Wall Street rise continues amid warnings of instability

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When the US jobs figures for June were issued on Friday, Wall Street's S&P 500 and NASDAQ indexes both climbed to new record highs, because the jobs data were regarded as a "Goldilocks" moment—neither too hot, nor too cold.

Coming in at 850,000, the jobs growth number—beating economists' estimates of 720,000 and well above the figure of 583,000 for May—was regarded as a sign of recovery for the US economy, but not enough to push the Federal Reserve towards tightening its monetary policy, as the data showed there were still 9 million people unemployed, compared with 5.7 million in February 2020, before the pandemic hit.

As one analyst told the *Financial Times,* the jobs figures "couldn't have delivered better news for Wall Street. Enough new jobs to confirm the economy is on a roll, [but] enough jobless to give the Fed's current strategy a warm hug."

Another part of the good news for Wall Street was that, despite evidence of labour shortages in parts of the US economy, and the payment of higher wages, the rise in average hourly earnings for the month was only 0.3 percent, down from the increases in April and May.

The significance of the wages, jobs growth and overall employment data for Wall Street is not so much what they signify in and of themselves—though that is factor—but their implications for the policies of the Fed.

Since the Fed's massive intervention in March 2020, when it stepped in to halt a meltdown of the financial system with the injection of around $4 trillion, Wall Street has become ever more dependent on the flow of ultra-cheap money from the central bank.

This inflow is continuing at the rate of $120 billion a month—more than $1.4 trillion a year—through the purchase of Treasury bonds and mortgage-backed securities, and the financial markets are fearful that even a slight lessening of this support could have major effects.

Consequently, some analysts are issuing warnings that the present situation, in which markets continue to rise, based on continued economic growth, combined with monetary support from the Fed, is inherently unstable.

In a comment published in the *Financial Times* last week, Mohamed El-Erian noted that, as recorded by a recent Bank of America survey, markets were currently dominated by three core hypotheses: durable high economic growth; transitory inflation and "ever-friendly central banks."

El-Erian wrote that while he did not have a serious quarrel with the higher growth scenario, he did "worry a great deal about the widespread conviction that the current rise in inflation will be transitory."

He did not expect a return to the inflation levels of the 1970s, but "we have to respect the possibility of a shock to a financial system that has been conditioned and wired for the persistence of lower and more stable inflation."

If inflation remains low, and present rises prove to be transitory, then the Fed will maintain low interest rates. But if that proves not to be the case, then "a late slamming of the brakes, rather than easing off the accelerator, would significantly increase the rise of an unnecessary economic recession."

A much sharper warning about the state of the US and global financial system has been delivered by economist Nouriel Roubini, who came into public prominence because of his warnings prior to the financial crash of 2008.

In a comment in the *Guardian* last Friday, he warned that conditions were ripe for a repeat of the 1970s stagflation and the 2008 debt crisis.

He noted that debt ratios today were much higher than in the 1970s, while a mix of loose economic policies threatened to fuel inflation, rather than the deflation that occurred after the 2008 crisis.

"For now, loose monetary and fiscal policies will continue to fuel asset and credit bubbles, propelling a slow-motion train wreck," he wrote, and pointed to the warning signs.

These included: high price to earnings ratios for shares, inflated housing and tech assets, irrational exuberance surrounding special purpose acquisition companies (firms that are floated on the stock market on a cash only basis, with the aim of taking over another firm seeking a public listing) the crypto-currency sector, the level of high yield corporate debt (junk bonds), collateralised loan obligations, the increased use of private equity, meme stocks and runaway retail daily trading.

At a certain point this would trigger a loss of confidence and a crash, but in the meantime, loose monetary policies will continue to drive inflation, creating the conditions for stagflation, when the next economic shock arrives.

He noted that central banks were in a "debt trap." If they start to raise interest rates to combat inflation, they "risk triggering a massive debt crisis and severe recession" but if they continue on the present course, they risk double-digit inflation.

Roubini pointed out that the Fed was already in a debt trap, and its recent adjustment from an "ultra-dovish stance to a mostly dovish stance"—when its "dot plot" of interest rates at its June meeting showed a rise in 2023, rather than 2024—changed nothing.

The debt trap was in evidence at the end of 2018—more than a year before the onset of the pandemic—when the Fed dropped proposed interest rate rises and ceased its wind-down of asset holdings, because of the adverse reaction in financial markets.

In response to the Fed's plan to continue interest rates in 2019, after four rises in 2018, Wall Street had its worst December since 1931, and Fed chair Jerome Powell reversed course and then began cutting rates in July 2019.

"With inflation rising and stagflationary shocks looming, it is now even more ensnared," Roubini wrote.

There is also clear evidence that financial authorities are no better prepared to deal with a crisis than they were in 2008, or in the March 2020 meltdown, which triggered the latest round of massive financial support.

This was highlighted in a recent blog post by the Bank of England on the events of the spring of 2020. It was potentially more serious than that of 2008, because it centred on the $21 trillion US Treasury market—the bedrock of the global financial system, and supposedly a "safe haven" in times of stress, as investors buy government bonds. In the March crisis however, Treasuries were sold off.

The blog began by noting that while financial markets reflect changes in the economy, they can amplify them as well, and this was evident as the COVID-19 pandemic materialised.

It then drew attention to the role of margin calls in precipitating the crisis. Investors in financial assets use borrowed money at cheap rates to finance their activities, but have to place some collateral with the lender.

This enables them to make huge profits, so long as the underlying asset continues to rise in the market. But if there is a downturn, the lender demands more collateral, a margin call, to cover the fall and this can precipitate a "dash for cash," leading to a negative feedback loop because the value of financial assets falls further as they are sold off.

The blog post noted that net outflows reached more than 5 percent of assets under management for corporate bonds in the March crisis—the highest since the global financial crisis of 2008.

The risks of a self-reinforcing spiral, inherent in the operations of highly leveraged hedge funds, "crystallised in the US Treasury market in March 2020. ... Notably, hedge funds unwound US Treasury positions following severe portfolio losses and margin calls, contributing to a sharp rise in yields [interest rates] and market illiquidity."

As the blog noted "large-scale intervention by the Federal Reserve managed to restore market liquidity and break the self-reinforcing loss spiral."

But as other reports on the March crisis have noted, none of the underlying issues that produced it have been resolved, and no solutions were advanced by the Bank of England blog to prevent a recurrence.

In fact, it concluded with a profession of ignorance, saying merely that it had identified "key questions, emphasised by the Covid-related financial stress in early 2020, that warrant further investigation" and that the authors would "welcome further engagement with the research community on these issues."

Such a conclusion only emphasises the fundamental point that, in the final analysis, the destructive anarchy of the capitalist economy and its financial system, arising from the system of private ownership, is outside of conscious control and regulation.