Surprise move by European Central Bank to speed up debt purchases

Nick Beams
20 May 2015

The European Central Bank (ECB) will accelerate asset purchases under its €1.1 trillion quantitative easing program, in a clear sign of growing nervousness in financial circles over the turbulence that has hit global bond markets over the past month.

In a speech delivered on Monday night in London, Benoit Coeuré, a member of the ECB's executive board, said the central bank would front-load some of its purchases of sovereign debt to May and June, to deal with an expected shortage of liquidity in July and August.

Coeuré cited concerns about the shifts in the market for euro zone debt and said the "rapidity" of a reversal in the price of German 10-year bonds, Bunds, was "yet another incident of extreme volatility in global capital markets showing signs of reduced liquidity."

In the middle of April, the yield on the Bund—regarded as a key market indicator—fell to around 0.05 percent. However, earlier this month it came back to around 0.55 percent. This was a massive shift in a market where daily yield movements are usually no more than a few hundredths of a percentage point. The rise in the yield, which moves in an inverse relationship to the price of the bond, indicated there had been a major sell-off.

The "reduced liquidity" issues raised by Coeuré point to fears that there may not be sufficient buyers in the market for those who want to sell, possibly leading to a "rush for the exits" that could set off a chain reaction.

The instability in financial markets was underscored by criticism of the way in which the decision was released. Coeuré's speech was delivered on Monday night but it was not published until Tuesday morning.

"It's a bit strange that there's such a delay between the speech and its disclosure," Frederik Ducorzet, an economist at Crédit Agricole, told the *Financial Times*. "The ECB should try to avoid it in the future," he said. "Especially in a market that remains very nervous."

The ECB said it planned to publish the speech at the time it was delivered but an internal procedural error led to the delay.

The fall in the price of the Bund and the rise in its yield initially raised hopes that markets might be at a turning point—a "welcome outbreak of sanity," as one headline put it—in conditions where the volume of bonds trading with negative yields had reached as high as $3 trillion.

These hopes have been short-lived. The ECB decision was motivated by the fear that a rise in interest rates and a move back to more normal rates—ending the "insanity" where speculators would receive a negative return if they held bonds to maturity—would spark a crisis.

Financial markets are extremely nervous about what will happen if and when the US Federal Reserve starts to lift rates, a prospect that has been pencilled in for later this year, and the consequences of any move by the ECB to slacken its pace of sovereign debt purchases.

Coeuré's remarks were seen as aimed at countering concerns that the ECB would move to taper its purchases in the months ahead—a move that would see interest rates start to rise. ECB president Mario Draghi, in a statement last week, sought to dampen speculation that the bank would ease the pace of its bond purchases.

Bank of France governor Christian Noyer, who is also a member of the ECB's governing council, indicated the central bank was prepared to go further than its initial decision. "The purchase program will continue until the end of September 2016 [its scheduled completion date] and beyond if we do not see and a sustained adjustment in the path of inflation," he said.

Officially, quantitative easing is aimed at returning Europe's inflation rate, at present close to zero, to the ECB's target range below, but near, 2 percent. The real motivation is to provide massive supplies of cheap money to the banks and finance houses for their speculative activities.

The ECB announcement was welcomed by financial

© World Socialist Web Site

markets. European equities rose on the news and Wall Street's Dow Jones industrial index closed at an all-time high. Other indexes, however, experienced a fall because of concerns that the Fed may move sooner than expected on interest rates. Market analysts pointed to a "lot of fear" about the impact of higher interest rates.

While the ECB respected the taboo on any mention of lowering the value of the euro to secure an advantage in world markets, the latest move is also another shot in the global currency wars.

Concerns have been expressed in the US that the dollar's rise against the euro and other major trading partners is having an adverse impact on US transnational corporations in high-tech and pharmaceuticals, which derive much of their revenue from international operations. This led to the view that the Fed may delay any interest rate rise until next year, sending down the value of the dollar in recent weeks.

Now the ECB has responded. The euro experienced its second largest one-day fall in three and a half years on the back of Coeuré's remarks. According to Brenda Kelly, head analyst at London Capital Group: "If there is one thing certain that is evident from today's early activity, it's that the ECB is determined to see the euro weaken."

The ongoing market turbulence and the response and counter-response by the central banks is the daily expression of underlying fears of the consequences of any move away, even if only a small one, from the supply of ultra-cheap money to the financial system.

Writing in the *Financial Times* after the spike in Bund yields, economics commentator Gavyn Davies said the sudden reversal was a "salutary reminder of the much bigger shock that might occur when the central banks finally abandon their zero interest rate policies, though this still does not seem imminent."

Davies pointed out that the rise in bond yields occurred at a time when global economic activity was weakening, "which is highly unusual." In the US, the much-predicted second quarter uptick, following a growth rate of only 0.2 percent in the first three months of 2015, is not taking place, according to the most recent data. There are signs too that China's growth rate is falling below the official projection of around 7 percent for this year.

Davies warned that some of the products of the "asset management industry" developed during the ultra-low interest rate regime "might pose a systemic threat to market stability when the central banks normalise policy." The Bund "tantrum" could be "a warning of things to come, and on a much larger scale."

Such is the state of financial markets that some of the world's largest banks and finance houses, including HSBC, UBS and the BlackRock hedge fund, have warned that the low-interest rate regime is increasing the risk of instability. Issued under the auspices of the World Economic Forum, their statement called for the use of "macroprudential policies"—that is increased regulation rather than a reliance on interest rates—to address "over-exuberance within asset classes" such as real estate.

Anxious to protect their own interests, however, the finance houses said such measures had to be applied across the board, not merely to presently regulated institutions, otherwise money would shift to the shadow banking sector, increasing "systemic risk." The statement argued that increased macroprudential regulation could become a source of systemic risk itself.

Such risk arises from the very efforts of the major banks and finance houses to develop methods to dodge the effects of regulation, either by devising more complex financial products or shifting activity into shadow banking.

The largely self-serving statement was bereft of any concrete measures to halt what even the finance chiefs recognise as a gathering crisis. However, it did serve one useful purpose. It underscored the fact that there are no such reforms available. The measures adopted by financial authorities in an attempt to counter one problem, at best only transfer it to another part of the system, where it can assume an even more malignant form.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site