Look up: financial red lights are flashing again
Niall Ferguson

I saw the 2008 crash coming and was ignored ”a new one is looming”

The thing about which I have been most right in my career is the thing for which I have received the least credit. Beginning in June 2006, I wrote a series of articles and gave numerous speeches that predicted, with considerable precision, the global financial crisis. I began in June 2006 by observing that interest rate increases by the Federal Reserve would sooner or later have an effect on heavily indebted American households. â€œOver the next two years,â€ I noted, â€œthe monthly payments on about $600bn of mortgages taken out by borrowers in the so-called subprime market . . . will increase by as much as 50%.â€ In November 2006 I was all but pelted with bread rolls at a Morgan Stanley conference for arguing that the developed world as a whole might end up in the same mess that Japan had been in since the 1990s, fending off deflation with monetary and fiscal expedients and stagnating in terms of growth. The Fedâ€™s habit of intervening to prop up asset markets, I warned, had â€œencouraged speculative behaviourâ€ and spread the dangerous belief that â€œeveryone is too big to failâ€ . Two months later, I found it â€œperfectly possible to imagine a liquidity crisis too big for the monetary authorities to handle alone . . . Governments would need to step in . . . Federal bailouts for the likes of Goldman Sachs may seem unimaginable to us now. But financial history reminds us that [such] events do happen. And, when they do, liquidity can ebb much more quickly than it previously flowed.â€ By the autumn of 2007, it was becoming apparent to the professionals, if not to the public, that something was indeed amiss. But still people underestimated the danger. I argued that we confronted â€œa more toxic cocktail than many investors still want to believeâ€ , and that the crisis would be global and not just confined to America. In December 2007, I predicted a â€œgreat dyingâ€ of financial institutions as a â€œman-made disaster â€” the subprime mortgage crisis â€” works its way through the global financial systemâ€ . On August 7, 2008, more than a month before the bankruptcy of Lehman Brothers, I anticipated a â€œglobal tempestâ€ that would swiftly make the term â€œcredit crunchâ€ an absurd understatement. Looking back, I now realise I should have kept all of the above to myself, set up a hedge fund and short-sold everything in sight, beginning with US mortgage lenders. Instead, like the fool of an academic that I am, I wrote a book (The Ascent of Money) that was published just as my predictions were coming true. I tell you all this only so that you will read attentively my current thoughts on the global economy. After all, there is a lot about the present time that is reminiscent of those pre-crisis days. Almost every asset class is up. In all but a handful of housing markets (notably Ireland), inflation-adjusted home prices are above where they were on the eve of the crisis. From peak to trough, US home prices plunged by a quarter between 2006 and 2012. They have now recovered all that and added some on top. New York condos are 19% above their pre-crisis high. And real estate isnâ€™t the best performer of 2017. Back on January 1, you would have done even better to invest in emerging market equities. Another winner for the year was the Fang tech companies: shares in Facebook, Amazon, Netflix and Google are up between 30% and 60%. And the best trade of all? Bitcoin, up by a factor of seven since the year began. Altogether now: â€œThanks, Fed!â€ For it was the Federal Reserve, with its bold policies of zero interest rates and â€œquantitative easingâ€ , that saved the world from deflation and a second Great Depression. Now consider the following four reasons to be nervous. First, the monetary policy

party is drawing to a close. The Fed and now the Bank of England are raising rates. The combined assets of the big four central banks â€" the Fed, European Central Bank, Bank of Japan and Bank of England â€" will peak in December 2018, but the rate of expansion has already started to slow. Moreover, global credit growth in aggregate is slowing. History shows that monetary tightening acts with long and variable lags. But it does act, often on stock markets. Second, as the economist Charles Goodhart and others have argued, we are at a demographic inflection point. Globally, the ratio of workers to consumers has peaked. Between now and 2100, Chinaâ€™s working-age population is projected to shrink from 1bn to below 600m. Already many labour markets look tight, with unemployment rates and other measures of slack leading economists to expect a surge in wages and inflation. Countries such as Germany that think immigration will help matters will be disappointed as many newcomers lack the skills to be easily absorbed into a modern workforce. What is more, the rising dependency ratio as populations age doesnâ€™t translate into higher saving but into higher consumption, especially on healthcare. Welfare safety nets have encouraged many retirees not to provide completely for the costs of a prolonged old age. This leads to the conclusion that the end of the 35-year bond bull market is nigh. Bonds will sell off; long-term rates will rise. The question is whether inflation will increase as much or more. If not, then real (inflation-adjusted) interest rates will rise, with serious implications for highly indebted entities. The Bank for International Settlements recently published â€œearly-warning indicators for stress in domestic banking systemsâ€ . Two big economies with flashing red lights are China and Canada. Point three: regardless of monetary policy, a networked world â€" whose biggest companies are dedicated to reducing the cost of everything from shopping to searching to social networking â€" is a structurally deflationary world. According to the World Bank, a bewildering range of occupations â€" from food processors to finance professionals â€" have a 50% or higher probability of being â€œcomputerisedâ€ , with technology entirely or largely replacing human workers. Already Waymoâ€™s driverless cars are on the streets of Phoenix, Arizona. Last week, Elon Musk unveiled the spectacularly cool Tesla truck, which no doubt shares the self-driving features of Tesla cars. I have seen the future and it drives itself. Todayâ€™s drivers need to retrain as nurses. Oh, and if you debtors were pinning your hopes for an inflation surprise on a new Middle Eastern crisis, as in 1973, 1979 and 1990, I have to disappoint you. According to the International Energy Agency, America is halfway through the biggest expansion in oil output by any country in history â€" an additional 8m barrels of oil a day between 2010 and 2025 â€" thanks to the ingenuity of shale oil drillers. Even without electric cars, we would avoid a serious oil shock even if Iran and Saudi Arabia went to war tomorrow. No two financial crises are the same. The next one will not be like the last one. But there will be a next one and, as the monetary medication begins to be withdrawn, it draws nearer. This time, mark my words. Niall Fergusonâ€™s new book is The Square and the Tower: Networks, Hierarchies and the Struggle for Global Power (Allen Lane)