

Bonds gripped by a “vicious loop”

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The global bond market sell-off is continuing as yields (interest rates) in the US reach their highest level in a quarter of a century in what has been characterised as a “vicious loop.”

This is a situation where investors in bonds record losses because of the fall in their prices, leading them to sell some of their holdings in order to maintain their cash position or meet margin calls (demand for increased collateral) from their lenders, resulting in further falls in the market.

A *Financial Times* (FT) report said the sell-off had now “triggered waves of selling by funds, according to investors and traders. They said a feedback loop had taken hold this week: yields rose to levels at which certain funds were obliged to sell Treasuries, setting off further bouts of bond sales that pushed borrowing costs higher.”

Priya Misra, a portfolio manager at JP Morgan told the FT: “It’s this vicious loop. And you have to wonder what is going to break it.”

These sentiments were echoed by Daniel Gottlander who told the FT spillover effects were typical of a major sell-off but there were usually investors willing to step in and buy bonds at the lower price and stabilise the market. However, that had not happened, he said, and “the marginal buyer has not shown up yet.”

The size of the sell-off is indicated by the sharp rise in yields. The yield on the 10-year US Treasury bond, which forms a base line for US and global financial markets, was 3.96 percent on February 27 on the eve of the launching of the US war on Iran. It now stands at 5.3 percent, having risen by 0.5 percentage points in September. These are major movements in a market where the shift of a small fraction of a percentage point can be significant.

The yield on the 30-year US Treasury bond has risen to 5.62 percent, its highest level since June 2002. This is despite efforts by Treasury secretary Scott Bessent to

intervene in the market by increasing buybacks of longer-term bonds from \$2 billion per operation to \$6 billion. When the initiative was announced in mid-August the yield on the 30-year was 5.2 percent. It has risen more than 40 basis points since then, with no sign of coming down.

Bessent, who offered criticism of former US Treasury secretary Janet Yellen when she did the same thing, has shifted the issuance of new US debt to the shorter end of the market—one- and two-year bonds and even shorter—to try to lessen the higher interest rate cost at the longer end.

But these manoeuvres—expected to amount to around \$1 trillion over the next year—fail to address the fundamental problems: the US debt mountain, now at more than \$40 trillion and rising and the growing interest bill of more than \$1 trillion, fast becoming the largest item in the US budget.

In fact, they may even increase financial risks because of the need to constantly refinance the debt.

According to Maya MacGuineas president of the bipartisan Committee for a Responsible Federal Budget: “The particular focus on the short term leaves us really vulnerable to levels of rollover risk.”

The growing US debt crisis is being replicated across the major capitalist countries to one degree or another and is particularly sharp in France which is very much in the eye of the storm in Europe.

Its borrowing costs on 10-year bonds have increased by the largest amount of any G7 country since the US war on Iran began, rising from 3.2 percent to 4.8 percent this week. This has lifted the so-called spread, the difference between the rates on French and German bonds, to more than 1.2 percentage points.

French bonds fell on the borrowing announcement by the government this week and, as John Authers, a Bloomberg columnist noted, resulted in a “further stark widening in the spread over German bunds.”

“Only in the worst days of the eurozone’s sovereign debt crisis in 2011 and 2012, has the spread risen so fast. Talk of a second euro-zone crisis, this time with an epicentre in Paris, is growing, and it’s easy to see why.”

That crisis was only ended in July 2012 when the then president of the European Central Bank, Mario Draghi, pledged “to do whatever it takes to preserve the euro” and that it would be enough. Fourteen years ago, that turned out to be the case. Whether it might be so again is another question, given the increase in eurozone debt from €8.6 trillion in 2012 to €13.9 trillion at the beginning of this year as the debt crisis is compounded by increased military spending.

The increase in debt used to finance the massive AI build out is another factor which could set off global financial turbulence, as highlighted in the prospectus issued by the AI giant Anthropic for its initial public offering (IPO) expected in November, a preview of which was obtained by Reuters.

It must surely rank as one of the most extraordinary documents ever issued in the history of capitalism. Anthropic has warned that its technology may pose “existential risks to humanity” and almost a third of the document detailed a series of “risk factors.” It testifies to the utter irrationality and crisis-ridden nature of the capitalist system that a major company issues a prospectus which says: supply us with billions and put us in a position where we may risk blowing up the world.

The threat to humanity does not arise from the technology itself but from the fact that it is privately owned and in the hands of giant monopolies each of which is in a relentless drive to become top dog and appropriate for itself the lion’s share of the profits to be obtained from AI at whatever the cost.

It has already been noted that the circularity involved in the AI boom, in which companies are providing money to others which is then used to buy their products, contains the risk of a financial crisis.

It has now been reported that the Anthropic prospectus acknowledged that close to a quarter of its revenue last year came from just two clients.

But on this somewhat shaky foundation, and with no clear prospect of how sufficient profits will be made to earn a sufficient rate of return on the hundreds of billions being outlaid, the Anthropic IPO, coming in

with a valuation of \$2 trillion, is set to be the largest in history.

There are growing warnings about where the growing dependence of financial markets on the continuation of the AI boom is heading. The Bank of England (BoE) has warned there could be a “sharper correction” than took place over the summer, when the shares of semiconductor companies and AI-related firms slumped in July, because of the growing use of debt to finance AI development.

“The rapid increase in artificial intelligence-related debt issuance broadens the exposure of capital markets to development in AI,” the BoE Financial Policy Committee said.

A similar warning was issued on Wednesday by the US global investment firm KKR which said credit markets could experience volatility if there was an AI downturn because the rising debt levels left investors exposed to “an unusually concentrated investment cycle.”

Christopher Sheldon co-head of credit and markets at the firm told the FT: “We don’t think enough people are talking about the potential volatility if AI growth slows.

“This is multiples on trillions of dollars of market value. The knock-on effects across the broader markets could be very meaningful.”



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