Inflation sets off gyrations in global bond markets

Nick Beams
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It has been a turbulent week for bond markets. The inherent fragilities of the global financial system are being exposed by the rise of inflation, the continuing and deepening COVID-19 pandemic and a resurgence of working-class struggles.

The week began with the Reserve Bank of Australia (RBA) being forced to abandon its targeting of the yield on an April 2024 bond at 0.1 percent. This was because of a sell-off that saw the yield rise to 0.8 percent, meaning the central bank would have had to buy up all the available bonds in order to maintain its objective.

Faced with a rush for the exits, which sent the bond price down and its yield up, the RBA decided to scrap the policy it had put in place in response to the financial crisis that accompanied the start of the pandemic in March 2020.

The RBA decision attracted world-wide attention because it pointed to developments in global markets. Investors, who had acted on assurances by central banks that inflation is "transitory," were hit with losses, sometimes significant, because short-term bond prices fell in response to fears price rises were becoming entrenched.

Attention then shifted on Wednesday to the US Federal Reserve. As expected, it announced the tapering of its asset purchases by $15 billion per month until next June when they will cease altogether.

Financial markets, which had priced in tapering, responded positively to the Fed's decision—with Wall Street continuing its surge to new record highs. This was largely because of Fed chair Jerome Powell's insistence that the central bank's base interest rate of virtually zero was not going to be lifted in the immediate future.

Powell did not sound any alarms as one of his central objectives is to ensure the stability and continued rise of the stock market. But his remarks indicated that the Fed, like other central banks, is being buffeted by forces it does not fully comprehend much less know how to control.

For example, Powell said that while economic activity had expanded at the rate of 6.5 percent in the first half of the year, in the third quarter "real GDP growth slowed notably from this rapid pace." This was because the Delta variant had held back the recovery and activity had been restricted by supply constraints and bottlenecks in the motor vehicle industry.

However, he had no answer to meet this problem, noting that "our tools cannot ease our supply constraints" before offering a profession of faith.

"Like most forecasters, we continue to believe that our dynamic economy will adjust to the supply and demand imbalances, and that as it does, inflation will decline to levels much closer to our 2 percent longer-run goal," he said.

But as to how long it might take for inflation to come down from its present headline rate of 5 percent Powell had no idea. It is "very difficult to predict the persistence of supply constraints or their effects on inflation," he said.

While there was broad support for the Fed's latest decision, there are concerns it is responding too slowly to the rise in prices and it may have to make a rapid adjustment.

Paul Jackson, head of asset research allocation at Invesco, told the *Financial Times*: "If the Fed ends up behind the curve, then they could end up raising rates very quickly and in big amounts."

Such a move would have a major impact on Wall Street because its rise to record highs has been built on a mountain of debt that has only been sustained by ultra-low interest rates.

On Thursday the Bank of England (BoE) was in the spotlight as its Monetary Policy Committee (MPC) handed down its latest decisions.

In the period leading up to the MPC meeting, financial markets in Britain and around the world had largely priced in that there would be an increase in the central bank base interest rate from its present record low of 0.1 percent. As a result, the BoE would be the first major central bank to lift rates since the start of the pandemic.

This assessment was based on remarks by its governor Andrew Bailey last month that the central bank "will have to act" if inflation proved to be stubbornly high.

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UK inflation has shown no sign of slowing with predictions that it will rise from its present level of 3.1 percent to as much as 5 percent in coming months. So it appeared all but certain the base rate would be lifted.

It was not to be. The BoE's MPC voted seven to two to maintain its present rate.

This set off a series of swings in UK and global markets in the opposite direction to that earlier in the week.

The yield on one-year government bonds almost halved within hours, falling by 0.22 percentage points in the biggest move since 2009 in the wake of the global financial crisis.

These falls were reflected in other markets with yields on the US two-year Treasury bonds falling. The yield on German one-year government bonds, already in negative territory, dropped by 0.08 percentage points, the largest one-day fall since the crisis of March 2020.

While these bond market movements are small in absolute terms, they can have major effects because they impact on large amounts of money—hundreds of billions of dollars—that surge through financial markets every day. This takes place as investors make bets, often involving complex operations, on which way interest rates and other variables, such as currencies, will move.

At his press conference following the decision, Bailey pushed back against assertions by journalists that he had sent a message to markets, insisting "none of us" said rates would go up in November.

"It was a very close call," he said. "We are in a situation where the calls are close, they're quite hard."

He was also questioned on an assertion in his prepared remarks that "monetary policy can do little to affect inflation in the near term."

The present inflation, he said, was not being caused by excess demand in the economy pushing up against supply as in the past. Rather it was the result of a "supply side shock" and monetary policy could not increase the supply of computer chips or gas.

Asked why central banks did not see this shock resulting from the pandemic, he provided no answer.

It recalled the famous "Queen's question" in 2008 when the British monarch asked a group of learned economists why none of them had seen the financial crisis coming.

Bailey warned that if monetary policy was used in the wrong context to try to combat inflation this could make things worse for households.

However, his real concern, like that of his counterparts, is not the millions of workers struggling to make ends meet as the prices of necessities escalates. His worry is the stability of financial markets where a rise in rates could precipitate a collapse in the debt-based house of cards.

The overriding concern as regards inflation is its effect on the development of class struggle. This was made clear at the conclusion of his prepared remarks when he said the "short-term evolution of the labour market will be crucial in determining the scale and pace of the response" by the BoE to inflation.

If inflation becomes what central banks term "anchored," that is if workers begin to press for higher wages, then the BoE will move to lift rates, inducing a contraction in the economy, to suppress those demands.

There is a broader conclusion to be drawn from a viewing of the press conference. The BoE governor, together with other central bank chiefs, find themselves in an entirely new situation. They have no real idea about the trend of global growth, the direction of inflation, when and how global supply chains will operate, and what is developing in the labour market.

For the past three decades and more, they have been able to operate under conditions where inflation has been kept at low levels. Cheaper goods have resulted from the globalisation of production and the suppression of the struggles of the working class which has led to a persistent downward trend in real wages.

Now that situation has changed dramatically, triggered by the pandemic. Global production has been thrown into disarray and the working class is moving back into struggle, not only against the effects of the pandemic but in response to the impact of the policies leading up to it.

Whatever confusion the central bankers may have, they are guided by a sure class instinct, honed by the experience of centuries of rule: that the future course of the profit system over which they preside depends on the defeat of the growing movement of the working class by whatever means necessary, including authoritarian forms of rule.

For the working class, the crucial issue is the fight for an internationalist and socialist perspective aimed directly at the conquest of political power.

This week's gyrations in financial markets, together with the deepening of the murderous policies of the ruling class on the pandemic, indicate this confrontation is coming increasingly to the fore.

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