Bond market “rout” a result of major structural shifts

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There is a growing realisation in financial and media circles that the selloff in the US bond market, which has seen a rapid rise in interest rates, is the product of far-reaching shifts in global financial markets.

The initial hope was that the turbulence was simply the product of the interest rate hikes by the US Federal Reserve over the past 18 months—from near zero to more than 5 percent. After some initial turmoil, stability would return when the market accommodated itself to the understanding that rates would remain higher for longer than initially expected.

However, that conception is giving way to the recognition that the period in which the escalation of US government debt could seemingly be endlessly financed because interest rates were at historic lows has come to an end.

The scope of the selloff, which has seen yields on 10-year Treasury bonds move to around 4.9 percent (prices and yields move in opposite directions) is indicated in some calculations made by Bloomberg.

It estimates that about 46 percent of the value of bonds with maturities of ten years or more has been wiped out in the market plunge. And 30-year bonds have lost 53 percent of their face value.

What the plunge signifies in the longer term and what structural shifts are at work were issues canvassed in a weekend article in the *Wall Street Journal* (WSJ) headlined “Wall Street isn’t sure it can handle all of Washington’s bonds.” It began by noting that the “autumn bond market rout” was challenging the long-standing belief that the US government could not sell too many Treasuries.

“Ever since the Federal Reserve broke the inflation scare of the 1980s, Wall Street and Washington have shrugged off multitrillion dollar deficits, counting on America’s global standing to provide perpetual demand for its debt that could finance the spending. Now the steep decline in the prices of Treasuries—meant to be the world’s safest and easiest-to-trade investment—are forcing markets to confront the possibility that the rates required to place all this debt will be higher than anyone expected.”

The financial press invariably avoids reference to the class struggle in its analysis or makes only fleeting reference to it. But in fact, the gyrations in the financial markets are always the distorted expression of underlying class relations.

What the WSJ refers to as the “inflation scare” of the 1980s was the wages struggles of the working class which were only “broken” through massive interest rate hikes, inducing the deepest recession to that point since the 1930s, the violence of the state—in particular the smashing of the air traffic controllers’ strike by Reagan in 1981—and the betrayals of the trade union bureaucracy which facilitated this onslaught.

The forcible suppression of the class struggle was a key factor in shaping fiscal and monetary policy.

It enabled successive governments to run up massive deficits escalating debt to record highs at very low interest rates while the Fed pumped money into the financial system to finance speculation. The process started with the October 1987 stock market crash and was massively escalated via quantitative easing in the wake of the 2008 crisis.

These conditions have now changed. The working class in the US and internationally is engaged in the most significant class battles in four decades, to which the WSJ makes only passing reference. It notes only that “the strength of the labour market is one reason why bond yields have soared this year.”

The bond market “rout,” as it is termed, was set off by the Fed’s recognition that the inflation resulting from COVID was not “transitory” and what it called the “very tight” labour market was fuelling the wages struggles of the working class. The Fed moved to suppress these struggles through a higher interest rate regime to slow the economy or even induce a recession.

Thus, the two conditions which determined the operation of financial markets over the past several decades—the endless supply of virtually free money to the financial and industrial corporations and the suppression of the class struggle—have been reversed.

Herein lie the seeds of another financial crisis as it becomes increasingly difficult to finance US government debt which continues to escalate not least due to ever-increasing military spending.

The question is being raised as to whether a Treasury auction, in which it sells new debt, could fail. This was once considered to be virtually out of the question but is now regarded as a possibility. There have already been warning signs—the Treasury market freeze of March 2020 and a similar but smaller occurrence a year later.

There are a number of factors feeding into the operations of the market.

First, there is the very size of the administration’s financing demands. More than $1.76 trillion of Treasury bonds were issued in September. As the WSJ noted, this was “higher than in any full year in the past decade, excluding 2020’s pandemic surge” with no decrease likely.

Then there is the question of who will buy government debt. Banks have been a mainstay of the market, but they are starting to pull back.

This is for two reasons. Regulations introduced after the 2008 crisis to strengthen the banks’ capital base have made it more expensive for them to hold bonds. Secondly, there has been a retreat from the market following the March scare when Silicon Valley Bank went under, along with two others, because of the losses incurred on their holdings of Treasury bonds as prices fell.

Three of the four largest bank failures in US history took place not least because of the fall in bond prices in which they had heavily invested.

Reporting on how “huge US government borrowing” was adding to “bond market pain,” the *Financial Times* cited the remarks by Fahd Malik, a fixed income portfolio manager at AllianceBernstein.

“More than anything, banks have not been coming to the scene to buy these Treasuries. There’s no marginal buyer, so that increases these moves,” he said.

Pointing to the underlying shifts in the market, he noted that “economic data shouldn’t be moving the market as much as it has been.” In other words, the reaction of the bond market to adverse data is larger than it would have been in the past.

Another factor is the withdrawal of the Fed. As part of its interest rate tightening program, directed at trying to suppress the wages struggles of the working class, it has been running down its holding of Treasury bonds.

International shifts are also playing their part. Japan and China, both of which run trade surpluses with the US, have invested large amounts in the US Treasury market. While they have yet to make significant reductions, they are pulling back.

On top of this there is growing concern over the stability of the US market as well as the continual standoffs in Congress over the debt ceiling and government spending. A number of countries, including China, Brazil and Saudi Arabia, are making efforts to lessen their dependence on the dollar in financing international trade.

This confluence of factors is working to create the condition for a significant crisis in the largest and most important financial market in the world, that for US government debt. It is not possible to predict how, when, and in what form it may emerge. But there is no doubt that the reaction, as history and the experience of 2008 shows, will be an intensification of the attacks on the working class.