers' unable to find employment reporting themselves as not seeking work reduce the unemployment rate figure. Adjusting for them takes the unemployment rate to above 6% or more according to some estimates. These facts of persisting unemployment and precarious work are corroborated by the evidence on falling labour force participation and nominal wages that are not responding to reduced unemployment rates.

Celebrations over the US recovery, which is still being seen by some as leading a synchronised global upturn, have been premature. Neither has the recovery been particularly robust, nor is there reason to believe that, even if it persists, it would restore pre-crisis growth levels and resolve the problems inherited from the crisis. Indeed, the very

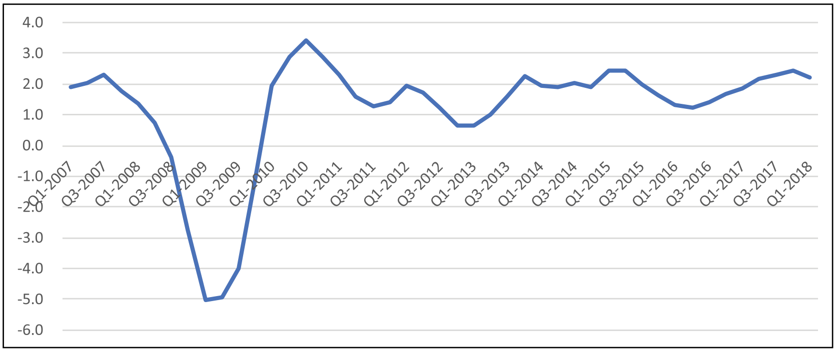

Figure 2. G7 Growth trends since the 2007–2008 crisis.
Source: OECD 2018. OECD: Organisation for Economic Cooperation and Development.

strategy for inducing recovery, by relying so heavily on loose monetary policy alone, has operated to increase the fragilities that could generate another similar crisis in future. These fragilities mostly relate to debt bubbles and asset price inflation.

Unconventional monetary policy

The intensity of the primary policy response to the 2008 financial crisis in the advanced economies, in the form of prolonged use of 'unconventional' monetary policies involving near-zero interest rates and massive liquidity infusion, is evident from the numbers. In the United States, the Federal Reserve resorted to a policy of 'quantitative easing' involving purchases of Treasury Securities of between USD45 million and USD75 million a month. A similar policy was adopted by the European Central Bank (ECB), which after some initial hesitation accelerated its acquisition of bonds in 2014 in response to extremely low growth. As a result, by December 2017, the six central banks that adopted policies of 'quantitative easing' – the US Federal Reserve, the ECB, the Bank of Japan, the Bank of England and the Swiss and Swedish central banks – reportedly held more than USD15 trillion of assets, more than four times the pre-crisis level The US Federal Reserve held assets worth a little less than USD1 trillion before the crisis; by December 2017, it rose to USD4.5 trillion – around one quarter of US gross domestic product (GDP). The ECB accumulated assets of USD4.9 trillion, around two-fifths of the European Union's (EU) GDP (Allen and Fray, 2017).

This strategy of massive liquidity creation, combined with the reluctance to impose regulations that would restrict financial activity, led to significant increases in debt-financed private expenditure. Therefore, even the modest and hesitant recovery was riding on the persistence of a credit bubble similar to that leading up to the crisis of 2008–2009. Financial institutions burdened with liquidity were willing to lend, to avoid being penalised with low interest rates on deposits with the central bank. The recovery was also facilitated by the return of borrowers to the debt market, encouraged by the boom in equity and real estate markets.

In the USA, the boom hugely inflated the ratio of net worth to disposable incomes of households and the non-profit organisation sector. That ratio, which stood at a high of

623% before the crisis in 2007Q4, fell to 506% in the depth of the crisis in 2009Q1. It has since risen, slowly at first and rapidly after 2012, to touch 679% in 2017Q4, significantly higher than before the onset of the 2008 crisis. The stock market boom is reported to have raised household wealth by more than USD6 trillion in 2017, triggering once again a version of the 'wealth effect'. This in turn encouraged debt financed spending by the private sector, which drove the growth underpinning the still-weak recovery. This was also reflected in stock market behaviour, especially in the USA. In the United States, the cyclically adjusted price-earnings ratio of the stock market was more than 30 in 2017, exceeding its post-1982 average by almost 25% (Bank for International Settlements (BIS), 2018b: 7). The Schiller historic price to earnings ratio in April 2018 was higher than at any previous time, other than the level recorded during the tech bubble that peaked in 2000 (Shiller, 2000). Such a process of rapid increase in valuations was not as evident for European and UK equities, but that could be partly the result of wealth holders from those countries investing in dollar denominated financial assets in New York.

