The global economic crisis: Capitalist roots and financial shoots

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Cartoons by Zapiro
This presentation covers:

1) Background: causes
2) Financial capital ascends
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
10) Keep in mind context!
   a) *global accumulation cycle*
   b) *global uneven development*

(Most data and graphs are drawn from the International Monetary Fund reports in October 2008 unless otherwise specified)
1) Cause: Declining per capita GDP growth rate, since early 1970s

Correcting GDP for ‘genuine progress’ makes this trend even more extreme (shown here in absolute terms)

Source: redefiningprogress.org
Root ‘overaccumulation’ process: source of declining US profits during globalisation/financialisation era

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).
Dani Nabudere’s thesis vindicated

The Crash of International Finance Capital and The Rise and Fall of Money Capital
2) In the West, financial capital ascends

(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

... with financial innovations facilitating the bubble’s growth...

Source: IMF Global Financial Stability Report
... 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...

Source: IMF, World Economic Outlook, October 2008
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...
... 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>Equity Price Index (percent change)</th>
<th>Equity Market Capitalization/GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Peak to trough Rise to peak</td>
<td>Peak to trough At peak</td>
</tr>
<tr>
<td>Hong Kong SAR</td>
<td>July 1997–Aug. 1998 99</td>
<td>-60</td>
</tr>
<tr>
<td>Korea</td>
<td>Apr. 1996–Aug. 1998 100</td>
<td>-83</td>
</tr>
<tr>
<td>Thailand</td>
<td>May 1996–Aug. 1998 174</td>
<td>-93</td>
</tr>
</tbody>
</table>

Memorandum item:

**Advanced economies**

<table>
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<th>Equity Price Index (percent change)</th>
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<td>Peak to trough At peak</td>
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</table>
Stock market crashes, pre-2008... including vast devaluations of Western finance even before 2008...
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...
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...

... 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)

<table>
<thead>
<tr>
<th>Category</th>
<th>Outstanding</th>
<th>April 2008 GFSR</th>
<th>Estimated loss</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>Total for loans</td>
<td>12,370</td>
<td>225</td>
<td>425</td>
</tr>
</tbody>
</table>

Source: IMF Global Financial Stability Report

...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></th>
<th>Outstanding</th>
<th>April 2008 GFSR</th>
<th>Estimated mark-to-market loss October 2008</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.
8) Is inflation a way out? Devaluing financial assets through inflation...a viable strategy for deflating debt?...

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
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
## 10) Context! 1: the accumulation cycle

**Long-wave analysis (Bernstein/Nicholas)**

<table>
<thead>
<tr>
<th>trough</th>
<th>peak</th>
<th>trough</th>
<th>duration</th>
<th>hegemonic power</th>
<th>technology</th>
</tr>
</thead>
<tbody>
<tr>
<td>1790</td>
<td>1814</td>
<td>1848</td>
<td>58</td>
<td>Britain</td>
<td>canals</td>
</tr>
<tr>
<td>1848</td>
<td>1872</td>
<td>1893</td>
<td>45</td>
<td>Britain</td>
<td>railways, steam (steam engine)</td>
</tr>
<tr>
<td>1893</td>
<td>1917</td>
<td>1940</td>
<td>47</td>
<td>Britain</td>
<td>steel, combustion engine, electricity, chemicals, telephone</td>
</tr>
<tr>
<td>1940</td>
<td>1975</td>
<td>2000?</td>
<td>60</td>
<td>United States</td>
<td>electronics, plastics, aerospace, nuclear energy</td>
</tr>
<tr>
<td>2000</td>
<td>2030</td>
<td>2050</td>
<td>50</td>
<td>United States</td>
<td>computers, biotechnology, robotics</td>
</tr>
</tbody>
</table>
Long-wave analysis (Kondratief/Bernstein/Nicholas)

**IDEALISED ECONOMIC LONG WAVE MODEL**

**THE ‘UPWAVE’**

Prices start to rise slowly along with economic activity. Prosperity increases until prices rise rapidly and it’s boom-time.

**Minor Recession**

**25-30 YEARS**

Prices and/or inflation peak leading to a recession. The ‘downwave’ begins here.

**Minor Recession**

**8-10 YEARS**

This recession is longer and steeper than any that took place during the ‘upwave’.

**Whooppee!! An economic recovery. Things are just like they used to be. It’s going to last forever!**

**Whoops! Something’s happened. We didn’t expect this one at all. It never happened in the upwave. High unemployment. Bankruptcy. Depression.**

**20-25 YEARS**
Context 2: uneven global development
(see next presentation for Africa analysis)

GDP, 2007
($ trillions)
World: $54.3
US: $13.8
Europe: $12.2
Africa: $1.1