STAGES IN THE NEW DEBT DEFLATION FISHER-MINSKY CRISIS [1]

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1. Introduction

The aim of this paper is to analyze the current phase of the global crisis that began in the United States in 2007 as a financial crisis linked to sub-prime mortgages. The current phase, which began during the last quarter of 2008, is characterized by the interaction of the financial crisis —far from having been overcome— and the deepening and universal expansion of the recession in production. I will go into this in greater detail further along. Section 2 summarizes my position about the nature of the global crisis. Section 3 presents a proposal about the stages this crisis has already gone through. Section 4 examines the advance of the recession in the world economy; and Section 5 focuses on the development of deflation. Finally, Section 6 presents some conclusions and perspectives for the future.

2. About the Characterization of the Global Crisis

As I put forward in a previous paper (Guillén 2009), the global crisis is the most important capitalist crisis since World War II. It is a new type of debt-deflation crisis, highlighting the limits of the finance-dominated regime of accumulation in place since the 1980s and characterized, among other things, by securitization, that is, a financing regime based on issuing securities and derivatives.

Setting up this finance-dominated accumulation regime sustained by liberalization, deregulation, and the globalization of goods and financial markets was the response of the cutting-edge sectors of capital and the main capitalist powers when confronted with the "great crisis" that began in the late 1970s. That great crisis put an end to the state-monopoly mode of regulation in place since World War II and the Fordist regime of accumulation it was based on (De Bernis, 1988). It is my opinion that

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today's global crisis is not a new "great crisis," but rather an extension of the one from the 1970s.

Let me explain. Neoliberal globalization fostered a new regime of accumulation dominated by finance, but was incapable of establishing a new mode of regulation. While this regime of accumulation made it possible for some capital sectors to amass enormous fortunes, it was incapable of ensuring the structural stability for capital reproduction in the system as a whole. And this was because the new regime was based on "market fundamentalist policies" involving the classical and neoclassical creeds of market equilibrium and self-regulation.

Globalization, deregulation, and financial liberalization deepened financial markets' fragility, encouraging over-indebtedness by economic agents. Similarly to myself, Soros pinpoints the origin of this crisis not only in the mortgage bubble, but in what he calls the "super-bubble" that he associates with three phenomena: 1) the long-term tendency of ever-increasing credit expansion linked to anti-cyclical policies implemented after the Great Depression; 2) the globalization of financial markets; and 3) the progressive elimination of financial regulations and swift growth of financial innovations. According to Soros, the last two trends appeared in the 1980s because that is when market fundamentalism became the international financial system's guiding principle (2008: 136). These trends were actually processes that restructured productive systems to deal with the "great crisis" of the 1970s. As I have written elsewhere, "all these processes —globalization, labor market 'flexibility' and the establishment of a 'finance-based regime of accumulation'— were responses by the cutting-edge sector of capital and their governments, seeking a way out of the crisis. The idea was…to find new ways of reproducing capital and changing the relations between capital and labor to favor the former." (Guillén, 2007: 287).

In addition, as several analysts have pointed out (Borón, 2009; Guillén, 2009; Chesnais, 2009),[2] this crisis is unprecedented and multifaceted. The economic and financial crisis combines with others: the food crisis, the ecological crisis, and the global warming crisis; and with the limits of an energy paradigm and a mode of

[2] "In my opinion, in this new stage, the crisis will unfold in a way that will combine the first truly brutal manifestations of the world climate crisis with the crisis of capital as such….We are facing a new kind of crisis, a combination of this economic crisis with a situation in which nature, treated with no regard whatsoever and mistreated by Man in the framework of capitalism, is now reacting brutally" (Chesnais, 2009: 2).

consumption based on the use and abuse of fossil fuels. In many ways, we are facing what Braudel called the crisis of "Western civilization."

Therefore, the origin of this crisis cannot be reduced to the lack of regulation or prudent supervision of financial markets as some analyses suggest. For example, Krugman, who has been very critical of neoliberal economic policies, may well fall into this error.

"What made this disaster possible?" he asks. "The answer is that over the past quarter century the financial protections established by the New Deal were gradually eroded. In response to the banking crisis of the early 1930s, Congress enacted legislation that created a financial safety net: on one side, bank deposits were insured; on the other, banks were regulated to keep them from taking excessive risks….Since the 1980s, however, our financial system has become increasingly dependent on what is widely known as the 'shadow banking system': institutions that in effect carry out the functions of banks but are structured to evade regulation" (2009: xii).