Simultaneously, there has been a substantial increase in private debt of both corporations and households – another area of potential vulnerability. Even before the process of deleveraging to wind down the large debt accumulated prior to the 2008 crisis could be consolidated, it was reversed, leading to a rise in the volume of debt. According to the Institute of International Finance (2018), global debt stood at USD247 trillion in June 2018. In the United States, outstanding private debt rose significantly, such that by 2017Q4 it was 1.3 times higher than its 2010Q1 level. The outstanding debt of non-financial businesses grew at an annual rate of only 0.3% between mid-2007 and end-2013, but thereafter increased by 1.5% until end-2017. Household debt showed even bigger changes. Outstanding household debt shrank at the pace of 0.5% per annum between mid-2007 and end-2013, but grew thereafter at the rate of 0.8% per annum. Aggregate household debt balances increased for 14 consecutive quarters until October–December 2017. In that quarter, they were USD473 billion higher than the previous (2008Q3) peak of USD12.68 trillion (New York Federal Reserve, 2018). As of 31 December 2017, total household indebtedness, at USD13.15 trillion, was 18% above the 2013Q2 trough. Strikingly, revolving debt of households – largely credit card debt – rose by USD120 billion or by 13% between January 2016 and February 2018, to touch a record USD1031 billion.

Mortgage balances accounted for 66% of such debt. In many advanced economies (Australia, Canada, Switzerland, Sweden, Korea and Norway), household debt as a percentage of GDP is high and rising; in some others (Spain, United Kingdom, United States and Netherlands), it is high even if flat or falling. The share of mortgage debt in the total debt of these countries is high, between 72% and 97%, and it has been suggested that 'supply factors may have been more important than demand in driving household credit' (BIS, 2018a). In short, easy liquidity conditions are encouraging financial intermediaries to push mortgage loans, leading to high (and even rising) levels of household debt.

The other implication of the abundance of cheap liquidity resulting from developed country quantitative easing was that a range of investors borrowed cheap, investing in equity and debt markets in developed and developing countries alike, resulting in a strongly synchronised speculative spiral in asset markets. It was and is inevitable that this boom divorced from fundamentals will give way to a bust.

Trends such as these can be described as signs of 'froth' in financial asset and housing markets. They underline the fact that, while easy and cheap money policies have not been successful in delivering a robust recovery, they have triggered speculative investments financed with low cost money in assets varying from government bonds, equity and emerging markets article of different kinds to real estate and alternative assets. The result has been a process of inflation in asset prices that feeds on itself. What is significant is that this problem is no longer restricted to the United States economy, as it largely was in the run-up to the GFC of 2008. Rather, such bubbles are evident in a number of systemically important economies, in Europe and among emerging markets.

Slow withdrawal of easy money policies

The emergence of such bubbles and the attendant fragility has created dilemmas for monetary policy in the advanced world. Central banks admit that they cannot stay with their 'accommodative' monetary policies and must trim their bloated balance sheets – but they cannot do so quickly or sharply without reversing whatever recovery is under way. Indeed, central banks have been extremely tardy and slow in reversing what was meant to be a short-term response to the crisis. It is now taken for granted that, especially when compared with the huge and rapid accumulation of balance sheet assets, the process of trimming balance sheets will be slow and only partial. Interest rates too are being lifted slowly, if at all. In the USA, the plan is to reduce Treasury security holdings by an average of only USD18 billion per month until the end of 2018 (BIS, 2017). Moreover, the balance sheet size of the Federal Reserve even in 2025 is expected by market participants to be around 15% of GDP, as compared with a 6% level prior to the crisis. On its part, the ECB announced in October 2017 that it would only halve its bond-buying programme from EUR60 billion to EUR30 billion a month starting from January 2018. Combined with small increases in policy interest rates, if any, and advance information on likely monetary policy shifts, this gradualism has muted the effects of the ostensible policy reversal on the behaviour of market participants. Speculative investments therefore continued because market participants took account of the gradual central bank retreat in their calculations.

