

One year on: Lessons of the March financial crisis

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Next Monday marks one year since the start of a financial crisis on Wall Street that had the potential to go beyond the crash of 2008 and bring about the collapse of the global financial system.

As Randal Quarles, vice-chair for supervision on the Federal Reserve's board of governors, told a conference organised by the Institute for International Finance (IIF) in November, it was, as the Duke of Wellington had said of the Battle of Waterloo, "a damn close-run thing."

The crisis was eventually halted by a massive unprecedented intervention by the Fed, running into trillions of dollars, in which it became the effective backstop for all areas of the financial system. Together with action by other central banks, above all the European Central Bank which expanded its bond buying program, a complete meltdown was averted.

But as a November 20, 2020 report of the Financial Stability Board, an international body comprising representatives of the G20 set up after the 2008 crash, made clear nothing had been resolved.

It said the "exceptional measures taken by the central banks were not aimed at addressing the underlying vulnerabilities that amplified the stress" and the "financial system remains vulnerable to another liquidity strain, as the underlying structures and mechanism that gave rise to the turmoil are still in place."

There was a sharp reminder of that fact on February 25. There was a mini-version of the meltdown a year ago when a \$68 billion auction of seven-year US Treasury bonds was undersubscribed by 40 percent, forcing the underwriters to purchase the bonds because there were no buyers.

The crisis a year ago was triggered by the onset of the COVID-19 pandemic and the realisation in financial markets that, contrary to the assertions by US President Trump that it was only a "scare," it would have major economic consequences and threatened the most significant economic contraction since the Great Depression of the 1930s.

The stock market underwent a significant fall with the S&P 500 index falling by 10 percent in the week starting February 24. Fed chair Jerome Powell indicated he would soon bring forward a cut in interest rates. But the market slide continued fuelled at least in part by a precipitous fall in the price of oil—an indicator of the depth of the global slump.

On March 9 stock markets had their worst day since the 2008 crash with the Dow losing 2000 points.

As stocks continued to fall, on the evening of Sunday March 15 Powell called a press conference to announce a series of emergency measures aimed at trying to curb another plunge when markets opened the next morning. The Fed cut its base interest rate to zero and

announced it would buy \$700 billion worth of bonds, starting with an \$80 billion purchase on March 17. That is the Fed was going to spend more in 48 hours than it had outlaid in most months after the 2008 crash.

Powell's announcement was to no avail. The Dow plunged by 3,000 points—its biggest one-day point loss in history—a reduction of 13 percent, the second biggest one-day percentage decline ever.

While the fall in the stock market drew most attention in the media, the underlying significance of the crisis lay elsewhere. It was rooted in the \$20 trillion market for US Treasury bonds—the foundation for the US and global financial system. The Treasury market, the deepest and most liquid in the world, functions as a kind of safe haven for financial investors.

The stock market and bond market generally move in opposite directions. If the stock market falls cash is moved into US Treasury bonds, pushing up their price and lowering their yield (interest rate)—the two have an inverse relationship. But in March the relation between stocks and bonds broke down. The prices of both stocks and bonds were now falling. Not only were stock prices falling but Treasury bonds were as well because of the "dash for cash," as it was later characterised.

Such was the depth of the bond sell-off that when traders looked at their screens they could find no offers for purchases. Previously long-established financial relationships had been completely overturned.

As the *Financial Times* reported in an analysis of the crisis published last July, "rumours of hedge funds collapsing due to imploding Treasury bets" spread "like wildfire" and some market participants "fretted that the Treasury might face the previously unimaginable scenario of a failed auction of US government debt."

As Nick Maraoutsos, co-head of global bonds at the bond trader Janus Henderson, told the newspaper: "There was a point in time we were wondering if the bond market would really ever function again."

Faced with a complete collapse of the global financial system if the crisis continued to deepen, the Fed intervened again. To that point its measures had been confined to the framework established after 2008. Now it went much further. On March 23, an hour and half before markets opened, Powell announced a series of new measures.

Boosting the purchases of Treasury bonds and mortgage-backed securities to \$600 billion in a single week, he announced that the Fed was to start buying corporate bonds that were still rated as investment grade. The Fed intervention was further extended over the next days to cover the market for commercial paper (the means by which companies raise money in the short term to finance their working capital) and indicated support for the markets for municipal bonds, student loan debt and credit card debt.

Because the freeze in the Treasury market had flow-on effects to every other area, the Fed had to effectively place a safety net under the entire financial system. This was extended globally as it expanded dollar swaps for other central banks, which also cut interest rates and stepped up bond-buying programs.

The Fed intervention, flooding the financial system with further trillions of dollars, coupled with the bailout organised by the US government under the CARES Act, halted the immediate crisis.