It is true that financial deregulation, the lack of prudent supervision of the banks, and the scant or non-existent regulation of non-banking financial agents and tax havens increased systemic risks. It is also true that better regulation would diminish the effects of the financial crisis. But that does not mean that better regulation would avert crises. As Marx showed a century and a half ago, as did Keynes and post-Keynesian thought more than 50 years ago (Minsky, 1986), crises are endogenous processes inherent to capitalist accumulation, that is, to monetary economies whose objective is to maximize profit.

3. The Stages of the Global Crisis

As mentioned above, the global crisis is a prolongation of the "great crisis" of the 1970s, which was not resolved with neoliberal globalization. Quite to the contrary, the latter aggravated financial instability and economies' deflationary tendencies. Several years ago, G. de Bernis (1986) proposed the hypothesis that all great crises, regardless of their specific differences, go through two major phases: a first one in which inflationary trends and international expansion predominate; and a second one in which deflationary trends and closing off of economies hold sway. Based on this hypothesis, I posited that in the case of the "great crisis" of the 1970s —which we still have not left behind us— the first clearly inflationary stage concluded in 1982 with the foreign debt

crisis. This led to financial globalization and to the second phase, marked by a series of systemic debt-deflation financial crises: starting with the bursting of the Japanese bubble in 1990, continuing in Mexico in 1994-1995, the East-Asian crisis in 1997-1998, the 2000 NASDAQ crisis, Argentina in 2001, and culminating in the current global crisis with its epicenter in the United States.

The current global crisis already has a history of its own. Up until now, May 2009, it has gone through two stages. The first stretched from August 2007 to September 2008. This is when the subprime mortgage crisis broke out, with its gradual but inexorable collapse of the bond and mortgage-based derivatives market (CDSs, investment vehicles, etc.). Since the entire financial pyramid was built on a foundation of indebtedness, in this stage, credit began to contract. The impact on stock markets was limited: in the central countries, they dipped slightly, but in many emerging countries they continued to rise. The stock market crash began in July and August 2008 when turbulence on the bonds market stepped up (see table 1).

TABLE 1

STOCK EXCHANGES						
COUNTRY	Jun-07	Dec-07	Feb-09	% Jun 07-Dec-07	%Dic 07- Dec 08	% Dec 07- Feb 09
ARGENTINA	2,190.87	2,151.73	1,135.96	-1.79	-49.82	-47.21
BRASIL	54,392.00	63,886.00	42,100.00	17.45	-41.22	-34.10
CANADA	13,906.57	13,833.06	9,047.28	-0.53	-35.03	-34.60
USA DOW J.	13,408.64	13,264.82	8,270.87	-1.07	-33.84	-37.65
USA S&P	1,503.35	1,468.36	735.09	-2.33	-38.49	-49.94
MEXICO	31,151.05	29,536.83	20,537.10	-5.18	-24.23	-30.47
GERMANY	8,007.32	8,067.32	4,530.09	0.75	-40.37	-43.85
FRANCE	6,054.93	5,614.08	3,027.72	-7.28	-42.68	-46.07
ENGLAND	6,607.90	6,456.90	4,234.30	-2.29	-31.26	-34.42
SPAIN	1,640.40	1,642.01	885.17	0.10	-40.56	-46.09
AUSTRALIA	6,310.60	6,421.00	3,418.10	1.75	-43.01	-46.77
KOREA	1,743.60	1,897.13	1,179.84	8.81	-40.73	-37.81
CHINA	3,820.70	5,261.56	2,260.82	37.71	-65.39	-57.03
HONG KONG	21,772.73	27,812.65	13,539.21	27.74	-48.27	-51.32
INDIA	14,650.51	20,286.99	9,465.83	38.47	-52.45	-53.34
JAPAN	18,138.36	15,307.78	7,705.36	-15.61	-42.12	-49.66
MALASYA	1,354.38	1,445.03	894.60	6.69	-39.33	-38.09

Source: http://finance.yahoo.com/m2?u
http://www.fibv.com

During this first stage, the impact on the real economy was limited. Some analysts even doubted that the financial crisis could lead to a recession, much less a recession generalized throughout the world economy. It was in this context that the myth of "decoupling" the world economy was constructed.

The second stage has lasted roughly from September 2008 until today and is characterized by a sharp contraction of credit in all markets (bank credit, the securities

market, the inter-bank market, etc.); the beginnings of the banking crisis; the bankruptcy and virtual disappearance of the investment banking system and its absorption by the commercial banks; deepening deflationary trends in central economies; plummeting stock markets; and the beginning of a generalized recession. For the so-called "emerging" countries on the periphery, this stage has meant an abrupt withdrawal of external capital flows, which disrupts exchange rate policy and anti-inflationary policies based on "inflation targets". Countries like Brazil, Chile, or Mexico have suffered abrupt devaluations and, paradoxically, inflation spikes in an overall deflationary context.

