UK crisis fuels warnings on the stability of global financial system

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There is a growing sense among media commentators and analysts that the financial crisis in the UK signifies the emergence of an inflection point in the operations of the global financial system.

That is, to use the often-employed metaphor, it is the canary in the coal mine for the eruption of a crisis, suppressed for more than a decade and a half by the provision of trillions of dollars by central banks to the financial markets.

The UK events, involving an emergency £65 billion intervention by the Bank of England last week, doled out in daily injections of £5 billion until October 14 in order to halt a collapse of the bond market, are a case in point.

The crisis centred on pension funds. In the past these funds were able to meet their liabilities by investing in long-term government bonds of 10- and 30-years duration, known as gilts, confident they were able to secure an adequate rate of return. But the initiation of quantitative easing after 2008, combined with central bank interest rate cuts, meant that bond yields fell to historic lows.

To meet their obligations in conditions where their traditional sources of income were drying up, pension funds had to undertake investments in riskier assets such as corporate credit, equities and property in order to meet their liabilities.

They sought to hedge their risks from such investments through financial market operations via derivatives. They borrowed funds for this purpose using their holdings of government bonds, regarded as the safest of all assets, as collateral.

However, the price of bonds plunged following the Tory government's mini budget of September 23, which cut taxes on the corporations and the super-rich to the tune of £45 billion, financed by an increase in government debt of £72 billion. So the value of the collateral fell, and the pension funds were faced with margin calls from their lenders.

This led to a further bond selloff as the funds sought to meet these demands, exacerbating the plunge in bond prices and leading to demands for more collateral. Had this situation continued some 90 percent of pension funds, holding £1.5 trillion of assets, could have been rendered insolvent.

Like all crises, this one had its own national forms. But the concern is being voiced that in the final analysis it was the outcome of global processes.

The ultra-low interest rate regime of the past 15 years, which has boosted stock markets, is now being reversed as central banks around the world, led by the US Fed, are tightening monetary policy as they seek to suppress workers' wage demands in the face of the highest inflation in four decades.

In a recent comment on the UK crisis, *Wall Street Journal* columnist James Mackintosh wrote that it had sent a shock wave through global markets. It is "providing a warning to governments everywhere of the dangers of the new economic era we are entering," expressed in Britain through a toxic mix of politics, inflation and higher interest rates.

He noted that while superlatives were often used in market reporting "the ructions" in the UK were "truly extraordinary."

The Tory government's measures had such a "big effect because of the broader background of soaring interest rates, high debt, dire communications and the erosion of the country's institutional credibility" with most of those conditions applying "to a greater or lesser degree across the developed world."

"The most apocalyptic risk is that Britain is merely the first major victim of higher [interest] rates," he wrote, noting that, as had often happened in the past, it was problems in an area regarded as safe, in this case pension funds, that caused difficulties.

The Fed is basing its program on the belief that higher interest rates will be able to halt inflation as took place in the class war launched under Fed chair Paul Volcker in the 1980s.

But as *Financial Times* columnist John Plender commented, “changes in financial structure since Volcker’s day point to looming financial instability.”

According to Plender, “the chief role of the financial system is no longer to take deposits and make loans but to refinance the debt that sustains global growth and consumption” and “this complex system is increasingly dependent on shaky collateral.”

Another FT columnist, Robin Wigglesworth, has noted that the pension fund measures were not some flashy hedge fund strategy, but the “financial market equivalent of doing your family taxes.”

He noted that “true cataclysmic financial debacles tend to involve investment strategies and financial securities that everyone thought were boring,” raising the question of “what else like this may be lurking out there” in some “unlikely corner of the global financial system.”

In a recent comment on his Chartbook blog, dealing with the “bond market massacre of September 2022,” economic historian Adam Tooze, the author of a major study on the global financial crisis of 2008, began by noting it was not just the UK that was under stress.

“On the other side of the Atlantic too, tremors are running through the US treasury markets, the foundation of the dollar system,” he wrote.

Tooze cited a recent Bloomberg report, based on data from JP Morgan, according to which, “liquidity in the treasury market in extremely low” as conditions resemble “those seen in the pandemic and the period after the Lehman crisis.”

He said it was unclear to him who exactly benefited from the Bank of England bailout, and this suggested we are dealing with a system “riven with conflicts of interest.”

“Does it really make sense to perpetuate a system in which disastrous risks are built into the profit-driven provision of basic financial products like pensions and mortgages?” he continued.

He concluded with the observation that the crisis is the result not of some “some metaphysical uncertainty”, but rather of a “contradictory, incoherent and hazardous profit-driven system, which the status quo underwrites.”

But as a social democrat—he describes himself as a “left liberal”—Tooze essentially defends that status quo—the capitalist profit system. He regards it as the only viable form of economic organisation, and therefore halts at drawing the necessary conclusions arising from his own indictment of its operations.

This is because to do so would raise the necessity for its overthrow and the establishment of socialism—a perspective he abhors above all else. And so, he holds out the vacuous prospect of some kind of reform.

The working class, however, must reject these bromides and, basing itself on its own life situation, advance its own independent solution to the crisis. Faced with the ongoing decay and disintegration of the capitalist economy—bringing a future of social and economic devastation, combined with the ever-growing danger of war, the continuing mass death inflicted by COVID and the disastrous effects of climate change—it must undertake the struggle for political power to open the way for the reconstruction of the economy on socialist foundations.