

Further details emerge on the extent of the mid-March financial crisis

Nick Beams
22 May 2020

An article in the *Wall Street Journal* (WSJ) earlier this week provided further details on how close financial markets came to a meltdown in the middle of March.

Entitled “The Day Coronavirus Nearly Broke the Financial Markets,” the article recorded how markets in financial assets, usually regarded as being almost as good as cash, froze when “there were almost no buyers.”

“The financial system has endured numerous credit crunches and market crashes, and the memories of 1987 and 2008 crises set a high bar for market dysfunction. But long-time investors ... say mid-March of this year was far more severe in a short period. Moreover, the stresses to the financial system were broader than many had seen,” it said.

In testimony and interviews, US Federal Reserve chair Jerome Powell has been at pains to emphasise that regulatory mechanisms and policies introduced after the 2008 crisis have strengthened the financial system.

In his interview on the CBS “60 Minutes” program last Sunday, for instance, Powell downplayed the threat of unemployment reaching levels not seen since the Great Depression. In the 1930s, he said, the financial system had “really failed,” but that today “our financial system is strong [and] has been able to withstand this. And we spent ten years strengthening it after the last crisis. So that’s a big difference.”

In his interview on the CBS “60 Minutes” program last Sunday, for example, when asked about the prospect of US unemployment rising to levels not seen since the Great Depression, Powell stated that at that time the financial system “really failed.”

He claimed that in contrast to the 1930s, “Here, our financial system is strong [and] has been able to withstand this. And we spent ten years strengthening it after the last crisis. So that’s a big difference.”

In fact, Powell’s reassurances are contradicted by the Fed’s own Financial Stability Report issued last Friday. Focusing on the mid-March crisis, it noted: “While the financial regulatory reforms adopted have substantially increased the resilience of the financial sector, the financial system nonetheless amplified the shock, and financial sector vulnerabilities are likely to be significant in the near term.”

The events in mid-March revealed what has actually taken

place. While the Fed has taken limited measures to try to curb some of the riskier activities of the banks that sparked the 2008 crash, the dangers have simply been shifted to other areas of the financial system.

The speculation of the banks may have been curtailed somewhat, but it is now being carried out by hedge funds and other financial operators. They are financed with ultra-cheap money provided by the Fed through its low-interest rate regime and market operations, such as quantitative easing and, more recently, its massive interventions into the overnight repo market.

The WSJ report, based on interviews with Wall Street operatives, provided some insights into how the financial system “amplified” the shock of the pandemic.

Ronald O’Hanley, CEO of the investor services and banking holding company State Street, recounted the situation that confronted him on the morning of Monday, March 16. On Sunday evening, before markets opened, the Fed had announced it was cutting its base rate to zero and was planning to buy \$700 billion in bonds, but with no effect.

According to the report, a senior deputy told O’Hanley that “corporate treasurers and pension managers, panicked by the growing economic damage from the COVID-19 pandemic, were pulling billions of dollars from certain money-market funds. This was forcing the funds to try to sell some of the bonds they held. But there were almost no buyers. Everybody was suddenly desperate for cash.”

The article noted that rather than take comfort from the Fed’s extraordinary Sunday evening actions, “many companies, governments, bankers and investors viewed the decision as reason to prepare for the worst possible outcome from the coronavirus pandemic.” The result was that a “downdraft in bonds was now a rout.”

It extended into what had been regarded as the most secure areas of the financial system.

The WSJ article continued: “Companies and pension managers have long-relied on money-market funds that invest in short-term corporate and municipal debt holdings considered safe and liquid enough to be classified as ‘cash equivalents.’ ... But that Monday, investors no longer believed certain money funds were cash-like at all. As they pulled their money out,

managers struggled to sell bonds to meet redemptions.”

So severe was the crisis that Prudential, one of the largest insurance companies in the world, was “also struggling with normally safe securities.”

The article provided a striking example of how, when a fundamentally dysfunctional and rotting system seeks to undertake a reform, it generally only exacerbates its underlying crisis. This phenomenon has been long-known in the field of politics, but the events of mid-March show it applies in finance as well.

On the Monday morning when the crisis broke, Vikram Rao, the head of the debt-trading desk at the investment firm Capital Group, contacted senior bank executives for an explanation as to why they were not trading and was met with the same answer.

“There was no room to buy bonds and other assets and still remain in compliance with tougher guidelines imposed by regulators after the previous financial crisis. In other words, capital rules intended to make the financial system safer were, at least in this instance, draining liquidity from the markets,” the WSJ report stated.

The crisis had a major impact on investors who had leveraged their activities with large amounts of debt—one of the chief means of accumulating financial profit in a low-interest rate regime.

According to the WSJ article: “The slump in mortgage bonds was so vast it crushed a group of investors that had borrowed from banks to juice their returns: real-estate investment funds.”

The Fed’s actions, have, at least temporarily, quelled the storm. But it has only done so by essentially becoming the backstop for all areas of the financial market—Treasury bonds, municipal debt, credit card and student loan debt, the repo market and corporate bonds, including those that have fallen from investment-grade to junk status.

And, as Powell made clear in his “60 Minutes” interview, the Fed plans to go even further if it considers that to be necessary.

“Well, there’s a lot more we can do,” he said. “I will say that we’re not out of ammunition by a long shot. No, there’s really no limit to what we can do with these lending programs that we have. So there’s a lot more we can do to support the economy, and we’re committed to doing everything we can as long as we need to.”

The claim the Fed is supporting the “economy” is a fiction. It functions not for the economy of millions of working people, but as the agency of Wall Street, ready to pull out all stops so that the siphoning of wealth to the financial oligarchy, which it has already promoted, can continue.

An indication of what “more” could involve is provided in the minutes of the Fed’s April 28–29 meeting.

There was a discussion on whether the Fed should organise its purchases of Treasury securities to cap the yield on short and medium-term bonds. This is a policy employed by the Bank of Japan that has also recently been adopted by the Reserve Bank

of Australia.

No immediate decision was reached, but the issue is certain to be raised again. Over the next few months, the US Treasury will issue new bonds to finance the operation of the CARES Act that has provided trillions of dollars to prop up corporations while providing only limited relief to workers.

By itself, the issuing of new debt would lead to a fall in the prices of bonds because of the increase in their supply, leading to a rise of their yields (the two move in opposite directions) and promoting a general rise in interest rates—something the Fed wants to avoid at all costs in the interests of Wall Street.

The only way the Fed can counter this upward pressure is to intervene in the market to buy bonds, thereby keeping their yield down. This would formalise what is already de facto taking place, where one arm of the capitalist state, the US Treasury, issues debt while another arm, the Fed, buys it.

This would further heighten the mountain of fictitious capital which, as the events of mid-March so graphically revealed, has no intrinsic value and is worth essentially zero.

The ruling class cannot restore stability to the financial system by the endless creation of still more money at the press of a computer button. Real value must be pumped into financial assets through the further intensification of the exploitation of the working class and a deepening evisceration of social programs.

Financial crises are presented in the media and elsewhere as being about numbers. But behind the economic and financial data are the interests of two irreconcilably opposed social classes—the working class, the mass of society, and the ruling corporate and financial oligarchy whose interests are defended by the state of which the Fed is a crucial component.

As 2008 demonstrated, what emerges from a financial crisis is a deepening class polarisation. That will certainly be the outcome of the mid-March events. A massive social confrontation, already developing long before the pandemic arrived on the scene, is looming in which the working class will be confronted with the necessity to fight for political power in order to take the levers of the economy and financial system into its own hands.



To contact the WSWS and the
Socialist Equality Party visit:

wsws.org/contact