During the first stage, the turbulence emerged from the financial sector and passed over into the real economy. In the second stage, the movement is both ways: from finances to the real economy and from the real economy to the financial sector. This is why anti-crisis measures cannot be limited to reestablishing normalcy in financial systems, but must attempt to contain the recession in production. In many ways, the recession now shows the way the global crisis will go. As the most recent IMF report recognizes, there is "negative feedback" between deteriorated financial sectors and weak economies.

"The current outlook is exceptionally uncertain, with risks weighed to the downside. The dominant concern is that policies will continue to be insufficient to arrest the negative feedback between deteriorating financial conditions and weakening economies, particularly in the face of limited public support for policy action. Key transmission channels include rising corporate and household defaults that cause further falls in asset prices and greater losses across financial balance sheets, and new systemic events that further complicate the task of restoring credibility" (IMF: 2009: xii and xiii).

4. The Spreading Generalized Recession

Until a few months ago, while many analysts accepted that there was a financial crisis and recognized that the real economy was slowing down, they disallowed the possibility of a recession, pointing to the resilience and flexibility of the U.S. economy.

Today, not only is the U.S. economy going through a profound recession with no short-term way out, but economic activity has been paralyzed in practically the entire world with unprecedented synchronicity.

A year late, the Bureau of Economic Analysis (BEA), the body responsible for dating recessions, announced that the U.S. recession had begun in December 2007. That

is, now, in May 2009, the recession has already been going on for 16 months. This makes it the longest depressive cycle since World War II, including the 1974-1975 and 1980-1982 recessions. In effect, the decline began in the last quarter of 2007 when GDP dropped at an annualized rate of -0.2 percent. In that same quarter, private consumption weakened, its growth dropping by half, and gross private investment plummeted to an annualized 11.9 percent compared to the previous quarter (see table). However, during the first two quarters of 2008, GDP grew positively by 0.9 percent and 2.8 percent, influenced by the rise in exports due to a dropping dollar in that same period, as well as by the increase in military spending. That's as far as the resilience went. As soon as the crisis entered its second phase in the third quarter of last year, with the collapse of the financial market (the bailouts of Bear Stearns, A.I.G and Fannie Mae and Freddie Mac, as well as the liquidation of Lehman Brothers), GDP began its freefall (see table).

USA: GDP GROWTH
Seasonally adjusted at annual rates

	2006	2007-IV	2008-I	2008-II	2008-III	2008-IV	2009-I
GDP	2.8	-0.2	0.9	2.8	-0.5	-6.3	-6.1
Personal consumption expenditures	3	1	0.9	1.2	-3.8	-4.3	2.2
Durable goods	4.5	2.3	-4.3	-2.8	-14.8	-22.1	9.4
Nondurable goods	3.7	0.3	-4.3	3.9	-7.1	-9.4	1.3
Gross private domestic investment	2.1	-11.9	-5.8	-11.5	0.4	-23	-51.8
Fixed investment	1.9	6.2	-5.6	-1.7	-5.3	-22	-37.9
Residential	7.1	-27	-25.1	-5	-16	-22.8	-38
Nonresidential	7.5	3.4	2.4	2.5	-1.7	-21.7	-37.9
Government consumption expenditures	1.7	0.8	1.9	3.9	5.8	1.3	-3.9
Nacional defense	1.6	-0.9	7.3	7.3	18	3.4	-6.4

Source: Bureau of Economic Analysis (BEA)

Until now, GDP has dropped for three consecutive quarters, including the biggest declines since the Great Depression of the 1930s: -6.3 percent and -6.1 percent, respectively, for the fourth quarter of last year and the first quarter of this year. If we look more closely at national accounts, there is a worrying slowdown in private consumption, which has been the driving force behind the U.S. economy in recent years. This is linked to the reversal of the "wealth effect"; the fall in real estate and stock market prices; the high levels of household debt; uncertainty about the future of the economy; and rising unemployment. For its part, investment in all its forms has dried up (commercial buildings, equipment, and housing). Since the recession began,

gross fixed investment has contracted for five out of six quarters, with particularly steep slumps in the last two (see graph).

