Global financial bubbles and capitalist crisis

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13 October 2008, Caracas
These slides cover new data:

1) Background: deep-rooted causes
2) Financial capital takes over
3) Real estate speculation
4) Financial market volatility
5) Stock market devaluations
6) Housing devaluations
7) Financial losses
8) Is inflation a way out?
9) Currency movements are a key variable

Regrets, no conclusions yet – just a review of recent IMF data, with a few side remarks
Autopsy of financial meltdown, September 2008

What lies deep below current financial bubble?...

Source: IMF, Global Financial Stability Report

Sources: Bloomberg L.P.; and IMF staff estimates.
1) Background: Stagnant global real annual GDP growth, 1970-2008

...longer term cause of financial bubble...

Source: IMF Global Financial Stability Report

...apparent 2000s uptick but per capita growth declined since 1960s...

US corporate profits derived much less from manufacturing products; much greater sources of profits came from abroad; profits also came more from returns on financial assets. Source: Gerard Dumenil and Dominique Levy

Rest of the world: (———); Financial sector: (-----); Manufacturing: (..........)

Profits are measured before profit taxes. The rest of the world corresponds to the excess of profits made on US investments abroad over the profits made by the rest of the world on foreign direct investment in the US. (These profits may remain in the country where the investment is made.) Trade, Construction, Public Utilities, Transportation and Communications, and services are not represented.

Source: NIPA (BEA).
... last gasp of 2003-08
GDP growth based in part on a frantic ‘spatial fix’ to over-accumulation...

Global real trade growth (% per year)
1985-2008
(especially driven from E.Asia)

Source: IMF Global Financial Stability Report
(as implied by Baltic Dry Index)
2) In the West, financial capital takes over

(Borrowing as a percentage of debt outstanding annualized, seasonally adjusted)

... the ‘temporal fix’ via finance: reliance upon rising debt ratios...

Source: International Monetary Fund Global Financial Stability Report

Source: IMF *Global Financial Stability Report*

... with financial innovations facilitating the bubble’s growth...
... the next stage of US financialisation was generating securities on the back of actual credits, a great danger once the underlying values began to erode...
Worst threat: credit default swap spreads, 2004-08

... credit default swaps are part of $55 trillion credit derivatives market to insure banks against risk, but they create more risk especially when spread rises...

Source: International Monetary Fund, *Global Economic Outlook*, October 2008
3) Real estate speculation: US housing investment as % of GDP, 1952-2007

...these bubbles emerge on a fairly regular basis ("Kuznets cycle")...

Source: Federal Reserve Board, NBER
Household net worth and debt in the US

...artificial housing bubble as US households built real estate empires on debt...

Source: IMF, World Economic Outlook, October 2008
US & other housing bubbles (2002-06 prices)

... but not only the US, most major economies witnessed real estate speculation...

Source: Federal Reserve Board, NBER
4) Financial market volatility and contagion

... notwithstanding periodic bursts along the way, which increased volatility everywhere...

Financial market volatility, 1996-2008

Source: International Monetary Fund Global Financial Stability Report

... with periodic panic sales when it became apparent that financial assets are not undergirded with real assets...
5) Stock market devaluations (since 1994)
Source: International Monetary Fund *Global Financial Stability Report*

... huge losses especially in Third World stock markets, e.g. Thailand and Indonesia 90%+ crashes in 1998...

<table>
<thead>
<tr>
<th>Emerging markets</th>
<th>Peak to trough</th>
<th>Equity Price Index</th>
<th>Equity Market Capitalization/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>(percent change)</td>
<td>Rise to peak</td>
</tr>
<tr>
<td>Hong Kong SAR</td>
<td>July 1997–Aug. 1998</td>
<td>99</td>
<td>-60</td>
</tr>
<tr>
<td>Korea</td>
<td>Apr. 1996–Aug. 1998</td>
<td>100</td>
<td>-83</td>
</tr>
<tr>
<td>Thailand</td>
<td>May 1996–Aug. 1998</td>
<td>174</td>
<td>-93</td>
</tr>
</tbody>
</table>

Memorandum item: Advanced economies

... including vast devaluations of Western finance even before 2008...

Stock market crashes, pre-2008

Sources: Thomson Financial I/B/E/S; and IMF staff estimates.
Volatile $ flows into US stock market, 1990-2008

... but also in the North, e.g. $7 trillion devaluation in even New York, 2000-02...

Source: International Monetary Fund Global Financial Stability Report
Stock market volatility: emerging markets

... smaller stock markets in middle-income countries especially prone to boom/bust during late 2000s ...

Source: International Monetary Fund Global Financial Stability Report
Emerging market share devaluation, 2007-08

Source: International Monetary Fund Global Financial Stability Report

...with partial hits in last year...
Foreign holdings of equity, 2003, 2006
Source: International Monetary Fund Global Financial Stability Report

...with special danger when foreign portfolio investment can quickly flee...
Bursting the bubbles: IMF ‘heat’ indicator

Note: The heat map measures both the level and 1-month volatility of the spreads, prices, and total returns of each asset class relative to the average during 2004–06 (i.e., wider spreads, lower prices and total returns, and higher volatility). That deviation is expressed in terms of standard deviations. Green signifies a standard deviation under 1, yellow signifies 1 to 4 standard deviations, and red signifies greater than 4 standard deviations. MBS = mortgage-backed security; RMBS = residential mortgage-backed security.

