[The Next Financial Crisis?]

Paul McCarthy – Mannkal - 1 February 2016

"*The ASX's Elmer Funke-Kupper nailed it in the PwC survey of global chief executives tabled at Davos this week when he said the world was burdened with $US200 trillion of debt that could not be paid back.*"

The opening quote of an article by Stephen Bartholomeusz in The Australian last week (*A Global Debt Time Bomb Is Ticking*) neatly illustrated the threat to the world economy. Ironically, the warning was delivered at the Davos Forum, an annual gathering of the very global financial, corporate and political elite responsible for both the 2008 Global Financial Crisis and the subsequent near-decade of economic stagnation, which for many has been a depression.

At the root of the GFC was a long period of artificially low interest rates. Cheap money encouraged people and institutions to borrow, spend and chase increasingly risky returns. The returns turned out to not be worth the risk (in part, due to US Government lending on homes people couldn't afford). The crisis hit, the risk-takers squealed and taxpayer funds bailed them out. When this (predictably) failed to return business-as-usual, the US Federal Reserve, Bank of England, Bank of Japan and even the European Central Bank embarked upon unprecedented levels of Quantitative Easing, a program which, put simply, amounted to pumping cash into banks and large institutions. Academics claimed this would flow directly to households; the results have shown a slight trickle at best.

If insanity is doing the same thing twice and expecting different results, QE was a double-down bet on the asylum. This new cash splash, with money even cheaper than in the pre-crisis period, saw funds flow into commodities, energy, real estate, emerging markets, the Dow, vintage cars; any market where hard assets could be bought with cheap but idle cash. Where cheap money bid up a bubble prior to 2008, more, cheaper money has blown up a bigger bubble in more asset classes. But the real economy, of value-added production, has not recovered. No wealth is created by the government printing money (diluting the value of existing savings) and lending it to those who bid up existing assets. This creates "activity" and contributes to the flawed statistic, GDP, but doesn't increase the net stock of wealth – as is apparent in the US, where times are not good for most. Real incomes are not rising, jobs are not secure and many work part-time, often in multiple jobs to get by. Living standards have not grown in a broad-based manner over the last eight years. The alleged benefits of QE haven't transpired, but the increased debt remains.

Bartholmeusz quotes William White, former Chief Economist of the Bank for International Settlements, as saying, "Things are so bad there is no right answer. If they raise rates it will be nasty. If they don't raise rates it just makes matters worse." QE has turned out to be little more than an elites' version of Kevin Rudd's $900 cash splash which failed to ignite consumer growth because it didn't address the economy's actual problems. Offering cheap debt to bankers hasn't stimulated the real economy because it was already suffering from too much cheap and misallocated debt. Now, as the debt catches up with a weak economy, we must deal with the same problem as in 2008; just with a heavier debt burden.

Doubling down at a casino may result in the occasional euphoric win, when the game is one of pure chance. The economy, suffering heavy debt and mal-investment, is an entirely different proposition.