Central bank gradualism clearly stemmed from the fear that any sharp shifts in policy could shock and trigger a sell-off in equity and bond markets, and spur defaults on debt accumulated by households and firms in the era of cheap and plentiful money. That in turn could precipitate a financial downturn, which could lead to a crisis and have substantial external effects on real economies still struggling to recover. This is why central banks in the advanced economies 'supported' investors' beliefs that they 'would not risk impairing growth and damaging valuations' (BIS, 2017: 10). Since the resulting gradualism tends to dampen risk perceptions and reduce risk premia, it has the perverse result of encouraging further borrowing and even more risk-taking by effectively reducing uncertainty about the future, or at least the important element of policy uncertainty. In the event, despite the promises of central banks to suck up liquidity and hike interest rates, the gradualism effectively continued to encourage investors to borrow cheap and invest in risky assets.

By now, both theory and bitter experience should have made it clear to everyone that growth of this kind is unsustainable. Indeed, there were several signs in early 2018 that the bull run was ending. Globally, by early 2018 equity and bond markets were turning bearish, reflecting the widespread expectation that the era of cheap and abundant liquidity that could be leveraged for investments in capital markets was over. Central bankers in the major advanced economies have been looking for opportunities to start unwinding their unconventional monetary measures. That opportunity came with recent signs of consistent employment gains in the USA, and low but positive rates of GDP growth in many developed countries. But the moment central banks made clear their intention to allow rates to rise and draw back the monetary lever, markets turned unstable and headed south. So, the question is whether even the mild reversal of monetary policy stance would lead to a hard landing in asset markets with the implications that would have for the rest of the economy.

Boom reversal?

Ironically, just as global policy makers talked in early 2018 of a synchronised global recovery, investors seemed to be turning bearish. Obviously, the landing would be more likely to be hard and the external effects more damaging – more intense than the previous speculative spiral. This is of relevance because of significant differences in the volatility of different markets during the boom, even when they were synchronised in the direction of movement. Within the developed world, surprisingly, Germany seems to be home to a more volatile market as reflected in movements in the DAX (Deutscher Aktienindex or German stock index: see, for example, Handelsblatt Staff, 2018). South Korea was also characterised by significant volatility.

But in addition, emerging markets like India and Thailand have shown signs of unusually high volatility in the years after 2003 (see Chandrasekhar and Ghosh, 2018). Since net inflows were relatively so large and positive in most of these years, these countries are locations with large accumulation of legacy foreign financial capital investments in both equity and bond markets. If for any reason, such as the end of the era of cheap and abundant money in the West, investors choose to book profits or cut losses and exit, a phase of capital flight would ensue. That could trigger steep currency depreciation and balance of payments difficulties, and also damage the balance sheets of domestic players who had exposed themselves to unhedged foreign debt during the years of easy money. The external effects of all these would be extremely adverse.

Changed system behaviour

The optimism regarding a synchronised recovery ignores the evidence suggesting that the world economy does not behave either as it did, or as conventional macroeconomic analysis would suggest. Contrary to the expectations of orthodox monetarists, a prolonged phase of easy money policies has not triggered conventional goods and services price inflation. Interestingly, such inflation has not occurred even in contexts where unemployment rates have fallen. This is essentially because falling unemployment rates have not led to accelerating wage growth. Going by IMF figures, wage growth in the US was just 1.8% in 2016 and an estimated 2.3% in 2017, as compared with an average of 3.4% during 1999–2008. With wage growth sluggish, inflation has also remained low, despite low productivity growth (IMF, 2017). According to observers, the 'Phillips curve', which captured an inverse relationship between the unemployment rate and inflation and provided the basis for central bank policies, seems to have 'flattened out'. So even to the extent that a hesitant recovery reduces the level of unemployment, it does not create conditions where a conventional monetary stance leads to monetary tightening (see, e.g. Cunliffe, 2017; The Economist, 2017).

In early 2017, this prompted Claudio Borio, the head of the Bank of International Settlements' monetary and economics department, to call for a change in the principles that guide contemporary monetary policy. Noting that '[T]he most fundamental question for central banks in the next few years is going to be what to do if the economy is chugging along well, but inflation is not going up', he expressed the view that

> [c]entral banks may have to tolerate longer periods when inflation is below target, and tighten monetary policy if demand is strong – even if inflation is weak – so as not to fall behind the curve with respect to the financial cycle. (cited in Jones, 2017)

This creates a dilemma. On the one hand, if balance sheets are trimmed too fast, the fear is that a crisis may follow. On the other hand, if they are not trimmed fast enough, they encourage excessive risk taking, set off asset price bubbles, and once again create the environment for a more brutal collapse. The problem is that, having ridden on one bubble with monetary easing, governments and central banks find they have not won themselves a recovery from the recession. They cannot allow that bubble to subside, and so must continue with the monetary policies that inflated it. But doing so may simply generate more bubbles, increasing the probability that one or more of them would burst.

