Bond Market Sell-off Signals Mounting Financial Crisis

By Nick Beams
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The instability of the global financial system and the potential for another crash have been underscored by a major sell-off of government bonds this week. Yesterday saw European markets display levels of volatility not seen since the euro zone debt crisis turmoil of three years ago.

In the course of the day, the yield on the German 10-year government bond, which moves inversely to its price, jumped by 21 basis points (a 0.21 percentage point rise) to 0.80 percent, before falling back to its opening level of 0.59 percent.

In the middle of last month, the yield was just 0.05 percent, with predictions that it was on its way to zero.

Other markets in Asia and the United States have also showed considerable volatility. The US bond market this week suffered its longest losing streak since 2011, with the yield on the 10-year bond treasury note rising at one point to its highest level for the year.

It has been estimated that in the last two weeks alone some $2 trillion has been wiped off global share and bond markets.

The rapid rise in European yields indicates that there has been a massive exit from the bond market after investors and speculators had shovelled billions of dollars into purchases following the initiation of the European Central Bank's asset purchasing program which pumps €60 billion per month into financial markets.

Money poured in because of the belief that, as a result of the ECB's actions, bond prices would continue to rise and, despite falling yields, there were big profits to be made via capital gains. Markets operated according to the theory that while it may be foolish to buy at an elevated price there was a bigger fool who would pay even more in the near future.

The scale of the swing can be gauged from the fact that in normal times the yield on bonds only moves by a few hundredths of a percentage point in the course of a day.

But normal calculations have been thrown awry by the near-zero interest rate regime of the world's major central banks and the associated asset-purchasing programs, so-called quantitative easing.

Consequently, market analysts were at something of a loss to find an explanation for this week's events, as evidenced by a range of comments cited in today's *Financial Times*.

“The movements of recent days have been extremely unusual and the magnitude doesn’t reflect the economic data we’re seeing,” said James Athey, investment manager at Aberdeen Asset Management.

Michael Riddell, bond fund manager at M&G investments, told the newspaper: “It is difficult to understand exactly what is driving this. But that’s in part because central bank action has blunted the relationship between the feedback from the economy and prices in markets.”

Ralf Presser, the rates strategist as Bank of America Merrill Lynch, said there was a “lot of soul searching at the moment” because it was thought that the yield on German 10-year bonds was heading for minus 20 basis points. In other words, the price of bonds was going to continue to rise.

In addition to the gyrations on the bond market, another indication of mounting financial instability is contained in a report issued today which claims that emerging markets—a target for speculators in search of higher profits—have suffered a bigger exit of capital over the last three quarters than that experienced in the financial crisis of 2008–2009. The total outflow from the 15 largest such markets in the nine months the end of March was just over $600 billion, compared to an outflow of $545 billion in the same period to March 2009.

A spokesman for the firm publishing the results said the selloff could continue into the second quarter of the year. An even bigger contraction has been recorded in the foreign currency reserves of emerging markets; these have plummeted by more than $374 billion from December last March, amid falling growth rates—down to 3.9 percent in February from 4.1 percent the previous month.

While it is not clear yet where the losses in European financial markets have been sustained—and they could run into many billions of dollars—the potential for another financial catastrophe was made clear in a report issued by the Joint Committee of European Supervisory Authorities earlier this week.

It covered conditions in financial markets from September 2014 to March this year in the lead-up to this week’s sell-off. The report began by noting that since the last report in August “financial system risks” had “intensified further.”

Persistent low interest rates had sustained the demand for riskier investments and provided investors with incentives for enhancing their returns. “This is frequently achieved by renewed build-up of leverage [that is, increased debt]” with such increases “mainly limited to financial institutions outside the banking system.”

But it also indicated that “fundamental questions” remain about the “sustainability of some banks’ business models in search for sustained and solid profitability” in an environment of low interest rates.

In a warning of the possible consequences, it concluded: “A fragile market equilibrium, could be disrupted by some large or several unexpected negative events.” This could lead to a reassessment of risk which “would have a substantial impact on the financial system via decreasing asset values.”

This week’s events certainly fit the description of an “unexpected negative event.”

The report also gave the lie to the claim, advanced by financial authorities in support of the program of quantitative easing, that in the long run it will provide a boost to the real economy.

Describing investment levels as "anaemic" and remaining below the pre-2008 trend, it said that with low growth rates, savers turn to bubbles to reach their targets and "over time, productive investments are crowded out, as real resources are misdirected."

That is to say, far from leading to an improvement in the real economy via increased investment, the policies of the central banks, which have fuelled bubbles and enabled the accumulation of vast profits via financial speculation, make an already dire situation even worse.

The worsening state of the global economy has also been highlighted by figures on the American economy, which show that it all but stagnated in the first quarter this year, recording an expansion of just 0.2 percent. It would have been negative but for a build-up of inventories, often an indicator of recession.

But these figures could be revised down in the coming weeks amid further evidence of economic weakening.

The US trade deficit for March rose by 43 percent to $51.4 billion, the worst figure since October 2008 and the largest percentage increase since 1996. These figures indicate that US export performance in the first quarter may have been worse than initially estimated, prompting a report by BNP Paribas that the American economy could have contracted at an annual rate of 0.4 percent in the first quarter.

The turbulence in financial markets and the worsening outlook in the real economy are an indictment of capitalist governments and financial authorities around the world.

Not only have their policies provided no economic "recovery," their handing out of virtually free money to the finance houses and speculators has created the conditions for another financial catastrophe which will result in further far-reaching attacks on the social conditions of the working class.