The recession affects all sectors and branches: auto, construction, the new economy, steel, foundries, finance, wholesale and retail sales, and services. When the financial crisis finally hit hard in the United States in the last quarter of 2007, in some circles there was the erroneous belief, the myth, that certain countries could "decouple" themselves from its effects. The idea gained popularity that even in the case of a recession in the United States, the world economy's growth cycle would be maintained and the European Union, Asia, and the emerging countries could continue growing. For example, in his last book, George Soros stated that although in April 2008 a recession was inevitable in the United States, there was not yet any reason to expect a global recession. He went on to say that powerful forces for expansion had been put into motion in other parts of the world that could counteract a recession in the United States and a slowdown in Europe and Japan (2008: 209).

It soon became clear that this "decoupling" did not exist, much less in an economy as globalized as today's. In a previous publication (Guillén 2009), I maintained that the crisis would globalize for two reasons: first, because the real estate "bubble" was not a U.S. phenomenon, but involved many countries; and second, because the orgy of securitization and derivatives also involved European and Asian banks and financial intermediaries. It is also difficult to imagine decoupling in a world that is more integrated than ever through foreign trade and financial flows. Neither is it possible to expect decoupling in the framework of a world financial "architecture" in which the United States acts as the buyer of last resort by financing its deficits through external savings. In other words, the boxcars cannot keep moving when the locomotive has stopped.

Some very large economies like China or India may be able to resist the onslaught of the crisis and keep growing. However, their GDP will grow much more slowly and only if they manage to refocus their development strategies toward their domestic markets.

Most countries have gone into recession, or will in the next few months. The recession is generalized and deep. Undoubtedly, it is the most important recession since World War II. It involves the United States, the European Union and a large number of the so-called emerging countries on the periphery. In tables 2 and 3, I have gathered quarterly growth data for 32 of the world's most important economies. If we use the

conventional definition of a recession that says it is two consecutive quarters of negative GDP growth, we can see that in the fourth quarter of 2008, 11 countries were in recession, including such important ones as the United States, Germany, Japan, the United Kingdom, Italy, Sweden and some of the more relatively developed emerging nations: Hong Kong, Singapore, and New Zealand. If we only look at performance for the last quarter of 2008, we see a drop only comparable to the 1930s: Japan, -12.7 percent; Italy, -7.1 percent; the United States, -6.2 percent; the United Kingdom, -6.0 percent; Sweden, -9.3 percent; South Korea, -20.8 percent; Thailand, -22.2 percent; Singapore, -16.9 percent; Brazil, -13.6 percent; México, -10.3 percent; and Chile, -8.3 percent. In that period, the developed countries as a whole suffered an unprecedented annualized 7.5 percent contraction (IMF 2009: xi).

TABLE 2

REAL GDP GROWTH								
CONTRY	2006	2007	2o trim. 2008 t/t	2o. trim. y/y	3er. Trim t/t	3re.trim. y/y	4o Trim t/t	4o Trim y/y
WORLD	5.0	4.9						
DEVELOPED COUNTRIES	3.0	2.7						
EURO AREA	2.8	2.6	-0.7	1.4	-0.8	0.7	-5.7	-1.2
GERMANY	2.9	2.2	-0.4	1.7	-2.1	0.8	-8.2	-1.7
FRANCE	2.0	1.9	-0.3	1.1	0.6	0.6	-4.6	-1.2
SPAIN	3.9	3.8	0.1	0.8	-2.0	0.9	-3.8	-0.7
ITALY	1.8	1.5	-1.1	-0.1	-2.0	-0.9	-7.1	-2.5
NETHERLANDS	3.0	3.5	0.5	3.0	0.1	1.8	-3.4	-0.5
IRELAND	5.7	5.3	-2.1	-0.8	-2.1	-0.8	-25.7	-7.5
USA	2.9	2.2	3.3	1.8	-0.5	0.8	-6.2	-0.8
JAPAN	2.4	2.1	-3.0	0.7	-0.4	-0.1	-12.7	-4.6
UNITED KINGDOM	2.9	3.1	0.8	1.6	-2.0	0.3	-6.0	-1.9
CANADA	2.8	2.7	0.3	0.7	1.3	0.5	-3.4	-0.7
SWEDEN	3.3	4.1	-0.1	0.7	-0.4	0.0	-9.3	-4.9
SWITZERLAND	3.2	3.1	1.5	2.4	0.1	1.7	-1.2	-0.1

