Market turbulence linked to conflicts over ruling class policy

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11 September 2015

The lead-up to the meeting next week of the US Federal Reserve, at which it will decide whether to lift interest rates for the first time since the beginning of the global financial crisis in September 2008, has turned into a battleground.

Despite the fact that Fed Chairwoman Janet Yellen, who is said to favour an interest rate increase sometime this year, has made clear that any initial rise will be small and that any further movements will be gradual, large sections of the financial markets are demanding that the near-zero base rate remain in place.

They are making their demands known through large sell-offs on stocks on Wall Street, causing violent swings in the market, in response to any data that suggest that the Fed may begin to move.

A typical example occurred on Wednesday. Following a 7.7 percent rise in the Japanese market, the largest since October 2008, Wall Street jumped on opening. But then came the news that a key jobs survey, said to be closely watched by Yellen, had shown that total job openings in the US had risen to 5.75 million for July, up from 5.32 million in June. This was the occasion for a major sell-off, with the Dow Jones Industrial Average finishing 239 points down, a swing for the day of 411 points. This was because the jobs report was considered to increase the likelihood of an interest rate increase.

The market gyrations are an expression of the toxic combination of greed and fear that underlies financial markets, arising from their parasitic dependence upon ultra-cheap money as the source of profits and wealth.

Powerful financial interests are motivated simply by the determination that nothing should be done to in any way curb their speculative activities. But this outright greed and the insistence that the Fed and other regulatory bodies are there to serve their interests is not the only factor in the present situation.

There is also the fear that financial markets, and the global capitalist system more broadly, have become so dependent on cheap money that any lessening of its supply and steps toward the return of a more normal monetary regime, no matter how small, can collapse the whole system like a house of cards.

This view has been articulated by two of the world's major economic institutions, the World Bank and the International Monetary Fund, as well as a number of financial commentators. As one commentator on CNBC put it recently, if markets are so concerned about a possible 0.25 percent increase in rates, then the problems of the world economy are more serious than anyone previously thought.

On Wednesday, the chief economist of the World Bank, Kaushik Basu, told the *Financial Times* that the Fed risked setting off "panic and turmoil" if it decided to lift rates at next week's meeting and should wait until the world economy had stabilised.

Pointing to the impact of the August 11 devaluation of the Chinese currency and what it indicated, Basu said: "The world economy is looking so troubled that if the US goes for a very quick move in the middle of this I feel it is going to affect countries quite badly."

He said the World Bank's forecast for global growth of 2.8 percent, made only last June, was now under threat because of the slowdown in economies such as China and Brazil as well as other major industrial nations and that "overall we are going to get into a slow growth phase."

"All this put together and what has happened over the past two weeks with the Chinese markets leads one to believe that the scenario is looking worse than it did even in June," he said.

The International Monetary Fund (IMF) has already come out against a rate rise, with managing director Christine Lagarde stating last June that any increase should be put off until sometime next year. One of the major fears of the IMF is that a rate rise could set off a flight of capital from emerging markets which have become highly dependent on dollar-denominated debt.

So unstable are financial markets that the positions advanced by the IMF and World Bank could themselves be the trigger for significant turbulence if the Fed does decide to lift rates because the divergence of views will be seen as a major cause for concern, leading to a sell-off.

On the other hand, some central bankers in emerging markets consider that the uncertainty about what the Fed will do is itself a considerable cause of instability and that a rate rise should be announced. This view was articulated by Mirza Adityaswara, senior deputy governor of Indonesia's central bank. The Indonesian currency has been one of the most severely affected by the global turmoil, falling to lows not seen since the Asian financial crisis of 1997–98.

In a somewhat pointed criticism, not usual in central banking circles, he said: "We think US monetary policymakers have got confused about what to do. The situation has created the turmoil."

The Fed, he advised, should make a decision and then indicate to the markets that it will make one or two increases and then stop.

His views have been echoed by Peru's central bank governor, Julio Velarde, who said most emerging markets wanted the Fed to raise rates as soon as possible. "The uncertainty about when the Fed will hike will happen is causing more damage than the Fed hike will itself."

However some economic commentators have warned that the underlying fragility of the world economy makes a rate rise too dangerous at this point. According to *Financial Times* economic commentator Martin Wolf, a necessary condition for an increase is the confidence that it will not be needed to be reversed in the near future. "But it is impossible at present to have such confidence," he wrote Wednesday.

Writing in the same newspaper, former US Treasury Secretary Lawrence Summers warned that what he called conventional wisdom "underestimates the risks in the current moment." Pointing to the fallout from the Russian default of 1998, the Asian financial crisis of 1997–98 and US subprime lending, he said history taught that "financial interconnections are pervasive and not apparent until it's too late."

He pointed to a number of risks, including capital flight from China which could be larger than experienced by "any economy in history," decelerating productivity growth in the US, tightening liquidity conditions in a number of markets, and the growing importance of what he called "positive feedback" trading strategies where investors sell when prices go down.

If "some portion of these fears are warranted," he continued, "and the Fed tips toward tightening, its risks a catastrophic error."

While the US economy has been referred to as a "bright spot" in the global economy, it is here that some of the biggest risks may be concentrated.

With investment returns in the real economy having failed to recover after the financial crisis, profits are being accumulated by borrowing money at ultra-low rates in order to finance mergers and acquisitions and share buybacks. Leveraging—the use of debt—facilitates high returns on equity so long as interest rates do not rise. But even a small increase can throw the whole process in reverse.

According to a report in the *Financial Times* this week, a "turning point looms" for what it called the "US debt binge." The newspaper said energy companies that have used cheap financing but which now face the impact of falling prices could start to default. The report cited Barclays strategist Eric Gross, who noted that the problem for low-rated energy companies was not whether they paid interest at 7 or 9 percent, but whether "they can get financing at all."

The pharmaceutical and health care industry, which has seen a series of deals financed by debt, could also be hit if rates rise.

Overall, according to figures from Bank of America Merill Lynch, the debt burden of US high-grade companies is at its highest level since 2002, and even when sectors hard hit by falling commodity prices are excluded, leverage is now at the levels reached in 2008.

These developments make clear that, seven years since the collapse of Lehman Brothers, none of the measures taken by governments and central banks in response to the crisis have restored any degree of stability to the global economy. Instead, they have vastly enriched the financial oligarchy at the expense of the population, while setting the stage for a financial panic on the scale of, or even greater than, that of 2008.