Emerging markets

Corporate credit

Prime RMBS

Commercial MBS

Money markets

Financial institutions

Subprime RMBS

...worse coming in emerging markets, soon...


...the biggest financial investments emerged in US real estate, with higher fictitious valuations than other bubbles...

Sources: Reinhart and Rogoff (2008) and sources cited therein.
Bond market volatility, 2000-08

...bonds – issued so as to finance corporations, housing and countries – also became unstable, after a period (2004-07) of attracting overaccumulated capital...

Source: International Monetary Fund, *Global Economic Outlook*, October 2008
6) Housing devaluations: Change in prices, Jan 2007-July 2008

...and the bursting of the bubble began in the US, Japan, Denmark and Ireland in 2007...

Source: IMF, World Economic Outlook, October 2008
Writing off US household net worth (%/year)

... after 2000-02 stock market crash, household worth grew through housing, until 2007...

Source: International Monetary Fund - Global Financial Stability Report
## 7) Financial losses: IMF estimates of devalued US loans ($bn)

Source: IMF *Global Financial Stability Report*

<table>
<thead>
<tr>
<th>Category</th>
<th>Outstanding</th>
<th>April 2008 GFMR</th>
<th>Estimated loss October 2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Subprime residential</td>
<td>300</td>
<td>45</td>
<td>50</td>
</tr>
<tr>
<td>Alt-A residential</td>
<td>600</td>
<td>30</td>
<td>35</td>
</tr>
<tr>
<td>Prime residential</td>
<td>3,800</td>
<td>40</td>
<td>85</td>
</tr>
<tr>
<td>Commercial real estate</td>
<td>2,400</td>
<td>30</td>
<td>90</td>
</tr>
<tr>
<td>Consumer loans</td>
<td>1,400</td>
<td>20</td>
<td>45</td>
</tr>
<tr>
<td>Corporate loans</td>
<td>3,700</td>
<td>50</td>
<td>110</td>
</tr>
<tr>
<td>Leveraged loans</td>
<td>170</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td><strong>Total for loans</strong></td>
<td><strong>12,370</strong></td>
<td><strong>225</strong></td>
<td><strong>425</strong></td>
</tr>
</tbody>
</table>

...has IMF correctly estimated size of devaluation? $425bn...
### IMF estimates of devalued US financial assets: securities ($bn)

Source: IMF *Global Financial Stability Report*

<table>
<thead>
<tr>
<th>Asset Type</th>
<th>Outstanding</th>
<th>April 2008 GFSR</th>
<th>Estimated mark-to-market loss</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABS</td>
<td>1,100</td>
<td>210</td>
<td>210</td>
</tr>
<tr>
<td>ABS CDOs</td>
<td>400</td>
<td>240</td>
<td>290</td>
</tr>
<tr>
<td>Prime MBS</td>
<td>3,800</td>
<td>0</td>
<td>80</td>
</tr>
<tr>
<td>CMBS</td>
<td>940</td>
<td>210</td>
<td>160</td>
</tr>
<tr>
<td>Consumer ABS</td>
<td>650</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>High-grade corporate debt</td>
<td>3,000</td>
<td>0</td>
<td>130</td>
</tr>
<tr>
<td>High-yield corporate debt</td>
<td>600</td>
<td>30</td>
<td>80</td>
</tr>
<tr>
<td>CLOs</td>
<td>350</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total for securities</strong></td>
<td><strong>10,840</strong></td>
<td><strong>720</strong></td>
<td><strong>980</strong></td>
</tr>
<tr>
<td><strong>Total for loans and securities</strong></td>
<td><strong>23,210</strong></td>
<td><strong>945</strong></td>
<td><strong>1,405</strong></td>
</tr>
</tbody>
</table>

Note: ABS = asset-backed securities; CDO = collateralized debt obligation; CLO = collateralized loan obligation; CMBS = commercial mortgage-backed security; MBS = mortgage-backed security.
Writing off overaccumulated finance

Source: International Monetary Fund Global Financial Stability Report

...$1.4 trillion is the biggest absolute loss to date...

Banking losses (in billions of U.S. dollars, left scale)
Other financials (left scale)
Percent of GDP (right scale)
8) Is inflation a way out? Devaluing financial assets through inflation... a viable strategy for deflating debt?...

Source: IMF, World Economic Outlook, October 2008
Inflation rates


...lowest rates are in the West...
Price rises for oil, food, metals, 1980-2008

... and it appears oil price is due to speculation...

Source: IMF Global Financial Stability Report
9) Currency movements are a key variable: Importers and exporters of capital, 2007

.. the US still takes in the world’s surplus finance, mainly from Asia...

Source: International Monetary Fund, Global Financial Stability Report
G3 currency value changes, 2000-08

Source: International Monetary Fund Global Financial Stability Report

leaving the US$ still overvalued, in spite of the 30% devaluation since 2001...
G3 short term (real) interest rates

...compelling the US to raise rates from 2004-06, but can it continue?...

Source: IMF, World Economic Outlook, October 2008