Financial markets jittery on eve of Fed statement

Nick Beams
17 June 2015

The eyes of financial markets around the world will be turned today towards the statement issued by the US Federal Reserve Board at the conclusion of a two-day meeting, as well as the press conference that will be held by Fed Chairwoman Janet Yellen.

The Fed has already indicated that it intends to lift its base interest rate, now between zero and 0.25 percent, as the first step in a return to a normalised monetary policy regime.

But the size and timing of any increase has yet to be decided. Initially, it was thought that the first increase would occur this month, but that option has been all but ruled out. It is now expected that any rise will be put off at least until September. Last week, International Monetary Fund Managing Director Christine Lagarde called for any such move to be delayed at least until next year.

The concern in financial circles is that a Fed rate rise could set off a financial crisis, especially in so-called “emerging markets,” where much of the inflow of capital in recent years could be reversed.

The expectation of a rate increase, the first since 2006, has already sparked a significant movement of funds. According to a report published in the London-based *Daily Telegraph* last Friday, $9.27 billion moved out of emerging markets in the week of June 10, a larger outflow than experienced during the “taper tantrum” of June 2013, when the Fed first indicated that it would start to wind back its asset-purchasing program.

Lagarde’s call for the Fed to delay any decision on an interest rate increase reflects the findings of the IMF’s *Global Financial Stability Report* issued in April, which noted that the asset management industry has $76 trillion of investments and that any tightening by the Fed could cause a liquidity crisis, as investors en masse sought to leave emerging markets.

A financial crisis in these markets, or even significant turbulence, would far outweigh the impact of the Asian financial crisis of 1997-98. Emerging markets now account for more than half of global gross domestic product, a far greater proportion than in the period leading up to the 1997-98 crisis.

But even then, the crisis had significant consequences, leading to the Russian debt default in 1998 and the collapse of the US hedge fund Long Term Capital Management, which threatened the stability of the entire US financial system.

Emerging markets are not the only potential source of turbulence. The violent movements in European bond markets over the past two months may well be the harbinger of a new financial crisis. Towards the end of April, the yield on German bunds—ten-year bonds—was close to zero. Then it underwent a major surge to more than 0.5 percent in May, and last week hit 1 percent, indicating a massive sell-off. (The yield on bonds moves in the opposite direction of the price).

A recent *Bloomberg* article on BlackRock, the world’s largest hedge fund, with $4.8 trillion of assets under management, an amount equivalent to the gross domestic product of Japan, pointed to a growing air of perplexity in financial circles. “The gyrations gripping the world’s fixed-income market are so great that it’s almost impossible to make sense of them on a historical basis,” *Bloomberg* wrote, with investors across Europe “ripping up their old models” as they try to analyse the $100 trillion global bond market.

Scott Thiel, a top-level London-based investment officer for the hedge fund, told the news agency: “The German bund market is incalculably volatile. It doesn’t make sense to measure it in traditional respects.”

The rapid movement in the price of bonds since the

© World Socialist Web Site

end of April has led to losses of $640 billion in the holdings of sovereign debt, with the financial firm Citigroup pointing to greater risk in the European government bond market than when Lehman Brothers collapsed in September 2008.

The index of yield volatility on bunds has now reached nine times its average over the past 15 years.

Such violent movements pose the risk of significant losses, which could then set off a chain reaction throughout the financial system as they spread to equities and corporate bond markets, which have also been growing at a record pace.

An article published on the Australian web site *Business Spectator* last week posed the question: "Will the bond market start the next financial crisis?" A rising interest rate environment has not been seen for nearly a decade, it noted, "and therein lies the greatest risk… If rising yields spur a sell-off in corporate bonds, there is a growing fear that investors who want to sell won't be able to do so."

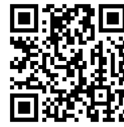
It is an expression of the depth of the economic breakdown and the inherent incapacity of regulations to exercise meaningful control over the vast movement of money that supposed "reforms," aimed at preventing another meltdown on the scale of 2008, could have, in fact, created the conditions for a new crisis.

Finance houses have been forced to cut back on their holdings of corporate debt, with the result that they may not be able to operate as a buffer for a falling market as they could in the past.

According to Stephen Schwarzman, chairman and cofounder of Blackstone, writing in the *Wall Street Journal*: "A liquidity drought can exacerbate, or even trigger the next financial crisis. Sellers will offer securities, but there will be no buyers. Prices will drop sharply, causing large losses for investors, pension funds and financial institutions. Additional fire sales will aggravate the decline."

In recent months, Yellen has given repeated assurances to the financial markets that the Fed will be "patient" and that any increase in rates will proceed gradually, in order to avoid market volatility, or worse.

But events may move out of the Fed's control, as there exist any number of possible triggers, including a major crisis in Europe. Such a crisis will come a step closer if no agreement is reached at tomorrow's meeting of the Eurogroup finance ministers, which has been described as the "last opportunity" to avoid a Greek debt default.



To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site