In fact, problems may arise even if the inflation rate that would justify tighter monetary policies and higher interest rates actually occurs. It could trigger a quick withdrawal from the easy money stance and unwind the asset prices spiral faster than needed for a soft landing. In the US economy, for example, such inflation would be a danger because of two reasons: first, the Trump tax cuts and threat of enhanced infrastructure spending could send prices upwards, and second, the possibility of a return to high commodity prices with the worst of the recession over.

World oil prices

Low commodity prices – and low energy prices in particular – were among the significant factors in the global tendency to low inflation despite a world awash in liquidity. But the decade since the global crisis has seen massive volatility in oil prices in particular. From its post-crisis low in early 2009, the spot price of Brent crude rose to above USD120 per barrel in mid-2014, only to fall thereafter to even below USD40 per barrel. The huge increase in supply relative to demand was among the factors that drove the collapse in oil prices after September 2014, intensified by the boom in shale oil and gas production in the USA (International Energy Agency, 2016).

Inevitably, given a cycle where a rise in prices leads to excess supply and then a price fall, this decline was also likely to be self-limiting after a point. Lower prices would drive many shale fields – especially potential ones – out of the market, and limited supply would dampen speculator expectations. In the event, price declines would moderate, leading to stability and even a partial reversal. In practice, these drivers took time to take effect. Geopolitical shifts, increased production and supply from Iran meant that supplies did not decline to the expected extent. In addition, the economics of shale also underwent a change: producers who had made large investments decided to get as much as they could from their fields, so production cuts were not sharp, even as technology improvements reduced costs of extraction of shale oil and gas, keeping investments going even when prices fell. The net result was that the low oil price scenario proved far more resilient than many expected, stretching well into 2017.

However, since then, other factors have intervened to affect the demand-supply balance in the volatile world of oil and gas. One was the ability of the principal exporting countries to limit supplies far more than Organization of the Petroleum Exporting Countries (OPEC) had managed in recent times. Besides greater discipline among OPEC producers overall, which helped implement quotas and restrict production, the largest producer, Saudi Arabia, changed its position on the oil price question and agreed to limit its production in late 2016. Oil producers, meeting in Vienna in December 2016, struck a deal that would hold back 558,000 barrels a day of crude from the market (Fletcher, 2016). This resulted in a sharp fall in available oil inventories, aggravated by political unrest in Venezuela and its effect on that country's oil production, as well as concerns about the Trump administration's decision to walk out of the Iran nuclear agreement and impose sanctions once again. This would shrink Iran's contribution to the global supply, heightening uncertainty in markets and triggering renewed speculation in oil. As a result, oil prices have been rising from July 2017. Indeed, the increase could have been even steeper, but for the US shale factor. Recent higher prices have meant that fields that were unviable have turned viable and investments that had to be stalled could be revived (Alonso Álvarez and Di Nino, 2017).

But the rise in oil prices need not have only negative effects on the global economy, since oil exporters (many of whom depend on oil revenues for budgetary resources) may ramp up public spending. Overall, however, since commodity prices are known to move in tandem with oil prices, global inflation may revive. That could hasten the retreat from the easy money and low interest rate policies adopted by central banks across the globe. This, in turn, could subvert the almost invisible recovery from the recession that optimistic analysts have been celebrating. And increasing oil prices would definitely affect large developing countries that are oil importers, such as China and India.

Concerns about global trade

A major change in the nature of the global economy in the decade after the GFC has been in global trade. Since the early 1990s – especially in the period 2002–2008, cross-border trade grew much more rapidly than total world output, and the integration of countries through greater exchange of goods and services essentially became the primary engine of growth. It is true that the explosion of financial activity that has become such a prominent feature of contemporary capitalism also added substantially to income growth, and indeed generated the bubbles that were then expressed in more trade. But whatever the origins, this period was also the apogee of trade globalisation.

