

Lehman Brothers, September 15, 2008: Six years later ...

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We vividly remember how the collapse of Lehman Brothers almost destroyed the world financial system.

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There was neither remembrance nor anamnesis of that horrible day which shook the financial world and brought it to its knees six years ago. On September 15, 2008, the world witnessed the collapse of Lehman Brothers Holdings Inc. We vividly remember how the collapse of Lehman Brothers almost destroyed the world financial system.

Many would feel happy to assume that the incident is passé and we have left the worst of the times behind us. However, closer looks at each of the following area - housing bubble, the public debt, economic recovery and financial markets - reveal the chinks in the armour. The vulnerabilities are more prominent than ever.

Housing bubble

We are deluded by the rising asset prices in recent times. Last June, the IMF in its Global Housing Watch website, announced that the global index for house prices is on the rise on a GDP-weighted basis. The momentum is as high and comparable to the period preceding that of the 2008 crisis. Swayed by the asset bubble, instead of tightening our seat belts we think that the economy is at last on the right track.

However, a housing bubble doesn't only imply high prices; prices can also soar as a result of demand and supply. Housing bubbles mostly appear when speculators enter a market where demand is already high and try to profit by short-term buying and selling. This further drives the demand and pushes prices up.

The euphoria attached to this phenomenon leads us to assume that the world economy has moved on. The governor of the Reserve Bank of India, Raghuram Rajan, has recently warned us about the global inflation of the asset prices and how it could trigger a major crash if investors stampeded to the exit all at once.

In fact, this whole show is based on speculation and corresponds very little with the pick-up in real economic activity. Speculation in real-estate makes housing prices disconnected with the real

economy.

The real estate market sharply corrected following the crisis of 2008. However, after a brief period, it started heating up. Housing prices around the world have gained continuously for seven straight quarters. If we recall the events leading to the sub-prime crisis, there are plenty of parallels visible and this should serve as a caution since the roots of the Great Recession lay in the housing bubble burst.

In mid-June, the IMF's Global Housing Watch warned about a possible development of another unsustainable global housing bubble. The report categorically indicated that the following countries - Australia, Belgium, Canada, France, the Netherlands, New Zealand, Norway, Sweden, the United Kingdom, and possibly Austria - are running the risk of home prices, considerably above the trend. The house price vis-a-vis both the income ratios and the rent ratios are substantially above trend. These indicators imply that the purchasing power of common citizens - both wage earners and otherwise - is not catching up with house price and rent increases.

Public Debt

The current conjuncture also witnesses a huge debt pile-up in government balance sheets. Public debt to GDP ratio has reached levels last seen in 1948-50, following the two world wars. Although public debt ratios had grown from the 1970s to the mid-1990s, they had declined before the 2008 financial crisis. They are northbound once again.

Speaking of debt, we need to mention its two major dimensions. Firstly, the possible impact of this debt on the national economies and on peoples' lives and livelihoods. Secondly, the question of the merit of the debt, or in other words the social desirability of the loans contracted.

This includes a number of issues, viz the good reasons beyond the debt, issues of genuine and informed public interest, the improvement or the betterment of peoples' standard of living or the social infrastructure of the country, reasons of greater common good and social justice.

In most of the cases, the merit is low as loans are contracted to benefit private capital, or perhaps those of the bankers themselves who lend money to the state, or political parties or leaders who have both direct and indirect, financial or others, interests in major infrastructure projects like highway or airport or big dams that cost astronomical sums and thus have to be financed by means of public debt.

Any financial crisis creates sizable strain on a government's budget. Getting caught in a crisis with a high public debt may restrict its capacity to respond and can result in a substantially laggard recovery. Besides, mostly in cases of countries outside the advanced industrial nations, the public debt hinders countries from doing investments in infrastructure, education, health, and other development-oriented social policies. The problem is of course not restricted to just debt itself, but the global capitalist economic system that creates it. This process leads to an endless cycle of poverty and human suffering.

