Interest rate hikes start to make their impact

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Nine months after the US Federal Reserve began lifting interest rates, forcing other central banks to do the same, the rise in the price of money is starting to surge through the global economy and financial system.

The rate rises, being carried in the name of “fighting inflation,” have been instituted to try to suppress the growing upsurge of the world working class in response to soaring prices by inducing a major economic slowdown or even a recession.

At present much of the media coverage focuses on the collapse of FTX. The main conclusion being drawn is that the demise of the $32 billion crypto exchange was the product of fraud committed by its founder Sam Bankman-Fried who operated what was essentially a Ponzi scheme.

But there are deeper forces at work. The spectacular rise of FTX, which was promoted as one of the safest outfits in the crypto world, was very much the outcome of the massive inflow of cheap money provided by the Fed after the market freeze of March 2020 at the start of the pandemic.

The fallout from the demise of FTX has called into question the future of the entire crypto system.

The publicly listed company, Coinbase, which operates a crypto exchange, only had a limited exposure to FTX, just $15 million, it said. But as the Financial Times reported last week its stock and bonds have been knocked, sparking “renewed concerns about the outlook” for the company.

At the start of the year, the company’s bonds were discounted at 93 cents on the dollar, now they are at 59 cents. The fall in its share price has been even more pronounced. Last November, when the Fed was still pouring money into the financial system, its shares were $369. They have lost 81 percent of their value so far this year.

In a report issued last week, Moody’s Investor Services said the collapse of FTX was a “credit negative” for Coinbase and warned that its “implosion” would “radically transform the cryptoecosystem” and raise doubts about the ongoing prospects of the entire industry.

The company has said it is a “strong position” and it has no meaningful exposure to the FTX demise. But such assurances will likely be taken with larger grains of salt given that FTX was also regarded as a safe operation.

The impact of rising rates and the end of cheap money goes far beyond the crypto world. It should be recalled that one of its first affects was the crisis in the British financial system in September-October when the supposedly safe strategies pursued by pension funds were called into question. This required an emergency intervention by the Bank of England after a collapse of the British pound and a massive selloff in UK bond markets.

Another area of concern is the commercial real estate market. It has also been boosted by low interest rates in the period since the 2008 financial crisis, but is now being squeezed by declining demand for office space as a result of COVID and higher interest rates.

In New York, the largest office space market in the world, there is now the prospect of “zombie” companies, according to a report in the FT last week. It cited comments by a major real estate company executive Doug Harmon.

During the prolonged bull market boom, “fuelled by historically low interest rates and nearly free money,” Harmon and his firm presided over record-breaking sales. Harmon now says he is carrying out “triage.”

He told the newspaper that rising interest rates were like petrol igniting an office firestorm. “Everywhere I go, anywhere around the world now, anyone who owns an office says: ‘I’d like to lighten my load.’”

In a sign of growing problems, the giant private equity firm Blackstone said last week it would limit the
redemptions investors could make in a $125 billion commercial real estate fund it operates.

The developments at Blackstone are part of a broader trend. In an article yesterday the Wall Street Journal reported: “Big and small investors are queuing up to pull money out of real-estate funds, the latest sign that the surge in interest rates is threatening to upend the commercial property sector.”

The interest hikes are not only hitting individual firms and key sectors of the economy but whole countries, particularly poorer ones with high levels of debt.

A New York Times article published at the weekend warned: “Developing nations are facing a catastrophic debt crisis in the coming months as rapid inflation, slowing growth, rising interest rates and a strengthening dollar coalesce into a perfect storm that could set off a wave of messy defaults and inflict economic pain on the world’s most vulnerable people.”

Earlier this year, it noted, the World Bank said as many as a dozen countries could face default next year and the IMF estimated that 60 percent of low-income countries were either in debt distress or faced a high risk of it and since then the situation had worsened.

The Council on Foreign Relations has said that 12 countries now had its highest default rating, up from three 18 months ago.

Global financial institutions recognise the mounting crisis, but nothing is being done. As the Times article reported, at the G20 meeting last month there were expressions of concern about the “deteriorating debt situation” but offered “few concrete solutions.”

The G20 statement simply reaffirmed “the importance of all actors, including private creditors, to continue working toward enhancing debt transparency.”

In the major economies the forecast is for a recession. Both the UK and the eurozone are predicted to move into recession next year with the US economy expected to grow by only 0.2 percent next year, according to the Wall Street Journal.

It reported that a survey of economists and investors by the Federal Reserve Bank of Philadelphia showed expectations were that GDP would fall in the next three or four quarters, the highest since the survey started in 1968.

The engineering of recession is now the central objective of the Fed. As the head of Blackrock’s Investment Institute, Alex Brazier, told the Journal, if the Fed wants to get core inflation down to its 2 percent target “it needs a recession.”

The Economist magazine in an editorial earlier said the term “permacrisis,” designated by the Collins English dictionary as their word for 2022, “accurately encapsulates today’s world as 2023 dawns. It cited the war in Ukraine, the serious risk of nuclear escalation and the highest levels of inflation since the 1980s.

It said much of the world would be in recession in 2023 and “in several places economic weakness could exacerbate geopolitical risks.” With many European economies on the edge of recession, higher interest rates “will further sap consumer spending and increase unemployment.”

Britain would undertake the biggest fiscal tightening of the G7 group of major economies while suffering the deepest recession, with Italy “also a worry.”

While the US economy was in better shape than Europe’s or China’s, America’s relative economic strength could prove a problem for the rest of the world. As it continued to aggressively raise interest rates, lifting the value of the dollar, it would oblige “other central banks to keep up.”

In other words, the effects of interest rate hikes over the past nine months, on both the financial system and real economy, are going to rapidly intensify in the coming period.

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