TABLE 3

REAL GDP GROWTH								
CONTRY	2006	2007	2o trim. 2008 t/t	2o. trim. y/y	3er. Trim t/t	3re.trim. y/y	4o Trim t/t	4o Trim y/y
KOREA	5.1	5.0	3.4	4.8	2.3	3.9	-20.8	-3.4
CHINA	11.1	11.4	7.9	10.1		9.0		6.8
INDIA	9.7	9.2		7.9		7.6		5.3
THAILAND	5.1	4.8	2.9	5.3	2.3	4.0	-22.2	-4.3
MALASYA	5.9	6.3		6.3		4.7		0.1
TAIWAN	4.9	5.7		4.3		-1.0		-8.4
HONG KONG	7.0	6.3	-5.5	4.2	-2.0	3.8	-7.8	-2.5
SINGAPORE	8.2	7.7	-6.6	4.0	-6.3	-0.5	-16.9	-3.7
AUSTRALIA	2.8	3.9	1.1	2.7	0.3	1.9	-2.1	0.3
NEW ZEALAND	1.5	3.0	-0.3	-0.3	-2.1	-0.3	-2.3	-2.3
RUSSIA	9.6	9.7		7.8		6.2		1.1
CZECH REPUBLIC	6.4	6.5	0.9	4.5	6.1	4.7	-2.4	1.0
HUNGARY	1.3	1.8	0.9	4.5	0.8	-0.4	-3.9	2.0
POLAND	6.5	4.9		5.8		4.8		2.9
BRASIL	3.8	5.4	6.6	6.1	7.4	6.8	-13.6	1.3
MEXICO	4.8	3.3	0.6	2.8	2.6	1.6	-10.3	-1.6
ARGENTINA	8.5	8.7	8.7	7.5			-1.2	4.9
VENEZUELA	10.3	8.4		7.1		4.6		3.2
COLOMBIA	6.8	7.0	2.8	3.7			-4.1	-0.7
CHILE	4.0	5.0	7.4	4.3	-0.2	4.8	-8.3	0.2

It is estimated that practically the entire world will enter into recession in 2009. According to the IMF, world GDP will drop 1.3 percent. The decline in developed countries will be even greater (-3.8 percent), including -2.8 percent for the United States, -3.8 percent for the countries in the euro zone, and -6.2 percent for Japan. The IMF also recognizes that output per capita will decrease in the countries that represent three-fourths of world output.

The countries on the periphery are not immune to the crisis. The main mechanisms for transmitting it have been the deterioration in the terms of trade, the shrinkage of emigrant remittances, and the massive withdrawal of private capital flows from financial markets.

The ECLAC estimates that the terms of trade in the region will fall 15 percent in 2009 (2008: 22). Prices of primary products have plummeted. In February 2009, they had dropped *vis-à-vis* their peak at the height of expansion as follows: oil, 51 percent; food, 18 percent; rice, 50.6 percent; maize, 47.9 percent; wheat, 41.9 percent; metals, 49 percent; and copper, 37.9 percent. The countries in Latin America most affected by the drop in migrant remittances will be Mexico, Bolivia, Ecuador, and most of Central America and the Caribbean.

However, the factor that has probably affected the peripheral economies the most, above all the ones most linked up to international financial circuits, is the abrupt withdrawal of foreign capital flows. The Institute of International Finance, an IMF-related body, predicts that private capital flows to emerging markets will decline to US$165 billion in 2009, a sum considerably lower than 2008's US$466 billion and 2007's record high of US$929 billion. Resources draining out of the money and capital markets toward safer instruments like U.S. treasury bills have not only affected stock market indexes and other financial variables, but have also caused severe currency devaluations in countries that were implementing pro-cyclical policies. Financial fragility is clear in places like the former socialist countries of Eastern Europe, which have taken on considerable foreign debt.

World trade has collapsed to a degree not seen since the depression of the 1930s. Growth in the volume of world trade declined from 7.2 percent in 2007 to 3.3 percent in 2008. By 2009, the IMF estimates an unprecedented contraction of 11 percent (2009: 10). The global nature of the crisis makes it clear that getting out of it cannot depend on the external market. There is no way out this time for any country through exports.

Although most governments are aware of the dangers of protectionism, clearly it is increasing and economies tend to close and look for ways out in the domestic sphere.

Because of the depth and generalized nature of the recession, the crisis's most ominous sign will be the swift rise in open unemployment, which will, in turn, aggravate it. Just in the United States, the epicenter of the crisis, where the recession first began, employment has been dropping since January 2008. By early March 2009, 4.4 million jobs had been lost, 3.3 million of which disappeared over the last six months (*The Economist* 2009b: 72). In April 2009, unemployment reached 8.9 percent, more than four percentage points above the 4.6 percent registered at the end of 2007. Some analysts are predicting 10 percent unemployment for 2010 and fear that it may surpass the postwar peak of 10.8 percent.

