Concerns mount over financial stability as US dollar falls and gold price soars

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28 July 2020

More information has emerged on the extent of the freeze in financial markets in mid-March that threatened to create a bigger financial crash than 2008 amid growing concerns that the massive creation of money by the Fed and other central banks, initiated in response to the crisis, is creating the conditions for an even bigger disaster.

One of the indications of a coming financial storm is the fall in the value of the US dollar and the sharp rise in the gold price.

Gold reached a record high of $1,944 per ounce yesterday, taking its increase for the year to 25 percent.

A report published in the *New York Times* last week on the March crisis—the trigger for the Fed intervention—focused on the speculative activity of hedge funds, beyond any regulatory reach, that had pushed "critical parts of the US financial markets" towards a collapse.

According to the report, some hedge funds were undertaking highly leveraged trades in support of strategies similar to those employed by Long Term Capital Management in 1998 whose demise nearly sparked a financial meltdown that was only averted by the intervention of the New York Federal Reserve.

In an example of the incapacity of regulatory authorities to in any way control the anarchy of the capitalist market, the report noted that tougher restrictions imposed on bank trading under the Dodd-Frank Act pushed "risk-taking to the shadowy corners of Wall Street."

In mid-March, as the economic impact of the COVID-19 pandemic became apparent, markets became very volatile and funding for the trades became unavailable. Many trades were no longer profitable and "some hedge funds were forced to dump government debt."

"Banks could have acted as stress relievers by buying securities and finding buyers," the article noted. "But they were already holding many government bonds, and could not handle more, in part because of regulations established after 2008. Everyone was selling—ordinary investors, foreign central banks and hedge funds. Hardly anyone was buying. The market for US government debt, the very core of the global financial system, was grinding to a halt."

As the effects of the pandemic began to spread, the Fed intervened by cutting interest rates to zero. But this proved to be insufficient and alarm bells rang when the yield on bonds began to rise—an indication of the sell-off cited in the article.

It pointed out that the dangers were not unknown and as far back as November 2016 a hedge fund working group, set up to examine the risks posed by many hedge funds using similar strategies, had warned they "could be a source of instability during turbulent times."

But with the coming to power of the Trump administration and its focus on boosting the financial markets the hedge fund working group was deactivated.

Former Fed chair Janet Yellen who was interviewed for the article, noted: "It's very dangerous to have a regime in which you know this can happen. The Fed did unbelievable things this time."

Reflecting its role as a mouthpiece for the Democrats, the *New York Times* would no doubt like to present the crisis as resulting from the actions of the Trump administration.

But the actions of the government in providing trillions of government support for corporations through the CARES Act and the "unbelievable" interventions of the Fed in providing further trillions of dollars for all areas of the financial markets—government bonds, corporate debt, including

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junk bonds, student and credit card debt, commercial paper and municipal bonds—have been fully backed by the Democrats in Congress.

The inflow of more than $3 trillion into financial markets in just four months has now led to what the *Wall Street Journal* has described as a "melt-up" in all financial assets.

"Stocks, bonds and commodities are heading for their strongest simultaneous four-month rise on record, highlighting the breadth of the market recovery during the 2020 economic slowdown," it reported in an article published over the weekend.

The signs are particularly apparent in technology stocks where "investors are buying assets in large part simply because they are rising."

'Such powerful rises are a concern for analysts who worry that the investments will suddenly fall in tandem if markets or the global economy face a fresh shock," the article continued.

The rapid rise in the price of gold is becoming matter of concern both because of what it indicates about the state of financial markets and, even more significantly, because with trillions of dollars being created at the press of a computer button, it could be the harbinger of a crisis of confidence in the world's central currency the US dollar.

When markets froze in the middle of March, the price of gold fell as investors scrambled for cash. But since then it had enjoyed a rapid rise with predictions that it has further to go.

In so-called "normal times" gold is not viewed as an investment because it does not bring a return in the form of interest. But with interest rates close to zero, or in some cases negative, this disadvantage is being eliminated and it is seen as a store of value as the stability of financial assets is called into question.

Apart from these immediate considerations there is the growing concern that the value of the US dollar is on a downward trajectory.

An article on Bloomberg commented that the pandemic had "unleashed a torrent of forces that are conspiring to fuel relentless demand for the perceived safety that gold provides."

Among the factors that have sent the value of the dollar to fall sharply against the euro and other major currencies, including the highly-traded Australian dollar, the article cited fears that further lockdowns could be ordered, unprecedented stimulus packages, the decisions by central banks to print money faster than they ever have before and the plunge of inflation-adjusted bond yields in the US into negative territory.

Speaking on the Fox channel's "Sunday Morning Futures," the billionaire hedge fund investor Ray Dalio, the head of Bridgewater Associates, said the conflict between the US and China could expand into a "capital war" that would impact on the dollar.

"There's a trade war, there's a technology war, there's a geopolitical war and there could be a capital war."

He said that if there was a law banning investment in China and the US moved to halt the payment of money it owes on Chinese-held Treasury bonds "it would have big implications, such as for the value of the dollar."

Besides the conflict with China, Dalio pointed to the implications of the massive interventions by the Fed for the stability of the entire monetary system.

"The things I worry about most are the soundness of our money. You can't continue to run deficits, sell debt or print money rather than be productive and sustain that over a period of time," he said.

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