Global Financial Crisis (Aug 2011)

by John Hutchinson

We are all familiar with the sequence of events of the financial crisis popularly known as "the credit crunch" which developed in 2007-8. This reached a climax in September and October 2008, symbolised by the collapse of Northern Rock, the demise of Lehman Brothers, the enforced nationalisation of RBS and HBOS and the bankruptcy of Iceland.

However, is this financial crisis over? Have we now moved into a second much more dangerous phase which has two significant points of focus? On the one hand, the banking crisis of toxic mortgages and esoteric financial derivatives (which not even the banks themselves understood) has given way to a sovereign debt crisis. Greece, Ireland and Portugal have all been forced to go cap in hand to the European bank and negotiate and renegotiate bail-outs of their insolvent banking systems. The contagion is threatening to spread to Italy and Spain and drag the whole Eurozone down under the weight of debt, even the industrial powerhouse of Germany.

On the other hand, the present impasse over the raising of the US debt ceiling exposes the dilemma over the continuing crisis as to whether further stimulation of demand through quantitative easing or the cutting of public spending is the way forward.

With both points of focus, political repercussions overshadow grim economic realities. The split between Republicans and Democrats threatens to trigger further downgrading of credit ratings as Democrats want to retain benefits and medical reform whilst Democrats cut taxes and slash public sector spending. This, in turn, could destabilise the global financial system if America‘s government bonds are no longer considered safe investments. As still the prime motor of consumption in the world economy, the paralysis of the United States would send shockwaves throughout the globe from which the BRIC economies would not be immune, dependent as they are on American demand.

The Euro and, indeed, the whole European project could implode if major economies such as Italy and Spain face the same pressures and crises of confidence that have brought Greece, Portugal and Ireland to their knees. Any run on the banking system would be catastrophic as there is such inter-connection of debt that the domino effect could make the collapse of Lehman brothers look like a picnic in which not even the combined might of the EU, the United States and world financial institutions would have the funds to pump liquidity into the banking/financial system.

We no longer seem to understand the difference between the real economy, the actual production of goods and services and the virtual one, the clandestine world of arcane investments and derivatives which seem to have lost all connection to production and employment.

Are these doomsday scenarios likely to come to pass? To discuss the implications of them and explore the fragility of the banking and financial systems, come along to the Tuesday session of the Manchester Salon.

Here are just a few articles/websites you may wish to consult.

http://downloads.bbc.co.uk/podcasts/radio/worldbiz/worldbiz_20110730-0030a.mp3

http://www.guardian.co.uk/business/2011/jul/31/global-economy-washington-deadlock-imf

http://www.telegraph.co.uk/finance/comment/rogerbootle/8673817/The-writing-is-on-the-wall-for-the-US-and-the-dollar.html

http://www.bbc.co.uk/news/business-13842763