People with jobs are also working shorter hours. The workweek dropped to 33.3 hours, the lowest since 1964. Precarious work is proliferating. Part-time workers are now one-third of the work force, as opposed to 20 percent in 1990.

Until now, open unemployment has advanced more slowly in Europe than in the United States, but it will undoubtedly increase rapidly in coming months as the recession advances. In any case, the rise in the number of the unemployed since the crisis broke out is by no means small. Unemployment in the European Union increased from 7.1 percent in 2007 to 7.6 percent in January 2009. In certain countries like Great Britain, Ireland and Spain, where the real estate bubbles burst like in the United States, unemployment has grown much more swiftly. In the United Kingdom, it went from 5.4 percent in 2007 to 6.5 percent in January 2009, while in Ireland and Spain, the spike has been enormous: open unemployment jumped from 4.6 percent to 11 percent from 2007 to February 2009 in the former, and from 8.3 percent to 15.4 percent in the latter in the same period. In the countries of the periphery, where unemployment figures do not reflect reality, we will see a new expansion of the broad universe of the informal economy; but this time, there will be no escape valve in international migration. One UN specialist estimates that the crisis will spawn 50 million unemployed worldwide.

5. Advancing Deflation

All the great crises of capitalism lead to great systemic financial crises. And all the great financial crises are debt-deflation crises. The current one is no exception. The

IMF is aware that deflation is a possible scenario for the developed economies' immediate future.

"Since the summer of 2008, there has been a sea change from concern in many countries that overheating and booming commodity prices could stoke excessive inflation to the opposite worry —that price deflation could exacerbate the downturn in activity, as occurred in Japan in the 1990s and more intensely during the Great Depression of the 1930s" (IMF, 2009: 22).

Deflation is always linked to processes of over-indebtedness of economic agents. Total U.S. debt as a percentage of GDP has shot up since the 1990s dot-com bubble; since then it has not stopped growing (see graph). It increased from 151 percent of GDP in 1959 to 373 percent in 2007 (Foster, 2009). As a result of the "financialization" of the economy that began in the 1980s as a response to the 1970s crisis, financial sector debt soared from 22 percent of GDP to 117 percent in the fourth quarter of 2008. In the United Kingdom, the joint pioneer with the United States of the finance-dominated regime of accumulation, gross financial sector debt reached 250 percent of GDP (Wolf, 2009).

Of course, as I have put forward elsewhere (Guillén, 2007), deflation does not manifest in the same way in contemporary capitalism as it did in the 1930s or, before that, in the great crisis of 1873-1896. Because of the very characteristics of the modes of regulation of those times, deflation was open and generalized. In the capitalism of today, in contrast, what we have is a "contradictory deflation". The deflation of prices is checked by a series of mechanisms (lender of last resort, budget deficits, etc.); this makes the deflationary process generally manifest itself over prolonged periods of economic stagnation and accompanied by the reproduction of fragile financial structures that are validated through government mechanisms to prevent a depression.

However, this does not mean that these mechanisms will always be effective and that open deflation —that is, a generalized drop in price of all commodities— cannot happen. The cases of Japan in the 1990s or Argentina in 2000 show that it can. Japan endured from deflation for an entire decade and Argentina for almost five years, until it was freed from its currency board straitjacket.

Although the world is not yet facing generalized deflation, the dangers are real. Up until now, deflation has been sectoral and concentrated in the following markets:

* Real estate

* Stock markets and bonds markets
* Primary products
* Productive activities in structural crisis like auto, iron and steel, aluminum, aviation, etc.

The deflation in the U.S. real estate market that gave rise to the current financial crisis is not over yet. Although in the last two months, the real estate market has stabilized relatively with the drop in interest rates and mortgage refinancing programs, sales continue to be extremely low. New home sales in March 2009 (353,000 units) had dropped 72 percent *vis-à-vis* their 2005 peak (1,283,000 units). Existing-home sales in March dropped 32.8 percent *vis-à-vis* their 2005 peak. Sale prices have dropped 18.8 percent for new homes compared to their 2007 peak, and 21.1 percent for existing homes compared to their 2006 maximum. Most analysts estimate that the deflation in the real estate market has not yet ended. In addition, it has extended to the sale of commercial properties. The drop will continue as long as the recession deepens, with the corresponding increase in unemployment and decline in real wages.

Many countries are experiencing deflationary real estate prices. According to *The Economist* (2009a), in March 2009, 16 countries registered dropping property values, compared to only six countries in the previous quarter. The fall in prices compared to last year has been particularly sharp in Great Britain (-17.6 percent), Hong Kong (-14 percent), Ireland (-9.8 percent), New Zealand (-8.9 percent), and Holland (-5.2 percent).