It sparked the escalation of stock prices over the next year, sending them to new record highs, amid a further round of speculation—the rise of Bitcoin, the escalation of Tesla shares to stratospheric heights, the GameStop mania, the escalation of special purpose acquisition companies (SPACs) which are launched on to the market as cash-only firms with the aim of taking over another company—to list just some examples.

In his address to the IIF conference, Quarles claimed that the ability of the Fed to stem the crisis showed that “the system worked.”

This view has been opposed in a report by The Systemic Risk Council, a private body comprising former government officials and financial and legal experts, in a statement issued last October on the March events.

“It is hard to claim, as some commentators have,” it wrote, “that Exchange-Traded Funds and other structures weathered the crisis successfully, when the whole market was propped up by central bank support operations. At most, agnosticism tempered with concern about market fragilities is warranted. At worst, serious vulnerabilities were obscured by the monetary and credit-market interventions.”

In the wake of the GameStop turmoil last month, the council sent a letter to Congress earlier this month urging it to ensure that the “unfinished business of rebuilding the financial system’s resilience resumes.”

But such a project, based on the conception that some rationality must be introduced, has a major problem which is rooted in the objective irrationality of the financial system as a whole.

This was pointed to by the Financial Stability Board report. It noted: “While defensive behaviours by various parts of the financial system are individually rational and in keeping with good risk management in the face of increased risks, they resulted in large mismatches between the aggregate supply of and demand for market and funding liquidity that put critical nodes of the financial system under strain.”

That is, the dash for cash, most sharply expressed in the crisis in the Treasury market, the very bedrock of the financial system, while rational from the standpoint of the individual market player threatened a disaster for the system as a whole.

The FSB did not comment on the implications of its findings. But they raise fundamental issues. The ideology of “free market” capitalism is that the rational actions of individuals and investment firms produce the best possible, indeed the only viable, foundation for the system as a whole.

Living experience however has demonstrated, and not for the first time, that the supposedly self-correcting mechanisms of the market, based on rational decisions by individuals, have proven to be utterly destructive, requiring a massive intervention by the state and its financial apparatus.

Moreover, a year on, financial authorities and regulators still have no real idea of what caused the financial freeze last March and therefore no policies to prevent a recurrence have been advanced.

As the *Financial Times* columnist Gillian Tett noted in a recent comment, this month a “mystery hangs over markets.” After peace

was restored by unprecedented interventions investors and politicians “seemed minded to sweep that horror under the rug.”

But, she continued, the mystery needed to be solved because the system “came close to disaster,” the bond market will face new stresses if and when US monetary policy tightens and it has already experienced gyrations such as took place on February 25. The source of the March turmoil was not understood which is “unnerving if you want to devise policy to avoid a repeat.”

Various explanations, she noted, had been offered, including the speculative activities of hedge funds. But that explanation was not sufficient because investigation had shown that foreign institutions “also dumped Treasuries in a destabilising way.”

Tett cited comments by Quarles that the March 2020 debacle showed that the growth of the Treasury market “may have outpaced the ability of private-market infrastructure to support stress of any sort” and this under conditions where the US debt keeps expanding.

Tett ended her comment with a call to the Fed to “explain to the public in easy-to-understand language what created the problem, and how to avoid a repeat.”

But if such corrective action were possible then it would have already been implemented more than a decade ago following the crash of 2008. The Fed developed no such measures but continued the very policies—based on the supply of ultra-cheap money—which set up the conditions for the March crisis, to which its response has been to provide still more trillions for the massive speculation which has ensued.

The massive stateisation of the financial system, does, however, point to both the source of the crisis and its rational resolution.

State intervention is first of all an expression of the fact that the market mechanism, based on private ownership and profit, is in an advanced and dangerous state of decay, threatening every day to produce an economic and financial crisis that can devastate the jobs and livelihoods of billions of workers around the world.

Such is the growth and complexity of the economy that it cannot be controlled and regulated in any rational matter under capitalist social relations. The doctrines of the “free market” have been refuted by living events. State control is an economic necessity, as even ardent “free marketeers” recognise.

But the crucial question is in whose hands is state power to be held. If it remains in the hands of the ruling financial oligarchy then, as history and the experience of the past decades show, the result will be a disaster for the working class and the mass of the population.

The lessons of the March crisis and the ongoing financial turmoil are clear. They point to the necessity for the working class to intervene with its own independent program—the fight to take political power and establish a workers’ government as the starting point for bringing the commanding heights of the economy and its financial system into public ownership under democratic control and the development of a rationally planned socialist economy to meet human need and not the destructive demands of profit.



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