In the process, a few developing countries – particularly China – emerged as major beneficiaries of such trade expansion, and then brought about a significant increase in

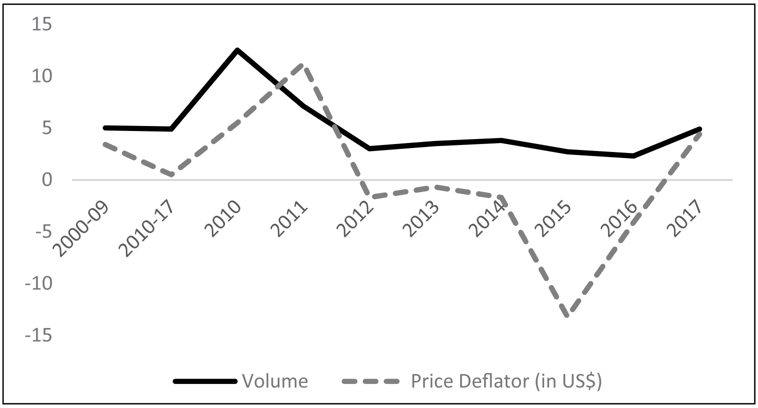

Figure 3. World trade in goods and services (% change per year) 2000–2017.
Source: IMF, 2018b.
IMF: International Monetary Fund.

what was known as South–South trade. The geographical relocation of production and the emergence of global value chains generated significant increases in intra-industry trade among developing countries, which were often directed to final demand in advanced economies, but simultaneously enabled income and demand expansion in the periphery. The associated growth of several emerging economies was more rapid than in the core, giving rise to theories of global income convergence and even of the 'decoupling' of some countries in the periphery (particularly those in developing Asia) from the growth poles in the North.

The GFC put paid to the latter theory, even as the arguments about greater income convergence were shown to be overly based on a very limited number of 'success stories' in the developing world. But the pattern of trade in the decade after the crisis has shown the fragility of that trade expansion. As indicated in Figure 3, the period after 2010 in particular has been marked by a significant deceleration of world trade in goods and services. Most of this has been because of price collapses, as volume changes have been far less marked. While trade volumes grew by an average of 5% per annum over 2000–2009, they decelerated only marginally to 4.9% during 2010–2017. However, increases in world trade prices slowed down from 3.4% to 0.5% per annum in the subsequent period, causing the growth in world trade values to fall below global output growth for the first time in the period of globalisation (i.e. after 1980). Indeed, from 2012 to 2016, world trade prices fell, sometimes sharply, driven by the end of the commodity super-cycle. The slight recovery in 2017 still left global trade values around 15% below those prevailing in 2011.

The situation deteriorated after 2014. Figure 4 shows that there were absolute declines in export values (in USD terms) of developing countries since January 2014. The value of exports of developing countries in the 6-month period July–December 2016 was as much as USD725 billion lower than the value 3 years earlier, in July–December 2014. Much of this decline was due to South–South trade: while exports to the advanced economies declined by 20% over this 3-year period, those to developing countries fell by 25%.

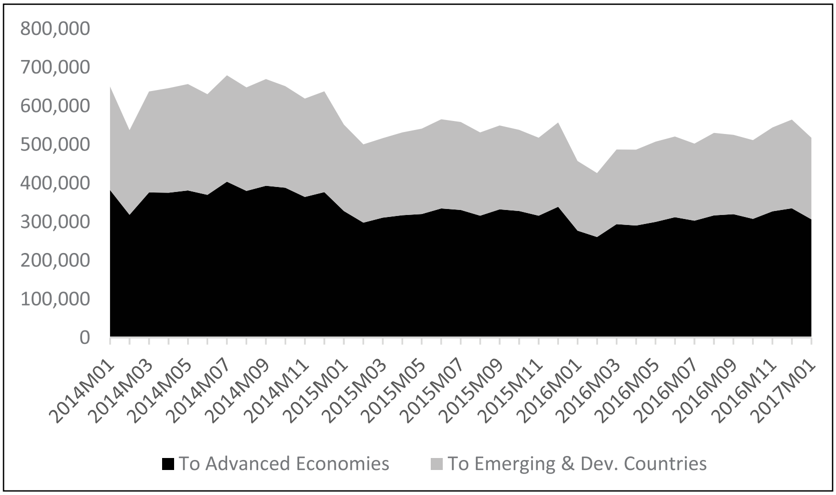

Figure 4. Exports of emerging and developing countries, $ bn.
Source: IMF, 2018c.
IMF: International Monetary Fund.

