Fed Buying Up Corporate Debt

[This is a letter I sent to friends on Oct. 7, 2008, together with an AP news report. –S.H.]

Hi everybody,

The AP article below from 2 hours ago is already way out of date! It starts by saying that the stock market is having a quiet day today. Since then the market dropped several hundred points and at the moment is down 233 points. It is hard not to pay some attention to such things!

But of course our theoretical focus should be elsewhere than on the stock market. The big drops are significant, and also the general high volatility of the stock market (up and down), which reflects the varying moods of the gamblers there between moments of sheer panic and other moments of relief and hope that this or that government measure will save their bacon. But the stock market is more a reflection or partial indicator of what is happening in the real economy. It doesn't even fully reflect what is happening in the rest of the financial sphere.

Of more significance than the current Dow Jones average are the revelations in the article that the Federal Reserve is now buying up corporate debt (in the form of "commercial paper"—short-term debt owed by one corporation to another). This is not related to the $700 billion government bailout of banks and financial institutions by promising to buy up their bad CDOs, credit swaps, and such which are based on sub-prime (or otherwise bad) mortgages. This is a *different* part of the credit market.

Apparently the Fed thought there might soon be some defaults on commercial paper if it didn't act immediately. It is another indication that the current financial crisis has moved far beyond the collapsing housing bubble and its effects on investments based on bad mortgages.

As the article mentions, one goal the Fed has here is to try to "unfreeze" this part of the credit market. In other words, there is a lot of credit out there already, but the goal is to find a way to allow for the creation of *more* commercial paper and other credit by corporations. If the Fed buys up some of the dubious commercial paper, this will—they think—allow corporations to issue *new* commercial paper.

So once again, in the middle of a collapsing credit bubble, what does the government try to do? Stop the collapse, and do everything it can to try to re-inflate that bubble. This might sound crazy, but it is actually rational, given their capitalist economic system. True, even if the Fed succeeds, it will only mean that there is a bigger bubble there to collapse later on, with even more devastating consequences. But at least it will put off today's problem until tomorrow.

As I claim in my work in progress on Capitalist economic crises (portions posted at: http://www.massline.org/PolitEcon/crises/Index.htm) capitalism could not work at all unless there is a more or less constant increase in debt (consumer, government, and business debt), and moreover debt that is increasing at generally an ever faster pace. Credit bubbles are absolutely essential to the system. And it is these various types of credit bubbles, and their rates of expansion—or popping!—that are the thing to focus on in a financial crisis.

True there are other bubbles as well, such as valuation bubbles in housing, or stock market bubbles. The biggest importance of these valuation bubbles is that they help *promote* the much more fundamental credit bubbles. Thus, if the prices of houses seem to always be increasing, it is easier to get people to take out ridiculously huge mortgages to buy houses (because of the "promise" that no matter how much they pay they will still come out ahead in the end). Moreover, secondary bubbles built on the securitization of mortgage debt can then occur, followed by yet another layer with credit "swaps" (unsecured "insurance") bubbles, and so forth. Bubbles beget more bubbles.

But by the same token, the popping of one bubble threatens to lead to the popping of others in sort of a chain reaction.

Since this is the case, and the Fed knows it, they are concerned to prevent the popping (or even the more gentle deflation) of even the secondary or tertiary bubbles. Furthermore, psychology is very important in any system built up as a house of cards. These are the sorts of reasons that the stock market sinking fast is so worrisome to the Fed.

There have even been rumors over the past day that the Fed itself intervened in the stock market, and started to massively buy stocks to halt the collapse in progress. I don't know yet if this actually happened or not, but it would explain how a drop that reached a record of 800 points was later turned around to being a drop of "only" 360 points or so.

In any case there are plenty of massive, and expensive, interventions in the economy going on right now, and by no means just the one $700 billion Wall Street bailout. The Fed has been loaning something close to a trillion dollars to the banks, for example, as well as buying up dubious commercial paper, and quite possibly buying up stocks directly.

Is the government "nationalizing" the entire credit industry, or indeed the whole economy? Well, no, but it is certainly moving in those *directions* at the moment. State capitalism is the de facto *direction* of movement during any major financial crisis in the capitalist-imperialist era.

