British pound collapse at centre of global currency and financial storm

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27 September 2022

Global currency and bond markets are being hit by a growing storm driven by the rise of the US dollar fuelled by interest rate hikes by the US Federal Reserve, which could start to shake the financial system.

The turmoil reached a new level of intensity this week, sparked by the reaction of financial markets to the UK mini-budget which handed out £45 billion in tax cuts to the wealthy while increasing government debt by £72 billion.

The reaction of the markets was to send the pound down to its lowest level in history. This led to a rapid sell-off of government bonds, sharply lifting their yields, or interest rates.

It was, in effect, a savage directive to the UK government of Prime Minister Liz Truss and her Chancellor Kwasi Kwarteng that the handout to the wealthy had to be accompanied by deep cuts to government social spending, coupled with further suppression of wages.

Yesterday the International Monetary Fund (IMF) intervened to give voice to the concerns of international finance capital, issuing what the *Financial Times* called a "biting attack" on the government's plan and calling for a "re-evaluation."

The IMF said it was "closely monitoring" developments and was "engaged with the authorities" in the UK.

"Given elevated inflation pressures in many countries, including the UK, we do not recommend large and untargeted fiscal packages at this juncture," it stated. "It is important that fiscal policy does not work at cross purposes to monetary policy."

Like other central banks, the Bank of England (BoE) is lifting interest rates, inducing a recession, to try to clamp down on workers' wage demands as inflation reaches its highest levels in more than four decades, now at double digit levels in the UK and threatening to go even higher. The bank is also reducing its holdings of financial assets.

But while the BoE is tightening monetary policy, the government's handouts to the wealthy are to be financed by the creation of still more debt.

The IMF statement also showed it is focused on the development of the class struggle. "The nature of the UK measures will likely increase inequality," it said.

The IMF is very conscious that the blatant handout of billions of pounds to the rich and super-rich, lifting inequality to new record highs, will make even more difficult the task of the trade unions in suppressing the struggle for wage increases. This struggle, now being joined by ever-wider sections of the British working class, is creating the basis for a general strike against the Tory government.

There was a near universal response from the representatives of finance capital to the UK government's measures, insisting they had to be accompanied by cuts in government spending.

The Institute for Fiscal Studies said Kwarteng was gambling with the UK's fiscal stability to push through the tax cuts "without even a semblance of an effort to make the public finance numbers add up."

Vivek Paul, the UK chief investment strategist for the giant global hedge fund BlackRock, said the government's moves were "just extraordinary." The market had delivered its verdict on the government's fiscal plans, and it was "not a good one."

The situation is increasingly being described as a "crisis of confidence."

For the financial system, confidence rests on two essential components: first, a belief that its political representatives have a clear plan for the overall economy and second, they can contain the most disruptive force of all—the movement of the working class. This confidence has been battered on both fronts.

Moreover, there are fears of mounting global turbulence. This is under conditions where the crisis of

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the British pound is the sharpest expression of the slide in all currency values against the dollar due to ongoing hikes in US interest rates. The Japanese yen is down to its lowest level in 25 years and other currencies are falling rapidly.

Those fears are focused on the bond market where prices are falling and yields are rising at an alarming rate.

In a comment yesterday, Bloomberg columnist John Authers noted: "This isn't at core a currency crisis, but a crisis of confidence in the bond market, which is much more dangerous. The shock to gilt yields [those on UK 10-year bonds] in the last five trading days has been epic. No shock this great and this sudden has happened before."

So far this month, the yield on the UK 10-year government bond has risen by 1.45 percentage points, the largest ever monthly rise according to data going back to 1979. In "normal" conditions rises in the order of just 0.5 percentage points, or even less, are considered large.

Authers raised the broader implications. Ever since the global financial crisis of 2008, he wrote, "everyone in the asset markets has known that there is one great risk above all others—that at some point confidence would run out and the bond market would revolt, causing a disorderly rise in yields. Then the edifice would fall."

That day of reckoning was delayed because the central banks could always print more money when they did not have to worry about inflation. Those conditions have now changed.

"The UK appears to be the first case of a truly disorderly bond selloff, where the moves are so swift that they affect the functioning of the financial system," Authers wrote. The whole world had to watch what was happening in Britain because it was a "test case for the confidence game that's likely to be repeated everywhere."

And while King Dollar reigns supreme at this point, the US is not exempt from the rising global storm.

Ralph Bostic, president of the Atlanta branch of the Fed, in comments reported by the *Financial Times*, said the UK situation had increased uncertainty over the trajectory of the US economy.

"The key question will be, what does this mean for ultimately weakening the European economy, which is an important consideration for how the US economy is going to perform."

Susan Collins, the incoming president of the Boston branch of the Fed, speaking at an event on Monday, warned that a significant economic or geopolitical event could push the US economy into a recession as the central bank's monetary policy tightens.

In a comment published in the *Australian Financial Review* on Monday, columnist Karen Maley cited remarks by Michael Hartnett, an investment strategist at Bank of America. Hartnett warned that what Maley termed a "savage" fall in bond prices would leave investors with no choice but to liquidate "the world's most crowded trades," namely the US dollar, US tech stocks and private equity.

According to Maley, Hartnett pointed out that "the present market shares many of the same traits that led to the 1987 share market collapse: including a volatile geopolitical situation, abnormal US markets far outperforming the rest of the world, and a lack of international coordination."

The only thing missing from the list, as Maley noted, was a currency crisis. That is now clearly unfolding, centring on, but by no means confined to, the British pound.

And it has a historical resonance. The crisis of the pound and the UK financial system at the end of the 1960s, was the harbinger of a dollar crisis that led in August 1971 to the decision by US President Nixon to remove the gold backing from the US currency and end the Bretton Woods monetary system established after World War II.

Much has changed since that time, but the crisis of the British pound could well be a warning of the demise of the entire system of fiat currencies, based on the US dollar, which has prevailed since the Nixon decision.

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