This was largely because of the dampened significance of China as an important market for developing country exports. The dramatic emergence of China as a substantial player in the global trade was significant not only because its exports have penetrated nearly all countries' markets, but because it became a major destination for developing country exports, especially of raw materials and intermediate goods. China's demand even drove up the prices of many primary products, leading to terms of trade improvements that contributed hugely to increased incomes in primary exporting countries. But in the period 2014–2017, China's share of total exports from developing countries as a group declined, recovering only slightly in late 2017. Conversely, the shares of the Euro Area and the United States were stable or increased slightly (Figure 5).[1]

The lower demand from China meant that, between July 2013–June 2014 and July 2015–June 2016, developing country exports to China fell by USD78 billion, amounting to around a quarter of the overall decline in exports to other developing countries. This reflects the change in China's own external strategy: as the Chinese economy rebalances towards more domestic demand-led growth rather than export-led growth, it requires fewer imports from developing countries to use in processing for further export. This explains partly why – even as Chinese exports to developing countries have been volatile but still remained largely at the same level since January 2014 – imports from developing countries fell quite sharply in early 2015, since then stagnating at lower levels. Therefore, China is unlikely to play the same role of providing a much-needed demand impetus for developing country exports that it played in the earlier decade. The possibility of Asia becoming a viable alternative growth pole for the world economy is also thereby undermined.

All this has to be seen in the context of the developing trade war that is incipient between the United States and China, something that could yet expand into a broader scenario of trade instability across many more economies. The protectionist actions of

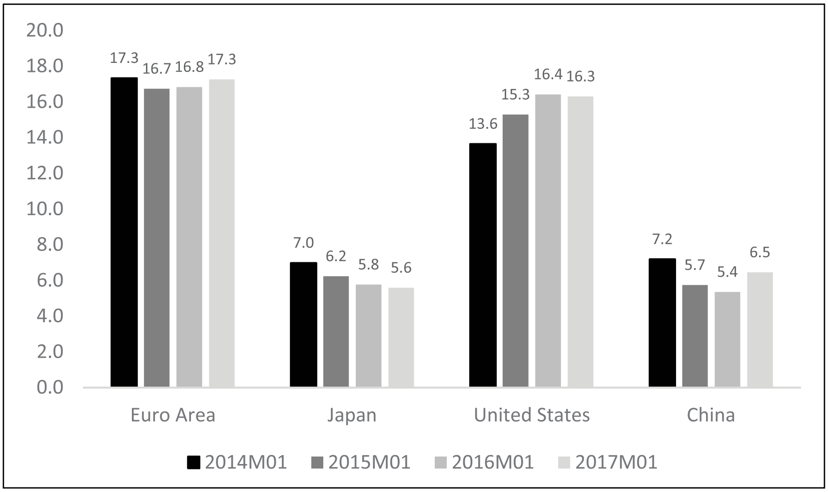

Figure 5. Major destinations of developing country exports (%), 2014–2017.
Source: IMF, 2018c.
IMF: International Monetary Fund.

the Trump administration are not likely to help the USA strengthen domestic producers and reduce its trade deficit, because they are not part of a wider and more systematic industrial policy that could regenerate economic activity and employment in the USA. But they could nevertheless set off a trade war that results in a shrinkage of world trade just as in the 1930s. The Trump administration sees in protectionist actions a way of forcing a robust recovery from long years of stagnation, but what it may actually get is an accentuation of the recession.

Implications for developing countries

As a result of all this, a decade after the GFC, developing countries still bear the scars in the form of lower growth and lower investment rates. When the crisis occurred, the developing world was seen to be different; its economies were supposedly more able to continue expanding because of the 'catching up' propensities assumed by mainstream theorists. There was much talk of the 'decoupling' of developing and advanced economies, with China and some other countries emerging as alternative growth poles – but this proved to be wrong.

It is certainly true that China, generally following more heterodox policies with substantial state direction of the economy, continued to show rapid (but decelerated) growth, and India also continued to grow reasonably quickly (although much of that growth reflected increases in finance and public administration). However, overall the developing world turned out to be much more dependent upon growth in the advanced economies, and over the past decade, its economic expansion also slowed.