Public debt (external and internal) paves the way for a huge transfer of wealth from the ordinary peoples of the southern countries to the creditors. The local dominant classes who act as middlemen, in the process, skim off their commission during the transfer.

Around the world, debt is a mechanism used to transfer wealth created by toilers and other working people for the benefit of the elite and the powerful. The lenders use debt as an instrument of

political and economic domination which set up a new hegemony.

In spite of possessing ample natural and human resources, the people of the South are systematically being bled dry as the annual outgo for the repayment of public debt is much more than the expenditure on education, health, social development and job creation all together.

The debt relief initiatives of past years have been plain travesty, as the stringent conditions attached to the “relief” harm more than the good done to the “beneficiary” countries. These impacts which initially afflicted the Southern countries are also touching the North starting with the crisis-hit countries of Europe.

Economic recovery

In spite of all the claims by the finance ministers, stock market analysts or various other experts, the economic recovery has been super-fragile, globally. After four-quarters of measly growth, the frail economic recovery of the Eurozone screeched to a halt in the second quarter of 2014. Growth was zero after only 0.2 % in the first quarter.

Some Euro zone economies like Spain are still recording real output below their levels. The possibilities of Europe slipping down to its third recession in six years can't be ruled out. Economic activities remain largely sluggish in almost all large economies in spite of a marginal improvement from the post-crisis lows.

Across the shores of the Atlantic even though the US economy continues to grow and add jobs, half of the Americans still think that the Great Recession never ended.

Average family incomes today are 3% lower than five years ago; new jobs pay 20% lesser than those lost during the downswing; and the percentage of the adult population with a job rests below pre-recession levels.

That's not even the worst of it. The American public apprehend that they would be mired in another recession, any day.

Even in economies such as India which escaped the worst of the crisis, growth has stuttered and yet to revert to potential. Earlier, a stream of financial flows from outside played a leading role in raising economic growth. It allowed for easy liquidity and low interest rates resulting in private corporate capital driven and debt-fueled growth and accumulation, initially. When structural constraints began to bite and the international crisis deepened, the economy went into a tail-spin.

Prominent economists who convened at China for the inauguration of the World Economic Forum were unanimous in their opinion that the global economy “remains vulnerable to geopolitical shocks, stagnation gripping Europe, and the consequences of continued gradual slowdown in China.”

Professor Joseph Stiglitz, speaking at the Discovery Leadership Summit in South Africa painted a grim picture of the state of the world economy. He blasted most of the policy choices being taken, especially in the US and Europe. He argued that those were unsuccessful in addressing the macroeconomic and social perils related to growing unemployment and inequality.

Stiglitz is bearish about the policies pursued by governments across-the-board in the name of lifting the global economy out of its worst recession

Financial markets

It would be wrong to assume that housing is the sole asset class to fall prey to animal spirits. There is also new financial ebullience globally. Stocks and equities are acclivitous in almost all global stock exchanges. One or the other stock index is scaling new peaks every other day. A major characteristic of the 2008 bubble was the enhanced propensity of stocks across the globe to rise and fall in unison.

Something similar is beginning to happen again. According to reports “the correlation between the S&P 500 and the MSCI Emerging Markets Index had been falling steadily after peaking in 2008 and 2009 but 2014 has seen a trend reversal of sorts. The correlation has again risen to crisis levels.” This indicates that the global markets are once again acting together and any signs of panic at any single point can have immediate domino effect.

Robert Wiedemer and his team of fellow economists were correct in their prediction about the crisis that hit the US six years ago and sank the country into severe recession. In a recent interview he predicted that “the coming market crash will result in a 90% stock market drop, 50% unemployment, and 100% annual inflation starting this year.”

Certainly, its not very good news.

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P.S.

* “Six years later ...”. Dhaka Tribune. Published: 04:04 september 26, 2014:
<http://www.dhakatribune.com/long-form/2014/sep/26/six-years-later#sthash.IL6jJCVV.dpuf>