Wall Street steps up pressure for deal on budget cuts

Patrick Martin
27 July 2011

Key agencies of the American financial aristocracy are beginning to assert themselves directly and openly in the mounting political crisis in Washington, demanding a deal that would combine raising the federal debt ceiling with trillions of dollars in cuts in social spending.

The Obama administration has forecast that soon after next Tuesday, August 2, the government will be unable to pay its bills without further borrowing, now barred because the Treasury reached the current debt ceiling of $14.3 trillion in early May.

Late Monday, the Chicago Mercantile Exchange, the main center for the trading of derivatives, one of the major forms of financial speculation, announced that it would no long classify short-term Treasury bills as risk-free when used as collateral by traders. The exchange also will require traders to provide larger amounts of longer-term Treasury bonds when using them as collateral.

The “haircuts” applied to the value of government securities used as collateral for trades ranged from half a percentage point for Treasury bills to a full percentage point for Treasury notes and bonds, with the changes to take effect on Thursday.

The CME justified the increases as a response to the greater volatility in the prices of US government securities because of mounting speculation that there will be at least a short-term interruption in US government payments to bondholders.

Already on Friday, when budget talks between the White House and congressional Republicans collapsed, the CME told traders it would raise the amount of collateral required to trade Treasury futures by 8 percentage points to 22 percent, according to a report by the Dow-Jones News Service.

These are the first concrete actions taken by a major financial institution to disfavor US government securities since the Obama administration first announced the August 2 deadline for raising the debt ceiling.

George Goncalves, head of interest rate strategy at Nomura Securities, told the *Financial Times*, “The bond markets in the US will now have the debt ceiling decision and deficit reduction talks as its highest concerns over the next week and a half.”

Interest rates on new issues of US government securities, while still low, rose Tuesday from 0.41 percent to 0.44 percent. The Treasury is auctioning $99 billion in new debt this week, using the funds to pay off maturing bills, but not increasing the total outstanding.

Moody’s Investor Services, one of the three main bond-rating agencies, warned its mutual fund clients Tuesday that the impasse in Washington over the debt ceiling threatened money market mutual funds.

A statement from Moody’s said, “Direct risks include the potential for a missed interest or principal payment on government bonds for a short period of time, as well as incremental weakening of the overall credit quality of money-market fund portfolios that have US government exposure.”

Moody’s had earlier warned that it would downgrade US government debt in the event that Congress and the Obama administration failed to reach agreement on lifting the debt ceiling by August 2.

Standard & Poor’s, another bond-rating agency, spelled a more detailed warning last week. S&P said that either of two events could lead to a downgrading of US government debt: if the debt ceiling was not raised, leading to a default on US government obligations; or if the agreement to raise the debt ceiling did not include sufficient spending cuts—in the eyes of S&P—to assure a declining path for future federal deficits.

The ratings agencies, like the Wall Street firms they represent, have lined up behind the Obama administration in seeking the largest possible deficit reduction package, at least $4 trillion over the next ten years.

S&P analyst John Chambers, discussing the downgrade warning, told the press, “Our working assumption is that this is the time to get a meaningful agreement by both parties. Once this moment passes, future moments will be more difficult to ascertain.”

In a further sign of unease in financial markets, the dollar fell Tuesday against most world currencies, while the price of gold rose $4.60 an ounce, ending the day at $1,616.80 an ounce. The price of gold topped $1,600 for the first time on July 18.

According to a report in the *New York Time*s, some hedge funds are stockpiling cash, planning to buy up US government securities at cut-rate prices if there is a default or debt downgrade which forces pension funds and other institutional investors to sell their Treasury holdings.

The price of credit-default swaps, which would pay investors in the event of a US default, has doubled in the last few weeks, which one financial columnist cited as "indicating a lively market for bets against America."

The orchestrated and artificial character of the debt ceiling crisis—there is no lack of willing lenders to the US government, only a legal prohibition on government borrowing that could be lifted by Congress any day—does not alter the fact that even a temporary US debt default could have devastating consequences for world capitalism.

The new managing director of the International Monetary Fund, Christine Lagarde, warned in a speech in New York Tuesday that action on the debt ceiling was urgent. "The clock is ticking, and clearly the issue needs to be resolved immediately. Indeed, an adverse fiscal shock in the United States could have serious spillovers on the rest of the world."

Lagarde then added: "But more fundamentally, a credible fiscal adjustment plan is needed sooner rather than later." This comment is the most significant one. Like her counterparts at S&P, Lagarde is demanding both a rise in the debt ceiling, to stabilize financial markets, and massive cuts in US social spending, particularly the entitlement programs like Medicare and Social Security.

Her prescription for the United States is the same as for Greece: the working people must pay for the crisis of the profit system, while the banks and big capitalists must be defended at all costs.

At the same time, Lagarde expressed nervousness about the political and social consequences, referring to the upheavals in Egypt and throughout the Arab world. "Social problems are a major concern to advanced economies too," she said. "The young in particular are having a hard time finding work—with potentially lifelong implications in terms of employability and income. At the same time, the older generations are fighting to protect their health and pension benefits."

The Obama administration welcomes the intervention of the financial markets and representatives of finance capital, which help to create a crisis atmosphere to push through measures that devastate Medicare, Medicaid, Social Security and federal programs supporting education, transportation, environmental regulation and housing.

Congressional maneuvering on the debt ceiling continued Tuesday with no agreement on a bill that can pass even one house, let alone both. House Speaker John Boehner's plan to raise the debt ceiling by $2.4 trillion and mandate spending cuts of $3 trillion was to be brought a vote late Wednesday night, amid mounting indications that it will be rejected by ultra-right Republicans tied to the Tea Party movement, on the grounds that the cuts are too small.

Representative Jim Jordan, chairman of the Republican Study Group, a conservative caucus of nearly two-thirds of Republicans in the House, held a press conference with a half dozen other right-wing congressmen to announce they would vote against the Boehner bill.

The Democratic alternative, drafted by Senate Majority Leader Harry Reid, would also raise the debt ceiling by $2.4 trillion and includes $2.7 trillion in spending cuts, although $1 trillion of that total is derived from reduced military spending as troops are pulled out of Iraq and Afghanistan over the next ten years. The bill is likely to be blocked by a Republican filibuster.

Late Tuesday, there were press reports that the House and Senate might agree on a temporary postponement of the crisis for 30 days by raising the debt ceiling by the amount required to get through the month of August. Obama had previously threatened to veto any such short-term measure, but his threats have proven empty at every stage in the protracted political maneuvering over the federal deficit.

What the intervention of Wall Street makes clear is that the Washington "debate" is limited to the financial aristocracy and its political operatives in the two big business parties. Workers' interests have no representation. On the contrary, there is a consensus among the capitalist politicians that the entire burden of the crisis of American capitalism must be placed on the backs of working people, through the destruction of social programs on which tens of millions rely.