

Germany moves into deflation as global bond prices point to deepening slump

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The German economy has slipped into deflation for the first time since 2009, in another indication of the deepening recessionary trends across the euro zone.

Preliminary figures issued by the Federal Statistics Office yesterday showed that consumer prices fell by 0.3 percent in December from a year earlier. The office said that when the results were harmonised with figures from Eurostat for the whole euro zone, to be released today, the decline will be 0.5 percent.

While the drop in oil prices was a key factor, so-called core inflation, which strips out energy and food, is believed to have fallen.

Prices had been expected to show a decline, but the rate of decrease was greater than expected. Economic analysts are predicting that Germany will remain in deflation at least until the end of the year.

German Commerzbank chief economist Jörg Kramer commented: “[E]xpectations for eurozone inflation now carry a decidedly downside risk. The drop in oil prices suggests that the headline inflation should stay below zero until autumn.”

Earlier this month, the European Central Bank (ECB) announced a program of quantitative easing, involving the purchase of €60 billion worth of government bonds per month until at least September. The ECB said this was needed to meet its mandate to keep inflation near to, but below, 2 percent per annum. That target looks further away than ever.

The official fear of deflation flows from its financial impact, in particular on debt. Every fall in prices increases the real level of debt burdens, choking off investment and worsening the economic downturn.

The euro zone has yet to return to output levels it reached in 2007, with investment well down on pre-global financial crisis figures. The depressed character of the real economy is reflected most clearly in

financial markets.

With profitable outlets in the real economy shrinking, money is being poured into bond markets, driving up prices and lowering yields to historic lows. The price of a bond, which brings a fixed annual return, and the yield or interest rate, calculated on the basis of its market value, stand in an inverse relationship to each other.

Yesterday, the yield or effective interest rate on the benchmark UK 10-year bond touched a low of 1.396 percent during morning trade. This was lower than at the worst point of the euro zone crisis in 2012 and the first time in history that it had gone below 1.4 percent. The yield on 30-year bonds also dropped to a record low of 2.102 percent.

The fall in bond yields reflects the outlook in financial markets that there is going to be no economic recovery and that the only way of accumulating profits is through ever-more parasitic forms of speculation.

There has been a flood of money into bond markets, seeking both a safe haven for cash and the opportunity to make money out of the bond-buying programs of the ECB and other central banks. As a result, interest rates have effectively turned negative in a number of markets.

“People tend to think of this as a European and Japanese issue but the move down in yields is a global trend. That increases your worry that economies are not responding to all this stimulus,” Citigroup chief economist Matt Kind told the *Financial Times*.

The newspaper noted the striking pace at which the “negative universe” is expanding. “Some €1.5 trillion of euro zone bonds with a maturity of more than one year—almost a quarter of the total—yield less than zero, according to JPMorgan’s calculations,” it reported. “Yields are also negative on Swiss and Japanese

bonds.”

At first sight the phenomenon of negative yields appears to be a contradiction in terms because every bond brings a fixed amount paid by the issuing government at regular intervals, decided on when the bond was issued. At the end of the bond’s term, the government pays back to the holder its face value.

But before they come to maturity, bonds are traded in financial markets because of the income stream attached to them. They can be bought and sold above their face value.

Consequently, the price of the bond may rise so high in the market that it exceeds its face value and the amount of interest payments made on it, hence bringing a negative rate of return.

It would seem, therefore, that there is no reason for making such investments. However, if bonds are purchased in the belief that their price will rise still further in the market, not least because of the bond-buying operations of central banks, then they can be bought and sold at a profit.

Furthermore, the rapid movement in currency values over the recent period means that vast profits can be made by getting on the right side of such shifts. As the *Economist* magazine recently noted, “international investors who bought Swiss bonds before the Swiss franc’s recent jump [against the euro] will have made a killing.”

The falling bond yields and the emergence of negative interest rates point to the enormous pressure generated by financial markets for the supply of cheap money to continue to flow from central banks.

If this supply stops and there is any return to what were once considered “normal” conditions, then the process of buying bonds at elevated prices in the expectation that they will keep rising will come to a shuddering halt. The potential consequences threaten to outweigh even those of the 2008 financial crisis.

Meanwhile, in the absence of any profitable outlets for investment in the real economy, the phenomenon of parasitism on steroids continues—an indication of the ongoing breakdown of the global capitalist economy.

Alan Ruskin, a strategist at Deutsche Bank, told the *Financial Times*: “It was less than a year ago that negative interest rates were still largely a footnote in a dog-eared history book about 1970s Swiss monetary policy. Either bonds are mispriced and large losses

loom for investors, or we have a big problem on our hands.”



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