This brings us to some fundamental features of capitalist economic crises in the imperialist era: 1) It is *only* the government and its intervention that stands any chance of controlling the crisis; 2) the government tries to do this by *merging* with the banks and corporations (if only "temporarily"), and 3) a full economic collapse in the modern era also means the bankruptcy of the government. (Contrary to what is often claimed, it is possible even for governments—who have the ability to just print money—to go bankrupt. They do so, for example, if the currency becomes inflated to the point of worthlessness.)

Scott Harrison

Stocks fluctuate after Fed corporate debt plan

By TIM PARADIS, AP Business Writer
2 HOURS AGO [Oct. 7, 2008]

NEW YORK - Stocks fluctuated in quiet trading Tuesday as investors appeared to adopt a wait-and-see approach to the range of options the Federal Reserve has laid out to inject the sluggish credit markets with a dose of much-needed confidence. Trading remained fractious, and the major indexes alternated between gains and losses a day after the market suffered another huge drop.

Investors appeared heartened if still cautious following the Federal Reserve's announcement that it plans to buy massive amounts of corporate debt in order to jump-start lending in the markets where many companies turn for short-term loans. The evaporation of faith the loans will be repaid has lenders weary and made it more difficult and expensive for businesses and consumers alike to borrow money.

Credit markets showed some signs of easing. The market seized up after Lehman Brothers Holdings Inc. declared bankruptcy and after the government helped rescue insurer American International Group Inc. Banks have become fearful about lending to each other. That paralyzed borrowing, and its effects have been felt by companies and consumers alike.

The Fed's latest move is designed to lubricate the lurching market whose troubles have spread to other parts of the economy though the measure stops short of a broad interest rate reduction that some traders have been calling for.

But the stock market was still extremely fractious

The Dow Jones industrials fell 74.07, or 0.74 percent, to 9,881.43, one day after it dropped below 10,000 for the first time in four years. The blue chip index fell as much as 800 points on Monday before closing with a loss of 370.

Broader indexes also rose. The Standard & Poor's 500 index fell 9.94, or 0.94 percent, to 1,046.95; and the Nasdaq composite index fell 21.40, or 1.15 percent, to 1,841.56.

Investors are still hoping to see other moves from the Fed to boost confidence, including perhaps an interest rate cut. Australia's central bank lowered interest rates by the largest amount since 1992 in a surprise move, and that reignited hopes that others including the Federal Reserve and European Central Bank might follow.

Both Fed Chairman Ben Bernanke and European Central Bank President Jean-Claude Trichet have speeches scheduled Tuesday, and the Fed is due to release minutes from the last interest-rate setting meeting.

Though not giving the market a rate cut that many traders have been clamoring for, the Fed has taken other steps to help unclog the credit markets. On Tuesday, policymakers provided more details about when it will make $900 billion in short-term loans available to squeezed banks.

The loans _ part of an effort to ease intensifying credit stresses _ are made available to banks through auctions. The Fed, in coordination with other countries' central banks engaged in similar efforts, laid out dates that it will conduct the auctions through the rest of this year.

Traders might get a better idea of what central bankers are thinking when the Fed releases minutes from its Sept. 16 meeting at 2 p.m. EDT. Policymakers, who will meet again at the end of the month later, left key interest rate unchanged at 2 percent.

Concerns about the credit markets still pushed investors into the relative safety of government debt. Investors moved into longer-term Treasury bonds, with the yield on the 10-year note fell to 3.52 percent from 3.58 percent late Monday.

However, speculation that the Fed might cut interest rates caused yields on shorter-term debt to rise. The yield on the three-month Treasury bill rebounded to 0.81 percent from 0.50 percent late Monday. Demand for Treasurys remains high because of their safety; investors are willing to take extremely low returns just to have their money in a secure place.

Oil prices rebounded to near $90 Tuesday, a day after plunging to an eight-month low on concerns a global recession will undermine demand for crude. Light, sweet crude rose $3.07 to $90.88 a barrel in electronic trading on the New York Mercantile Exchange.

In corporate news, Bank of America Corp. fell $4.82, or 15 percent, to $27.40 after reporting late Monday that profits fell 68 percent during the third quarter. The bank also said it will raise $10 billion by issuing common stock and slashed its dividend.