Figure 6 describes aggregate real economic output growth in the decade leading up to the global crisis and the decade thereafter in some major developing economies/

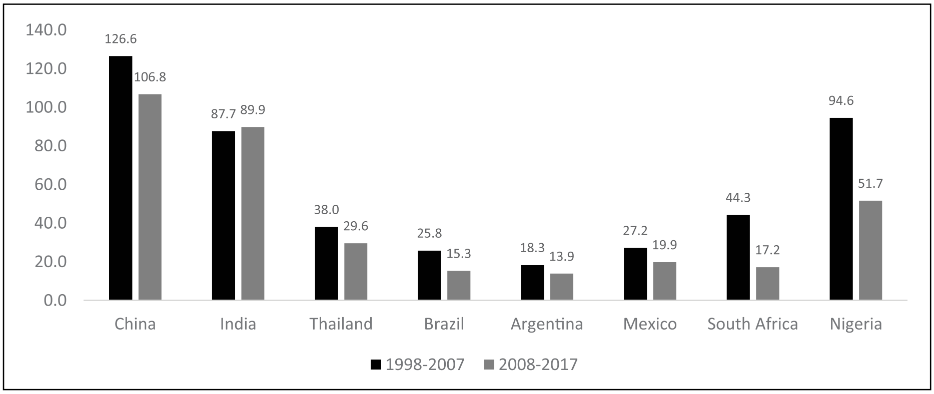

Figure 6. Change in real GDP in decade before and after Global Crisis (% increase over entire decade).
Source: The World Bank, 2018.

emerging markets. (It is worth remembering that the first period also included a global recession, in 2001–2002). Other than India, where there was a slight increase, all the other economies had less expansion than in the previous decade, in some cases very substantially so.

This deceleration reflected another feature, which surprisingly many countries of the developing world also had in common: a reduction in aggregate investment rates, typically accompanied by falling savings rates as well. Figure 7 shows investment and savings rates (gross capital formation and gross savings as proportion of GDP) in six major developing countries – the two largest in each developing region.

In four of these countries, investment rates showed declining trends – in some cases very sharp falls – after 2010. (The exceptions, Mexico and Nigeria, simply showed stagnation around relatively low levels.) China had exceptionally high rates of investment that crossed half of GDP in 2010, and reducing such high levels has been very much part of the Chinese government's efforts to rebalance the Chinese economy towards domestic consumption demand. But for the other five countries, low investment rates are involuntary and undesired: they still need to increase their investment levels if their development project is to continue. In India, for example, the falling investment rates have been a major source of policy concern for several years now, but various efforts to revive it have not been successful. In Brazil, the steep decline in investment rates has been associated with near crisis and political turmoil. In South Africa and Argentina, this decline has fed into other significant problems such as poor employment generation and lack of diversification.

Obviously, the factors behind falling and low investment rates (and to a lesser extent, savings rates) would be specific to each economy. Nevertheless, the broad common pattern is striking. It is true that this relates to only six countries, but they constitute the largest economies in three very distinct developing regions, and there is no immediately evident reason why they should all share this common feature.

So what is it about the global economy that is creating conditions for such a generalised decline in investment rates? The Chinese experience should be treated

