# Bond prices fall, financial risks rise

**Nick Beams**
**20 October 2023**

The selloff in the $25 trillion US bond market, one of the foundations of the global financial system, is continuing. The yield on benchmark 10-year US Treasuries rose to above 5 percent on Thursday, its highest level since 2007 on the eve of the global financial crisis.

The immediate cause of the selloff, which has seen the yield on the 10-year Treasury rise by nearly one percentage point since the end of July—an unusually large increase in such a short period of time—is the rate tightening by the US Federal Reserve. Since March 2022, the Fed has lifted its base rate by more than 5 percentage points.

There are indications that it is planning to keep rates steady at the next meeting concluding on November 1. However, it is expected that rather than rates being cut any time soon, they will continue to remain higher for longer.

In an event at the Economic Club of New York on Thursday, chair Jerome Powell said the Fed would proceed "carefully." This was taken as a sign that rates would not be lifted at the next meeting.

In the midst of heightened geo-political tensions and conflicts—the US-NATO war against Russia in Ukraine and now the US-backed Israeli genocide in Gaza—Powell pointed to new risks.

"A range of uncertainties, both old and new, complicate our task of balancing the risk of tightening monetary policy too much against the risk of tightening too little," he said.

The "highly elevated" geopolitical tensions "pose important risks to global economic activity."

While appearing to downplay the prospect of an immediate rate rise, Powell did not rule one out in the future. Although it is never directly referenced, the crucial question is whether the trade union bureaucracy can continue to suppress wages struggles of the working class and impose sub-inflation-rate contracts.

Powell again made clear, as the Fed has indicated from the time tightening began, that the central bank's key target is not inflation but the wages of the working class.

He noted that while conditions remained "tight," the labour market was "gradually cooling." Powell then indicated there was further to go and that "a sustainable return to our 2 percent inflation goal is likely to require a period of below-trend growth and some further softening in labour market conditions."

He underscored this meant further rate increases if necessary.

"We are attentive to recent data showing the resilience of economic growth and the demand for labour. Additional evidence of persistently above-trend growth, or that tightness in the labour market is no longer easing, could put further progress inflation at risk and could warrant further tightening of monetary policy."

The fall in bond prices and the rise in yields (the two move in opposite directions) has deeper causes than the immediate policies of the Fed. One of the key questions is the ability of the market to absorb the already elevated and increasing levels of US government debt, much of it the result of increased military spending. Now standing at $33 trillion, it has doubled over the past decade.

Writing in the *Financial Times* (FT), economic analyst and former bond trader Mohamed El-Erian said turbulence in the Treasury market pointed to deeper causes than inflation and the intentions of the Fed. The US bond market was "losing its strategic footing."

The major function of the market is the financing of US government debt. But according to El-Erian, despite the rise in interest rates "there is now genuine doubt who will readily absorb the additional supply of government debt associated with high deficits."

The Fed had reversed its previous policy and was selling bonds rather than buying them as took place under quantitative easing, he wrote.

Foreign buyers, notably Japan and China, were pulling back. A "significant portion" of the large domestic institutional investor base—pension funds and insurance companies, already holding quantities of bonds on which they had made large book-value losses because of the fall

© World Socialist Web Site

in prices—were not eager to acquire more.

El-Erian did not go further but the danger in such a situation is that an event, sometimes of an accidental character, can trigger a sell-off and then a rush for the exits as large-scale investors, who have often financed their operations with the large levels of debt, try to get out.

A number of commentators and analysts have pointed to the dangers building up in financial markets.

In an interview with the FT earlier this week, private equity investor J Christopher Flowers warned that an increase in investments by life insurance companies, searching for higher yields, in private credit investments was creating systemic risk.

"Too many people have piled into private credit and it has a special feature that a chunk of it is funded with life insurance assets," he said. "One of these days, some life insurance company is going to get whacked on their private credit.… You can have a run on a life insurance company."

Assets managed by private credit investments funds are at a record of $1.5 trillion with their annual rate of growth more than doubling to 23 percent between 2020 and 2022.

*Australian Financial Review* columnist Karen Maley has also noted the worsening situation in financial markets.

In an article last month, she pointed to the $16.5 billion takeover of the US cloud computing company Citrix by two private equity groups backed by a consortium of 30 banks led by Bank of America, Goldman Sachs and Credit Suisse.

The takeover was organised in January. But since then financial conditions had deteriorated to such an extent that the banks were not able to sell off their loans as planned "presumably because investors were insisting on such eye-watering discounts," and so kept them on their books.

In another article published earlier this week she wrote: "If there's one thing senior bankers can agree upon, it's that the next blow-up in financial markets will be centred on the massive US leveraged loan market."

Highly geared companies, she noted, that have taken out large loans are about to be hammered when it comes to refinancing because of the "huge rise" in their borrowing costs due to the rise in interest rates.

As Maley explained, it is hard to get a handle on the extent of the problems because, some bankers are worried that the rise of the private credit industry "has shifted a large amount of financial power into the hands of a few large, opaque asset managers outside the view of prudential regulators."

It seems there are new problems at every turn. On Friday, the FT ran an editorial on the warning by US Securities and Exchange Commission chair Gary Gensler on the impact of artificial intelligence (AI) on the financial system.

According to the editorial, Gensler "puts the likelihood of an AI-driven financial crisis within a decade as 'nearly unavoidable' without regulatory intervention."

However, there are major problems for containment by regulation to which the editorial indirectly points. One of the risks is that AI can leading to "herding" in which participants in the market make similar decisions based on what their AI models are telling them.

Furthermore, it continued, "the opaque nature of the systems also makes it difficult for regulators and institutions to assess what data set they are reliant on."

The case of AI underscores a broader issue. Its development is a major scientific and technological advance that could bring enormous gains. But under the capitalist system, based on private ownership and the anarchy of the market, its use threatens to spark a financial crisis, bringing devastating social consequences for billions of people as the experience of the 2008 crash demonstrated.

The contradictions of the capitalist system, expressing themselves in financial market turmoil, will not and cannot be resolved through regulation but only through the overturn of the private profit system and the development of a consciously planned socialist economy.

To contact the WSWS and the Socialist Equality Party visit:

**wsws.org/contact**

© World Socialist Web Site