The deflation of financial assets as a result of the crisis has been enormous. Just in the period from January to November 2008, stock markets lost US$17 trillion. In that same period, stock market indexes in the developed countries dropped 42.7 percent, while in the emerging countries, they plunged 54.7 percent. The IMF estimates that total losses in the so-called toxic assets (the paraphernalia of securitized debt, bonds, and derivatives) will reach US$4 trillion, two-thirds of which will be laid at the door of banks and the other one-third of insurance companies, pension funds, hedge funds, and other financial intermediaries.

Another sector touched by deflation are primary product prices, whose drop has severely affected the peripheral countries and revalidated the theory of the deterioration of the terms of exchange developed by Prebisch (1948) and Singer (1949) after World War II. The magazine *The Economist*'s commodities price index dropped 40 percent

between August 2008 and March 2009, with metals dropping 57.1 percent and food, 30 percent.

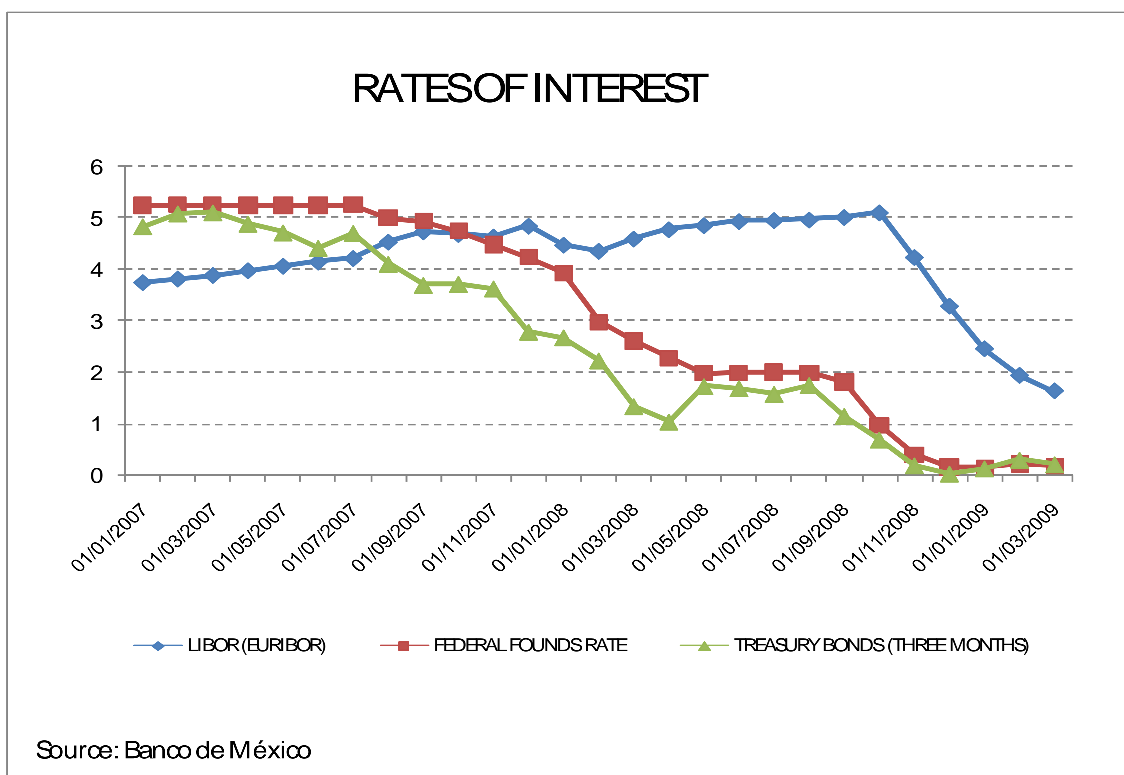
To conclude, in the sectoral deflationary cycle, we have industrial activities in structural crisis, like the auto industry, aviation or steel and iron or aluminum production, all of which have been severely affected by the recession and have resorted to open or veiled price reductions.

Signs that the world economy's main countries may be entering into a process of generalized deflation continue to proliferate. In March of this year, U.S. consumer prices dropped 0.4 percent for the first time since 1955. This was attributed to the reduction in fuel and food prices. If we exclude these, core inflation is still growing 1.8 percent. While this figure mitigates the problem, we see no reason to deny the existence of deflation by excluding commodities, since their plummeting prices are not the result of a change in the relative prices of these products, but an effect of the generalized recession itself.

