Central banks map horror 2023 for masses

By Elisa Barwick

In a 1 January interview with CBS News, IMF Managing Director Kristalina Georgieva urged central banks not to slow the fight against inflation despite tanking growth rates and a third of the world heading into recession. It will be a tough year, she said, "Because the three big economies, US, EU, China, are all slowing down simultaneously", but she demanded they "stay the course" of austerity measures guaranteed to worsen a recession forecast by many.

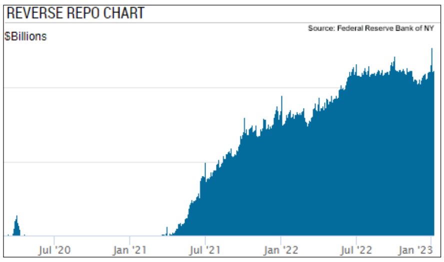
Veteran Asia-based journalist Anthony Rowley in the 31 December *South China Morning Post* gazetted the "risk of a liquidity crisis in the global financial system" on top of the existing myriad of global crises. Rowley points to December warnings by the Bank for International Settlements (BIS) of soaring off-balance sheet derivatives ("The unravelling dollar: BIS rings the alarm", *AAS*, 14 Dec. 2022), with off-balance-sheet foreign exchange swap positions held by banks reaching US$80 trillion according to the BIS Triennial Central Bank Survey. This "'hidden' US dollar debt" is a "scary" prospect, he wrote, "as foreign exchange rates swing ominously". With crashing stock and bond markets and currencies, not-for-profit educational institution the CFA Institute foresees the "breakdown of an entire system rather than of individual parts. In a financial context", Rowley explained, "it denotes the risk of a cascading failure in the financial sector, caused by linkages within the system, resulting in a severe economic downturn".

The dramatic swing from an extended period of monetary easing to monetary tightening is a major factor. Rowley cites a recent IMF blog warning of "heightened uncertainty" as liquidity worsens across all asset classes, posing potential "risks to financial stability". The IMF has also pointed to the "risk of a disorderly tightening in financial conditions that may interact with pre-existing vulnerabilities".

On 22 December *US News* reported a one per cent drop for November in a future economic activity index compiled by business organisation The Conference Board. This brings the six-month drop of the Leading Economic Index to 3.7 per cent. All sectors, including the labour market, manufacturing and housing fell, "reflecting serious headwinds to economic growth", said the organisation's senior director, Ataman Ozyildrim, with the only positive contribution coming from the stock market. Monetary tightening by the US Federal Reserve, he added, "is curtailing aspects of economic activity, especially housing. As a result, we project a US recession is likely to start around the beginning of 2023 and last through mid-year."

Despite the noted contribution from stocks, Reuters reported 31 December that Wall Street ended the year with its "biggest annual drop since 2008" and the first annual fall since 2018. For the year the S&P 500 was down over 19 per cent; the Nasdaq over 33 per cent; and Dow Jones by nearly 9 per cent. The energy and commodities sector were among the few sectors to mark gains. London's *Financial Times* estimates US$30 trillion was wiped off markets in 2022. Turkish-American economist Nouriel Roubini has forewarned of a further 25 per cent collapse of the S&P index under recession conditions.

S&P Global's measure of manufacturing and service sector growth, the US Composite PMI Output Index, showed a marked fall in December with manufacturing at a 31-month low, an economic contraction for the sixth straight month. Another global Purchasing Managers' Index for Manufacturing, provided by JPMorgan, also noted a global contraction in manufacturing, led by trans-Atlantic nations. The St. Louis Federal Reserve has concluded that the majority of US states have economies in recession.



While the Fed's tightening hurts the economy, behind the scenes the central bank is "foaming the runway" with a big cash buffer in preparation for a crash landing of troubled banks. The tightening strategy includes "reverse repo" (repurchase) agreements, where the Fed sells securities to participating institutions with an agreement to repurchase them at a future date. This withdraws liquidity from the banks in the reverse of repo operations which inject cash into banks with ultra-short-term loans. With reverse repos, money is parked at the Fed. At the same time, the Fed's wind-back of quantitative easing injections has proceeded at a slower than advertised pace, with its US$9 trillion balance sheet only shrinking by US$500 billion in seven months. At this rate it will take more than a decade to return to a pre-2008 balance sheet.

Reverse repo volumes have grown sharply since March 2021, coinciding with US President Biden's US$1.9 trillion stimulus package and the blowout of the Archegos hedge fund ("Does extreme Fed juggling act signal the end is nigh?", *AAS*, 9 June 2021), and since mid-2022 have remained at over $2 trillion dollars daily (see graph). The Fed is paying 4.3 per cent interest on these securities held by the banks, better than most market rates.

Along with crushing interest rates, the effect of this austerity is to drain credit that would otherwise go into private lending, i.e., into the economy. Austerity hurts the economy and the people but does not solve underlying problems. As former US Labour Secretary Robert Reich wrote in a 30 November blog post, "Most of the pain is borne by people who are already struggling to keep up with rising prices: lower-wage workers and the poor."

"[T]hese hikes", he said, "already fail to address a major driver of inflation—powerful corporations that are ratcheting up prices to pad their profit margins." Precipitating a recession that hurts the masses will not shift exorbitant energy profits one iota, for instance.

Writing on 12 December, American economist Joseph Stiglitz cited a report he co-authored for the Roosevelt Institute which shows that additional interest rate increases will have a minimal effect on inflation. Only rectifying supply problems will work; in fact "higher interest rates make it even more difficult to mobilise investments that could alleviate supply shortages". He wrote: "Central banks' unwavering determination to increase interest rates is truly remarkable. In the name of taming inflation, they have deliberately set themselves on a path to cause a recession—or to worsen it if it comes anyway. Moreover, they openly acknowledge the pain their policies will cause, even if they don't emphasise that it is the poor and marginalised, not their friends on Wall Street, who will bear the brunt of it."