Central banks tighten interest rates amid warnings of social crisis

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Central banks around the world have begun the most aggressive round of interest rate rises in more than two decades, according to a survey conducted by the *Financial Times* (FT), with more increases to come as inflation continues to surge in every country.

An attempt is being made to blame the soaring cost of basic items such as food, natural gas, and petrol on the Russian invasion of Ukraine by dubbing them "Putin's price hikes." But the surge, which was exacerbated by the war, began well before February 24.

The price rises are the outcome of the refusal of capitalist governments to take action to eliminate the COVID-19 pandemic through the necessary science-based public health measures. This led to supply chain constrictions and a massive expansion of the money supply by central banks which accelerated after the market meltdown of March 2020 at the start of the pandemic.

According to the analysis by the FT, there have been more than 60 interest rate increases by central banks in the past three months, the most since the start of 2000.

The interest rate hikes are being led by the US Federal Reserve and the Bank of England. The European Central Bank is set to start lifting its rate in July from the below-zero level it introduced after the 2012 euro crisis.

Despite the recent rises, which are being carried out in developed and less developed economies alike, the FT noted that "rates are still low by historical standards" with economists warning that "the recent rises are just the beginning of a global tightening cycle."

So far so-called emerging markets have been hit the hardest by the rate rises and the strengthening of the US dollar which has increased the debt burden on dollar-denominated loans. Money is flowing back to the major financial markets while emerging market bonds record their largest losses in more than three decades.

David Hauner, the head of emerging markets strategy at Bank of America Global Research, told the FT he expected the situation to worsen.

"The big story is that we have so much inflation in the world and monetary policymakers continue to be surprised by how high it is. That means more monetary policy tightening and central banks will continue until something breaks, either the economy or the market."

Some of the biggest rate rises have come in Latin America as central banks attempt to stop the outflow of capital. The interest rate in Brazil has been raised 10 times in the past year and now stands at 12.75 percent compared to just 2 percent in March 2021. Other countries including Mexico, Chile and Peru have also lifted rates.

However, the financial problems are not confined to the less developed economies. The latest *Financial Stability Review*, issued by the European Central Bank (ECB) last week, has warned of greater financial instability.

It pointed to growing dangers on a number of fronts. It said higher inflation and lower growth could increase market volatility and "challenge debt service capacity as financing costs rise."

Such developments "might not only amplify but could also trigger the materialisation of pre-existing financial vulnerabilities" previously identified, including "heightened debt sustainability concerns in non-financial sectors or the possibility of concerns in both financial and tangible asset markets."

It reported that large increases in commodity prices had posed "challenges" for liquidity management for some derivative market participants.

Derivatives are widely used by commodity traders as a kind of insurance against rapid movements in prices. But the markets have become so volatile the amount of money these traders need to place with banks, known as a margin, to finance their operations has risen sharply. Increasingly, they are now either eschewing derivatives altogether or making them in riskier parts of the market.

The ECB review also warned that while investment funds have so far been able to manage outflows in the wake of the war in Ukraine, "euro area non-banks remain vulnerable to a further market correction" because of liquidity and credit risk.

"Non-banks also have large exposures to weaker corporates which may be especially vulnerable to higher inflation and lower growth," it said.

At the macro-economic level, the review said governments in some euro area countries may have limited ability to provide support to the economy in the event of further shocks because of the high levels of debt they have already incurred because of the pandemic.

Coupled with concerns over debt sustainability this could spur "fragmentation pressures in sovereign bond markets." This refers to the situation in which interest rates on government bonds issued by weaker and more indebted economies, such as Italy and Spain, rise well above those on bonds issued by the stronger euro zone economies, such as Germany and the Netherlands.

In 2012 such a fragmentation threatened the existence of the euro as a single currency. The crisis was only ended when the then president of the ECB, Mario Draghi, pledged to do "whatever it takes" to maintain the euro.

There is now the possibility of such a crisis re-emerging. According to the review: "To the extent that higher sovereign vulnerabilities coincide with fragilities in the corporate and banking sectors, risks materialising in any of these sectors (in isolation or in combination) may lead to adverse feedback loops between sovereign, banks and corporations."

In other words, problems in the corporate sector could be transmitted to the banks which have financed them and in turn become a problem for the indebted governments which stand behind the banks.

When examining the growing economic and financial problems it is always necessary to remember that the official data on inflation, debt etc. are the expression, in the final analysis, of class relations and are the driving force for issues fought out in the class struggle.

These issues were highlighted in an article published last week by the UK-based *Byline Times* based on an anonymous interview with a "senior investment executive" at a "leading Wall Street firm" who pointed to the discussions going on behind the scenes in financial circles.

"All the major banks know that the cost of living crisis is out of control," the financial executive said.

"The pandemic was bad enough and highlighted how certain groups of people were going to be worse affected, the poor, minorities and so on. But the combination of energy and food shocks are a tipping point that will push Western societies over the edge.… So we are anticipating dangerous levels of civil unrest that could spiral into an unprecedented social crisis."

Over the past decade and more, governments and central banks to some extent been able to stave off financial and economic crises by bailing out corporations and injecting still more money into the financial system. But that was under conditions where inflation was at historically low levels. Now it is rampant, and that method is increasingly unviable.

"There isn't anything left in the toolbox of the existing financial system," the executive said. "We've run out of options. I can only see the situation worsening."