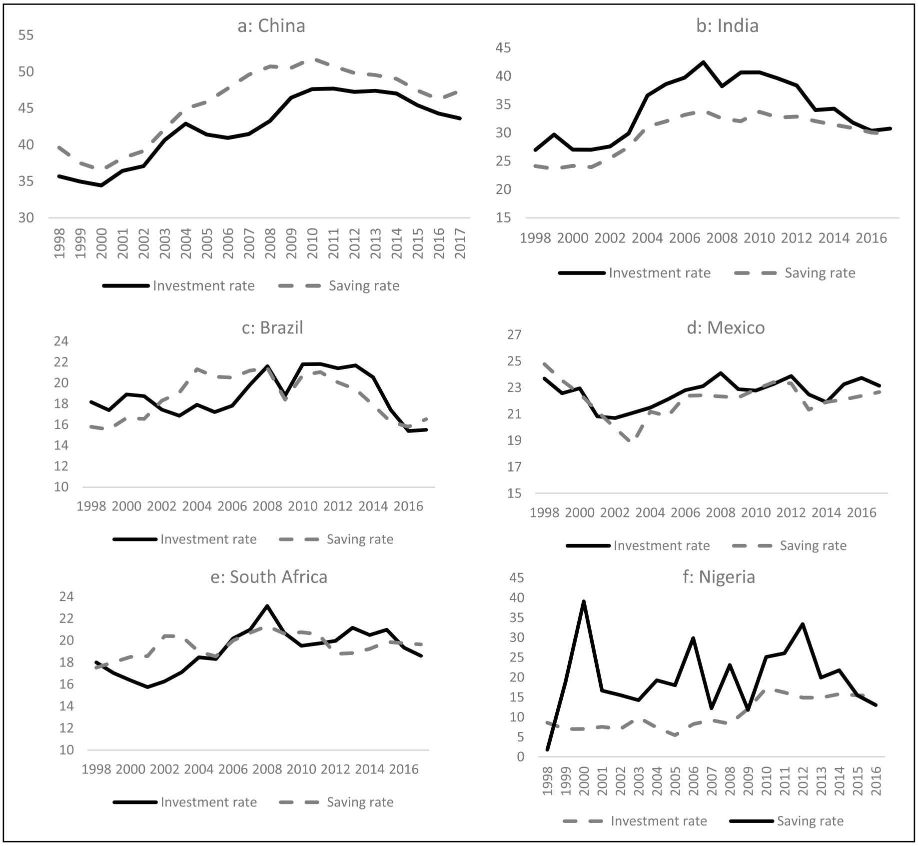

Figure 7. Investment and savings rates (% of GDP).
Source: The World Bank, 2018.

differently for reasons mentioned earlier, and also because China's investment rate remains excessively high, even with the recent decline. But the experience of the other economies points to the limitations of accepting the now-standard neoliberal approach to economic policy.

The prevailing macroeconomic policy model focusses on fiscal consolidation whatever the circumstances, and on more regressive tax strategies that privilege the rich; it relies on export demand as the main engine of growth, and thereby suppresses wage incomes and domestic demand. These together generate outcomes that do not allow domestic markets to expand as they could, which obviously acts as a disincentive to investment. If many or even most countries rely on this strategy, global demand is further inhibited. And in the prevailing uncertain global climate, when trade itself has become another battleground, such concerns become magnified for potential investors, who prefer to take easy pickings in the financial markets rather than engage in productive investment with unknown consequences. Real investment therefore suffers, and further impacts on output.

As long as developing countries remain tethered to the advanced economies – not just in terms of market integration but also, perhaps even more tellingly, in terms of approach to policy-making – these problems will continue and may worsen severely.

Conclusion: Inequality, instability and insecurity

Contemporary globalised capitalism has managed to overrun and conquer its opponents (such as: trade unions and other movements that could reduce capital's bargaining power; democratic processes that bring in regulation and accountability; voices speaking for the larger social good rather than the interests of big corporations) to the point where there are hardly any checks and balances. But such checks and balances are in fact essential for capitalism if it is to avoid economic volatility and achieve social stability and progress.

In purely economic terms, this 'success' has led to a major problem of demand deficiency, which in turn affects accumulation which is at the heart of this economic system. In the past, new sources of demand were created through financialisation and credit bubbles, but now appear to have run their course, despite almost endless injections of synthetic liquidity through very loose monetary policy. In addition to material stagnation, there are severe social and political consequences that are now evident in almost all societies across the world. Not only has inequality increased dangerously even beyond the extreme levels of a decade ago, there is also more widespread despair and alienation. The consequent socio-political responses are often unpleasant in the extreme and generate instabilities that threaten the very basis of functioning societies. In an almost textbook extension of the biological argument of the prey–predator relationship, capitalism has killed off all its prey, to the point that its own very existence is now threatened.

This is reflected in the persistent decline in rates of economic growth, often described as 'the new normal' or 'secular stagnation' – which matters crucially because capitalism exists in order to expand in economic terms. This is essentially because the system breeds massive increases in income and wealth inequality across the world, and so cannot generate adequate increases in effective demand without resorting to credit bubbles that have become increasingly ineffective over time. Yet the persistent increase in indebtedness, across households, companies and governments, generates fragilities that could easily bring on another financial crisis in some location. Falling growth, rising debt and increasing inequality are hardly news any more, but taken together they point to a morass from which the global capitalist system cannot extricate itself without fundamental transformation.

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Note

1. It should be noted that developing country exports here include exports from China, which complicates the matter slightly – but this should not affect temporal changes too much.

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