Financial house of cards becoming increasingly shaky

Nick Beams
9 June 2022

There are a growing number of indications that global financial markets could be hit with a storm potentially as serious as the March 2020 meltdown at the start of the pandemic.

Since that crisis, when the $23 trillion US Treasury market, the basis of the global financial system imploded, markets have been sustained by the trillions of dollars pumped in by the US Federal Reserve and other major central banks on top of the quantitative easing measures developed after the 2008 global financial crisis.

But now central banks are reversing course, lifting interest rates and seeking to wind back their asset holdings in response to four-decade high inflation in a bid to clampdown on workers' wage demands.

The most immediate sign of growing stress is the loss of liquidity in key areas of the financial system. Markets are deemed to be liquid when relatively small transactions only provoke a very small response. Conversely, an illiquid market is one in which a minor transaction can set off large movements leading to rapid, and unexpected, changes in financial conditions.

A report in the *Financial Times* (FT) this week drew attention to the worsening liquidity conditions.

"Liquidity across US markets," it said, "is now at its worst level since the early days of the pandemic in 2020, according to investors and big US banks who say money managers are struggling to execute trades without affecting prices."

It cited one investment officer at a financial firm who said bluntly: "Liquidity is terrible."

Minutes from the latest policy meeting of the US Fed show that officials "were concerned with the problems being created in the Treasury and commodities market by weak liquidity," the article said.

According to a Bloomberg index, the health of the US Treasury market is at its worst level since the March 2020 meltdown.

The FT report also cited findings from the major US bank JPMorgan Chase which warned that "liquidity recently started declining again, and market depth over the last three months is now the lowest since March 2020."

An example of the kind of violent movement which can occur took place last month when the two US retail giants, Walmart and Target, saw a combined total of $71 billion wiped off their share market valuation in just two days—the biggest plunge since the Wall Street crash of October 1987—when they reported that rising costs were affecting their bottom line.

The rapid rise in global inflation, especially energy, is a key factor in the growing instability. The head of the commodities trading firm Jeremy Weir warned at a conference this week that the oil market could enter "parabolic state." That is, their rise would resemble the right-side of a U-shaped graph.

He warned that oil prices could rise to as much as $150 a barrel. This echoed remarks made earlier this month by JPMorgan Chase chief Jamie Dimon that the US economy and its financial system were facing a "hurricane" and the oil price could rise to $150 or even $175 a barrel, up from its already high level of around $120.

Weir warned that price hikes of this magnitude would bring about a recession.

"If we see very high energy prices for a period of time we will eventually see demand destruction. It will be problematic to sustain these levels of and continue global growth," he said.

Another source of instability is the shift in monetary policy by the European Central Bank. The ECB will raise its base interest rate from its present negative level

© World Socialist Web Site

by 0.25 percentage points in July and again in September by at least the same amount. But the ECB's policy statement, issued after its meeting yesterday, said "a larger increment will be appropriate at the September meeting" if inflation persists or worsens.

The euro zone is facing a period of much lower growth and a recession as a result of the continuing effects of the pandemic and the sanctions it has imposed on Russian energy supplies. Under so-called "normal" conditions, this would indicate that a loosening of monetary policies to provide a stimulus to the economy.

But that is no longer possible with inflation in the euro zone now running at 8 percent and expected to go higher.

The lift in interest rates threatens to widen the gap between the yields on the bonds of the stronger northern European economies, Germany and the Netherlands, and those of the more indebted south, Italy and Spain.

The widening of this gap, coupled with a banking crisis, threatened the very existence of the euro as a single currency in 2012, which led to the then ECB President Mario Draghi pledging to do "whatever it takes" in order to stabilise the financial system.

The effect of the withdrawal by the ECB from its bond-buying program in July is another area of concern.

At the end of May, the ECB owned €341 billion worth of company debt, having increased its holdings by almost €140 billion since March 2020.

The dependence of the corporate bond market on the ECB was highlighted in remarks by Barnaby Martin, the head of European credit strategy at Bank of America, to the FT.

"The ECB became not just the buyer of last resort but the buyer of first resort. The sheer volume they were buying was enormous," he said. The question is what will be the market reaction to the withdrawal of this support which starts next month.

Under the policy of quantitative easing major hedge funds were raking in billions of dollars hand over fist because of the availability of ultra-cheap money. But the major investment fund Bridgewater is now anticipating a sell-off in corporate bonds that will not be short lived.

"We're in a radically different world," one the company's chief investment officers told the FT. If the Fed was committed to bringing down inflation to 2 percent "they may tighten in a very strong way, which would then probably crack the economy and probably crack the weaker [companies] in the economy."

The growing instability in financial markets, rampant inflation and the threat of recession underline the essential meaning of the political economy of the past decade and a half. All the measures undertaken by the central banks to try to avert an economic and financial breakdown have only created the conditions for ever-deeper crises.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site