Bond markets reveal growing concern over government debt

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For several months global bond markets, the chief source of financing for government debt, have been sending out signals that beneath the appearance of stability in the financial system and the continued rise in stock markets, all is not well.

While immediate factors, such as whether central bank interest rates are going up or down and the expected movement of inflation, affect bond prices, it is apparent that longer-term, deeper forces are at work.

The bond market is being moved by concerns over how much longer governments can continue to finance the mountain of debt they have accumulated. The International Monetary Fund estimates total global government debt to be $100 trillion. This is the result of the continual outlays governments have incurred in propping up their economies and corporations.

When interest rates were low or near zero after the onset of the COVID pandemic, the payment of interest on this debt was not a major problem. Now it is, because of the increase in rates since 2022.

This is attested to by the fact that despite the US Federal Reserve cutting interest rates by a percentage point since September last year, the yield (interest rate) on 10-year bonds in the US, and their counterparts around the world has risen. Under "normal" conditions they would be expected to fall.

The yield on the 10-year UK bond, or gilt as it is known, has spiked from around 3.6 percent last September to about 4.6 percent now. In recent days it has been trending higher, raising predictions it could reach 5 percent.

The US 10-year bond has undergone a similar movement which started at the same time as the Fed began cutting its base interest rate.

Significant attention has focused on the UK which experienced severe financial turbulence in October 2022 because of the attempt by the short-lived Liz Truss government to finance tax cuts for corporations and the wealthy by increasing debt. This set off an escalation in bond yields requiring the intervention of the Bank of England to prevent a full-blown financial crisis, leading to the resignation of Truss.

While the crisis two and a half years ago has sometimes been attributed to the excesses of Truss, or incompetence, the underlying causes of the near meltdown have remained.

The state of the UK was the subject of an interview given by billionaire Ray Dalio, the founder of the global hedge fund Bridgewater Associates, to the *Financial Times* (FT) this week in which he warned that it could be headed for a "debt death spiral." This is a situation where increasing amounts of money must be borrowed just to pay the interest on existing debt.

There was a risk that the combination of rising interest costs, now at £100 billion a year, and the need to roll over existing debt at a higher interest rate would produce a self-reinforcing cycle.

He said the situation looked "like a debt death spiral in the making."

The gilt market turbulence was a "supply-demand problem."

"Why else would long-term [yields] rise when there's an easing [of monetary policy], the exchange rate is going down, and the economy is weak?"

The supply-demand problem means that the issuing of government bonds (debt) exceeds the demand for them at a given price. Consequently, investors are only prepared to purchase bonds if their price is lowered with a consequent rise in the yield. (The two have an inverse relationship.)

The economic and social consequences of the emerging UK debt spiral were spelled out in an FT

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editorial last week. It said the lack of confidence in the UK economy had become "infectious," spreading from businesses to the financial markets. Bond yields were near their highest in 16 years.

The FT said the so-called "bond vigilantes" had the UK in their sights and would be looking for "improvements."

What that would consist of was laid out very directly. Tax increases had been ruled out because that would be "disastrous for confidence."

"But that means Labour must be prepared to make savings in high-cost, yet politically sensitive, areas such as welfare benefits, the civil service and the triple-lock on pension payments," the editorial said.

(The triple lock refers to the present arrangement in which pensions are increased by whatever is the highest number, 2.5 percent, the increase in wages or the rise in inflation.)

While the UK may be characterised as the "sick man" of the major economies as far as debt and interest payments are concerned, the position of the US is objectively even worse. However, it is able to sustain massive government debt, now approaching $36 trillion, with an annual interest bill heading for $1 trillion, because the US dollar is the global currency and in demand.

But there are growing warnings that even with this "exorbitant privilege" the US financial position is ultimately not sustainable.

In his FT interview Dalio did not confine himself to the UK but pointed to the situation in the US. He called for the deficit to be cut from its present level of 6 percent of GDP to 3 percent.

In a blog post he advocated for a cut in interest rates to 1 percent, letting inflation rise to 4.5 percent, increasing tax revenue by 11 percent, slashing discretionary spending by 47 percent or some combination of these measures.

But the Trump administration has ruled out tax hikes, and will cut corporate taxes, the Fed has no intention of reducing rates and will increase them again if inflation rises. This means that the focus is on spending. There is no question as to where the axe will fall, with the Department of Government Efficiency headed by the fascist billionaire Elon Musk calling for spending cuts of $2 trillion.

US government spending is around $6.3 trillion, of which nearly $1 trillion is on the military and the same amount on interest payments to bond holders. Neither of these items will be reduced which means that the target will be social services, health, education and other vital areas impacting the working class.

Trump has said Social Security will not be touched in his Make America Great Again program, advancing at times the bogus claim that tariffs will pay off government debt.

But all his assertions are founded on quicksand as the logic of the debt numbers makes clear. US government debt is at present around 100 percent of GDP. But on current projections it is set to rise to 200 percent of GDP within a decade. Even with the "privilege" conferred on the US because of the role of the dollar, this escalation is unsustainable.

In a recent comment, FT columnist Gillian Tett cited what she called the "influential" "Tree Rings" newsletter which warned that if the 10-year yield rises above the nominal US growth rate, then it is "mathematically certain to quickly trigger a debt death spiral."

In his FT interview Dalio provided no timeframe for the explosion of what he has characterised as a "debt bomb." He likened it to the development of a heart attack when plaque builds up and increases the risk of a piece breaking off.

"You can't tell exactly when that is going to happen, but you can say that the risks are very high and rising."

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