Uncertainty drives market gyrations

Nick Beams
9 January 2024

The New Year has opened with uncertainty the dominant feature of international financial markets. A number of questions are arising including: the direction of interest rate policy by the US Federal Reserve and other major central banks; the impact of the interest rate rises over the past 18 months on corporate debt and the commercial property sector; and the effect of rising government debt on the bond market.

Last year ended with a surge on Wall Street on the expectation that the Fed was going to cut interest rates at least three times this year, possibly as early as March, leading to the longest weekly “winning streak” for the market in almost 20 years.

But after the party there was what was characterised as a sobering up, with loss of 1.5 percent in the S&P 500 for the first week of the year after nine straight weeks of gains. This week opened with a rise.

The characteristic feature of the swings has been their domination by the so-called Magnificent Seven – Apple, Amazon, Microsoft, Nvidia, Tesla, Alphabet (Google’s parent) and Meta (Facebook’s parent). After being responsible for the largest portion of the rise, they accounted for 70 percent of the S&P’s decline in the first week of the year.

Their size and the degree of financial concentration they embody is indicated by calculations which show that their total market capitalisation of around $12 trillion is equivalent to the entire market capitalisation of the Canadian, British, and Japanese stock markets combined.

The reason for the swings is the endless calculation and recalculation of where finance capital believes Fed interest policy will go. The surge, which began in October, was given a significant boost by the Fed’s December 13 meeting and the clear indication by Fed chair Jerome Powell at his press conference that rate cuts were under active consideration. The sobering up came when the minutes of the meeting were issued which showed that the claims of a pivot may have been overblown.

The sharp swings in the market create the conditions for the appropriation of large amounts of money, but also for significant losses for those on the wrong side.

While speculation on the direction of interest rates continues, the longer-term effect of the rate rises carried out since March 2022, which have seen the Fed rate rise from near zero to around 5 percent, is starting to show up.

According to analysis by Bloomberg, non-performing loans, where there has not been a payment for at least 90 days, are expected to rise to a combined $24.4 billion at the four largest American banks—JPMorgan Chase, Bank of America, Wells Fargo and Citigroup—for the last three months of 2023.

This is an increase of $6.6 billion on the figure at the end of 2022.

One of the key areas of concern over the longer-term is commercial property. Loans taken out at historically low interest rates when the Fed was undertaking quantitative easing now must be refinanced at much higher rates. Moreover, the market for office space is experiencing a downturn.

According to a report by four economists published by the National Bureau of Economics, there is an underlying crisis developing in the banking system as $5 trillion of debt taken out in the zero-rate era becomes progressively due.

Colombia University professor, Tomasz Piskorski, one of the authors, said: “It’s not a liquidity problem; it’s a solvency problem.”

In the three months to the end of September, it has been reported the volume of missed payments for loans on properties rented to others rose by 30 percent, or by $4.4 billion, to $17.7 billion.

At the start of the year the FT reported that billions of dollars “will fall due on hundreds of big US office

© World Socialist Web Site

buildings that their owners are likely to struggle to refinance at current rates."

The size of this "wall of debt," as it has been characterised in the financial media, is estimated to be $117 billion.

The situation could worsen because, as Richard Hill, head of real estate at the global investment company Cohen & Steers told the FT: "We are in the very beginning of trying to weather the office markets downturn." The worsening situation had "everything to do with financing costs going back up."

Another factor which could bring significant financial turbulence is the rise in government debt. In a report issued in November, the Institute for International Finance said the global debt stock rose by over $9.5 trillion in the first three quarters of last year to more than $307 trillion.

The biggest increases were in so-called mature markets, the US, Japan, France and the UK.

With elections taking place in more than 50 countries this year, the IIF pointed to the interconnection between politics and finance.

"If upcoming elections lead to populist policies aimed at controlling social tensions, the result could be more government borrowing and less fiscal restraint. Budget deficits are already running well above pre-pandemic levels in many countries and are expected to add around $5.3 trillion per year to the global government debt."

This could increase the interest rate burden for many sovereign debtors, because of the expectation that rates would remain higher for longer and generate boom bust cycles in the fixed-income bond markets.

The report cited the recent volatility in the US Treasury market "partially triggered by speculation about a significant rise in government borrowing" as an example of what could take place.

Referring to the IIF analysis yesterday, the FT reported comments by Jim Cielinski, head of global fixed income at the bond trader Janus Henderson, who said deficits were "out of control and the real story is there's no mechanism for controlling them." The issue would become one of serious concern to financial markets in the next six to 12 months.

Robert Tipp, head of global bonds at PGIM Fixed Income, said: "We are truly in an unmoored environment for government debt compared with previous centuries. At present, countries such as the US and Italy were getting a 'free pass' but that could change."

How that could take place was referenced by Sir Robert Stheeman, the outgoing head of the UK's debt management office, in an interview with the FT last week. Without directly citing it, he recalled the financial crisis of September-October 2022 when the short-lived Truss government in Britain sought to finance tax cuts for the wealthy and corporations by increasing debt.

The bond market went into turmoil as pension funds faced a collapse and a major crisis was only averted through an intervention by the Bank of England.

Steetham noted that "in a world where we have debt to sell, policymaking cannot be divorced from the reality of the market."

While he did not spell it out, that reality could well assert itself in the form of a crisis as it did just 16 months ago.

To contact the WSWS and the Socialist Equality Party visit:

wsws.org/contact

© World Socialist Web Site