Strengthening recessionary trends in global economy

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In the wake of last week's turmoil on global stock markets, which saw the Tokyo market experience its biggest one-day fall since the October 1987 stock market crash before rebounding, attention is increasingly being directed to the strengthening recessionary trends in the world economy.

They are apparent in the top four economies: the US, China, Japan and Germany.

A widely followed and generally reliable report on investor sentiment said confidence had collapsed in both Germany and in the eurozone.

As the *Financial Times* reported, the ZEW Indicator of Economic Sentiment for the Eurozone fell 25.8 points to 17.9 in its biggest decline since the start of the pandemic. In Germany, the index fell by 22.6 points, a decline three times larger than suggested by a poll of economists, and the lowest level since the start of the year.

The comments on the numbers reported by the FT were all downbeat. ZEW president Achim Wambach said: "The economic outlook for Germany is breaking down." He said there was "high uncertainty" caused by what he claimed was an "ambiguous" monetary policy on the part of the European Central Bank, poor business data in the US and concerns over the prospect of military conflict in the Middle East.

The senior economist at Oxford Economics, Alexander Valentin, said the weakening growth outlook and worsening investor confidence provided arguments for the ECB to cut rates at its next meeting in September and again by the end of the year.

Other comments were in a similar vein. The senior economist at Deutsche Bank, Robin Winkler, said the optimism over a recovery in the German economy that had been present in the spring had now "completely evaporated." Germany's GDP in the second quarter contracted by 0.1 percent.

A note to clients from T Rowe Price said there was a "risk that GDP growth in Germany shrinks this year" and that it could become trapped in a "self-fulfilling loop where weaker expectations lead to weaker growth."

In China, GDP growth for the second quarter was 4.7 percent, a significant fall from growth of 5.3 percent in the first. The slowdown in the economy has set off an unusual battle between the country's banks and the People's Bank of China (PBoC), the central bank.

Faced with worsening economic prospects, banks have been investing money in the bond market, sending down yields to as low as 2.1 percent on 10-year bonds. (The yield on bonds falls as demand for them increases and the price goes up.)

For several months, the PBoC has been discouraging these moves and last week took the step of naming and shaming a group of four rural banks, saying they were "manipulating" bond prices in the secondary market.

The concern of the authorities, not without some justification, is that a situation could arise as took place in the US in March 2023. Silicon Valley Bank and other regional banks were confronted with major losses on their holdings of Treasury debt when interest rates rose, and they went under.

While there are concerns over financial stability, political considerations are also playing their part. The PBoC campaign is aimed at trying to head off other conclusions being drawn—that the turn to bonds and the fall in yields is an indication of concern about the direction of the economy and the need for a change of course in official policy.

As a comment in the FT this week put it, "China's bond market is now flashing urgent deflationary warning signs" and "policymakers would do well to

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take heed."

There has been some acknowledgement by President Xi Jinping of the need to increase effective demand and boost consumption spending, following a meeting of the Political Bureau of the Communist Party of China earlier this month. And the PBoC has recently referred to "insufficient effective [domestic] measures." But there is no sign of significant action.

The thrust of the government's economic policy remains focused on the longer-term objective of investment in "high quality productive forces." But this policy, which is aimed at increasing exports of high-tech goods, does nothing to address the domestic situation. It is characterised by the problems resulting from the debt problems in the property market and falling consumer confidence, leading to calls for action by central authorities.

In a sign of the downturn in the Chinese economy, especially in construction, the steelmaker Baowu has warned of a "long and harsh winter" ahead for the industry, under conditions where the benchmark price for iron ore has already fallen 30 percent so far this year.

After something of an upturn in 2023, the Japanese economy appears to be sliding back into a cycle of low growth. In the first quarter, it contracted at an annualised rate of 2.9 percent on the back of falling consumption spending , which recorded a decline for four consecutive quarters, the longest streak since 2009, and a decline in exports.

The forecast for the second quarter is for a rebound with expectations that it will be 2.1 percent on an annualised basis, according to a Reuters poll. But there are doubts about how long this might continue. The outlook is clouded because of the decision by the Bank of Japan (BoJ) to lift interest rates, thereby increasing the value of the yen, which could hit exports. The prospect for exports is also clouded by the signs of a slowdown, and possibly a recession, in the US economy.

The market turmoil of last week underscores the fragility of the financial system based on a mountain of debt, above all in the US.

The sell-off was sparked by a lower-than-expected US jobs report number and the interest rate decision of the BoJ. The resultant rise in the value of the yen led to the unwinding of so-called carry trades, in which cheap Japanese money was used to finance investments in US financial markets.

As the *Wall Street Journal* noted, the turmoil was a "deleveraging" episode in which investors using borrowed money had to sell assets in one area of the market to cover losses in another. It reported that according to Goldman Sachs, "July was one of the largest deleveraging episodes for hedge-fund clients" in the past 10 years.

In recent days, Fed officials have been taking to the airwaves to offer reassurances that the economy is not moving into a recession. But facts on the ground are telling a different story. Consumer confidence is down, and lower-paid workers are living off their credit cards in the face of steep price rises in basic necessities, well in excess of official inflation numbers. Total credit card debt has hit a record of $1.14 trillion.

And a jobs massacre has begun with thousands of layoffs in high-tech in past months and sackings in the auto industry. Since the start of the year, more than 8,000 jobs have been axed by the "Big Three" auto manufacturers in the US. Now it has been announced that 2,450 workers will be laid off at Stellantis' Warren Truck plant, threatening the complete shutdown of the factory.

Paramount has announced the closure of its TV studios and the firing of 15 percent of its workforce.

Meanwhile Wall Street, ever anxious to get its hands on cheaper money to sustain the debt mountain, has been calling for the Federal Reserve to start cutting its rate at its next meeting in September by at least 25 basis points (0.25 percent) and possibly by 50, followed by more cuts before the end of the year.

With signs of financial instability increasing and growing indications of recession, all eyes will be on the remarks of Fed chair Jerome Powell to the annual conclave of central bankers at Jackson Hole, Wyoming, later this month.

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