Deflationary tendencies are not confined to the United States: they involve most of the countries in the European Union, Japan, China, and Taiwan. In March, almost 20 countries registered annual drops in wholesale prices, and almost a dozen registered monthly drops in consumer prices.

I am not suggesting here that the world will necessarily repeat the deflationary experience of the depression of the 1930s. Historical conditions are different today. Governments and central banks have injected massive amounts of resources to contain deflationary tendencies. However, the results until now have been disappointing. The credit crunch continues: banks are reluctant to loan. There is no new bubble to fall back on. Attempts to breathe new life into stock markets have failed up until now. In this context, consumption will continue to be low. Because of continued uncertainty about a possible way out of the crisis, the spread between market rates and reference rates continues to be wide despite huge injections of liquidity (see graph 1)

GRAPH 1



Source: Banco de México

The danger that the main economies fall into the "liquidity trap" is real. Using monetary policy as a mechanism to stave off a depression has reached its limits because most governments have decreased nominal interest rates to practically zero. The shadow of Japan's 1990s deflation looms worldwide. The financial and productive processes feed on each other: the deepening recession (growing unemployment, the drop in real wages, etc.) kindles the financial crisis, and the continuing financial crisis deepens the recession. If deflationary trends take hold, real interest rates will skyrocket, making it more difficult for economic agents to get out of debt and aggravating the credit crunch and the productive system's weakness.

6. Conclusions and Perspectives

The global crisis is going through a second stage characterized by a credit crunch; the banking crisis; plummeting stock markets in the central and emerging countries; the beginnings of a generalized recession whose synchronicity and depth is unparalleled since World War II; and deepening deflationary tendencies in the central countries. Compared to the first stage when financial sector turbulence predominated, in

the second, there is turmoil on two planes: moving from the real economy toward financial sector and from finance toward the real economy.

The crisis still has a long way to go. The process of destruction of capital has not concluded yet. Until now, the developed countries have dropped interest rates as much as they can and implemented aggressive fiscal programs to salvage their financial markets, break credit restrictions, and contain the recession without managing to substantially change the overall uncertainty the world economy is operating in. Quite to the contrary, the horizon is darkening with the advancing clouds of deflation interlocking with the recession. This time, there will be no way out in external markets for any country. That fact will force them to restructure productive systems and search for a way out in domestic markets and in regional spaces for integration.

Globally, the anti-crisis efforts have centered on the Group of 20 (G-20). At the London April 2 summit, a series of accords were reached to deal with the crisis dubbed "the gravest threat to the world economy." The participants expressed their concern for reaching a global solution and sustainable globalization, based on an open market-based world economy, effective regulation and strong global institutions (Group of 20 2009). Its objectives: restoring confidence, growth, and job creation; repairing the financial system and reestablishing credit; strengthening financial regulation; funding and reforming international financial institutions; promoting trade and global investment while discouraging protectionism; and building a green, sustainable recovery.

To reach these aims, among other things they decided to increase International Monetary Funds resources by US$750 billion; to have the IMF issue US$250 in special drawing rights (SDRs); to increase the resources available to multilateral development banks by US$100 billion; to replace the existing Financial Stability Forum with a Financial Stability Board that would include Spain and the European Commission; and to extend financial regulation to include other instruments and intermediaries like hedge funds.

Beyond the rhetoric of British Primer Minister Brown, who called these measures "the end of the Washington Consensus," the decisions of the G-20 —which is little more than a redecorated G-7— are far from attacking the root causes of the crisis. More than a new order, what they try to do is re-float neoliberal globalization supplying more resources to the old, discredited multilateral institutions like the IMF and the World Bank without reforming them, and offering a bigger dose of financial regulation, the lack of which has been blamed for the crisis. However, they defend trade and

financial opening policies. Very particularly, they defend the free movement of capital to maintain the periphery anchored in an order dominated by globalized financial capital. They seek to reactivate capital flows to emerging countries to allow them to shore up their currencies and contain inflation. And they understand very well that overvalued currencies and price stability in open economies are to portfolio capital what water is to sharks.

In short, while governments' anti-crisis programs have implied the mobilization of enormous sums of capital to stabilize financial markets and curtail the recession, they seem to have as a starting point the idea that once the crisis is controlled by Keynesian mechanisms, everything will return to the way it was and the neoliberal order will be restored with just a few minor adjustments. This reveals that the real nature of the crisis is not understood, nor is its unprecedented nature and the need to start now a long-term transformation of a regime of accumulation, a wasteful mode of consumption, and an energy paradigm based on excessive use of oil that have reached their limits.

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