

Concerns grow over where speculative bubble will end

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In July 2007, as the conditions for the financial crash of September 2008 were building up due to the low interest rate regime of the US Federal Reserve, Chuck Prince, then the chief executive of Citigroup, summed up the prevailing view on Wall Street.

“When the music stops, in terms of liquidity, things will become complicated,” he said. “But as long as the music is playing, you’ve got to get up and dance.”

And Citigroup, along with the rest of Wall Street, continued to dance.

Nearly a decade-and-a-half later, in the wake of the largest-ever injection of money into the financial system, launched in response to the market crisis of 2020 at the start of the COVID-19 pandemic, the speculative dance on Wall Street is becoming ever more frenzied, despite the growing signs of another financial disaster.

Earlier this week, the *Wall Street Journal* reported that “sales of securities backed by bundles of risky corporate loans set a new monthly record for August” on the back of investor demand for higher yields.

Sales of collateralized loan obligations (CLOs), which are created by packaging individual corporate loans with junk credit ratings into a security, were more than \$18.7 billion for the month. This was the highest level since data began to be collected at the start of 2011.

The operation is similar to the packaging of sub-prime home loans—the trigger for the 2008 financial meltdown. But the total global market for CLOs is much bigger than sub-prime market ever was. According to JPMorgan Chase, the size of the CLO global market has passed the \$1 trillion mark. This year, Bank of America projects there will be \$140 billion worth of new CLOs and \$220 billion worth of refinancing.

The speculative mania is everywhere. Last month, S&P Global Ratings reported that sales of low-rated “speculative-grade” debt had already reached \$650 billion so far this year, and was on track to beat all-time annual records.

The *Financial Times* reported that senior analysts from both Moody’s and S&P said “furious demand from

investors on the hunt for higher-yielding assets at a time of low interest rates had given less credit worthy companies access to financing with loose lending terms.”

A comment by Philip Coggan in the same newspaper last week, titled “Welcome to the great speculative era,” drew a parallel between the South Sea Bubble of the early 18th century and the flooding of Wall Street with special purpose acquisition companies (Spacs) in 2020 and at the start of this year.

Spacs are cash-only shell companies that are created to buy existing companies in the expectation that their share price will rise when they are listed on the stock market. Coggan likened Spac operations to the South Sea company, which was described as “an undertaking of great advantage but nobody was to know what it is.”

When investors buy shares in a Spac they do not know what business it will purchase, “but presumably they believe it will be ‘an undertaking of great advantage,’” he wrote.

The Spac mania has eased off somewhat in recent months, but speculation has continued, reflected in the rise of cryptocurrencies—of which more than 6,000 have been created, apart from the most famous, Bitcoin—and the continuing rise of stock market indexes to record highs.

Its origins, as Coggan noted, go back to the share market collapse of October 1987, when the Dow index crashed more than 22 percent in a single day and the Fed stepped in to cut interest rates.

“The result,” Coggan wrote, “was a feedback loop in which low rates encouraged speculation, which eventually led to a financial crisis, which required low rates to counteract.”

Since the market meltdown of March 2020, to which the Fed responded by stepping in to become the backstop for all areas of the financial system, increasing its financial asset holdings by \$4 trillion virtually overnight and spending \$1 million a second, according to some calculations, the feedback loop has become even tighter.

In his speech to the Jackson Hole central bankers’ symposium last Friday, Fed Chair Jerome Powell indicated

that the central bank would start to wind back its purchases of financial assets, currently running at \$120 billion a month, either at the end of the year or the beginning of 2022.

But in a crucial reassurance to Wall Street, he made clear this was separate from any move to lift interest rates from their present level of virtually zero, and he signalled that they would not rise any time soon. The coming reduction in asset purchases “will not be intended to carry a direct signal regarding the timing of interest rate liftoff, for which we have articulated a substantial and more stringent test,” he said.

The official rationale for maintenance of the ultra-low interest rate regime is that the present spike in inflation, now running at between 4 and 5 percent, is due to transitory factors. But notably, in his review of price rises, Powell failed to mention housing. This was because it countered what former US Treasury secretary Lawrence Summers, one of the most prominent critics of the Fed, called Powell’s “serene” arguments that misread the inflation risk.

The latest data show that average home prices in major metropolitan centres across the US rose 18.6 percent in June, up from a 16.8 percent increase the previous month. Summers told Bloomberg that new tenants for houses were being hit with a 17 percent hike compared to what the previous tenant paid.

Throughout the creation of the speculative bubble, the policies of the Fed and other central banks in boosting the wealth of the financial oligarchy have received the backing of media financial commentators, praising their actions as preventing a return to conditions akin to the Great Depression following the 2008 and 2020 crises.

But concerns are now being voiced that social conflicts (they never use the term class struggle, but that is what they are referring to) are going to intervene if inflation continues and the bubble bursts.

In an interview with Bloomberg, Summers warned that job openings, combined with the number of people quitting their jobs, was a signal of “much more rapid wage increases” over time.

Financial analyst Mohamed El Arian, writing on Bloomberg, noted that investors would happily give Powell the benefit of the doubt on inflation, “because his policy has paved the way for increasing financial wealth.”

But there were concerns among a number of economists. The benefits for the economy of the Fed’s massive asset purchases, El Arian argued, “were limited, if any, while the risks to [the] economy and the financial system continue to mount.”

“I continue to believe there is just cause for concern about a monetary policy mistake that could undermine future economic wellbeing and financial stability, with adverse

social, institutional and political spillovers,” he wrote.

Financial Times columnist Robert Armstrong was more explicit in a comment on a paper presented to the Jackson Hole symposium that linked the low interest rates that have sustained Wall Street and the rising share of wealth and income going to the upper 10 percent of society, starting in the 1980s.

With a greater share of national income going to the upper layers, their savings increase, and with more savings and the same number of places in which to put them, rates of return on investments and interest rates had to fall.

The political implications were “nasty,” he warned.

The excess savings of the rich depressed interest rates, which in turn pushed up asset prices, meaning that the rich got richer still.

“Many governments are engaging in policies that, in all likelihood, make this flywheel turn faster. For how long are people who sit outside this wealth machine—a majority of voters—going to tolerate this?”

Speaking directly for upper-middle class layers, those in the top decile of income distribution, he concluded: “Those of us who own a few assets, and have done so well as a result in recent decades, should give this some thought.”

Some of the political representatives of this layer have already done so and started to act.

This is the origin of the campaign by the various pseudo-left tendencies in the US and around the world as they seek to divide the working class with the poison of identity politics.

This is coupled with equally vociferous attempts to subordinate the working class to the policemen of social inequality, the trade unions and their bureaucratic apparatuses, lest the eruption of class struggle blow apart the speculative bubble from which they have materially benefited.



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