Behind the US stock market rally

By Barry Grey
22 April 2008

Last week, the US stock market registered major gains, despite dire first-quarter reports from major banks and investment houses and a raft of data indicating a rapid slide into recession.

The Dow Jones Industrial Average rose 524 points, or 4.25 percent, for the week; the Standard & Poor's 500 Index gained 57 points, or 4.4 percent; and the Nasdaq Composite Index picked up 113 points, a rise of 4.9 percent. The major indexes closed at their highest points since February 1.

The upward spurt may well prove to be temporary, but the evident disconnect between the mood of big investors and the ongoing financial turmoil and economic distress is nevertheless a significant phenomenon that calls for an explanation.

The same trend was apparent on Monday, when the stock market essentially shrugged off more bad news from Bank of America and National City Bank, with the Dow giving up a marginal 24 points and the S&P 500 and Nasdaq closing slightly higher.

Bank of America said its first-quarter profit fell 77 percent, worse than anticipated by market analysts, and its credit-loss provisions rose by another $4.78 billion. National City announced it was seeking a cash infusion of over $6 billion, in exchange for discounted shares of its stock.

Last Wednesday, JPMorgan Chase announced $5.1 billion in write-downs and set-asides and a 50 percent drop in first-quarter profits. Nevertheless, its shares rose 5.1 percent. Overall, the Dow shot up 257 points.

On Thursday, Merrill Lynch, the investment bank and world's largest brokerage firm, posted a first quarter loss of $1.96 billion, recording for the first time in its 94-year history its third consecutive quarterly loss. The firm announced an additional $6.6 billion in asset write-downs, bringing its total markdown of mortgage-backed and other speculative securities to $30 billion since last summer.

Merrill also announced an additional 2,900 job cuts, bringing the total number of job losses announced over the past several months to 4,000.

The firm's quarterly loss, at $2.19 a share, was substantially higher than the $1.99 per share decline anticipated by market analysts. Yet Merrill's shares soared 4.1 percent on Thursday. Stock indexes overall were mixed, with the Dow and the S&P 500 ending the day slightly up and the Nasdaq down by 8 points.

On Friday, Citigroup, the world's largest bank by assets, reported a $5.1 billion loss for the first quarter, compared to a $5 billion profit for the same period a year ago. It had lost $10 billion the previous quarter. The bank took over $13.8 billion in write-offs and its revenue dropped 48 percent compared to the first quarter of 2007.

Citi announced it would lay off some 9,000 employees in the next twelve months, on top of 4,000 job cuts announced in January.

The company's share price shot up 4.5 percent, and the overall stock indexes soared: the Dow closing up 229, the S&P 500 ahead by 25 and the Nasdaq up 61.

Shares of financial companies as a whole, which declined 14.7 percent in the first quarter, rose 5.2 percent last week, despite the dismal earnings reports from some of the biggest financial houses.

The spurt in banking shares coincided, moreover, with many indications of deepening slump and surging inflation.

* California reported a 0.5 percent jump in its jobless rate in March, to 6.2 percent.

* Housing starts plunged 11.9 percent in March to reach their lowest level in 17 years.

* The Federal Reserve's "beige book" national survey reported consumer spending "softening" across the country. For the six weeks to April 7, three quarters of the Fed's 12 districts experienced "slowing in the pace of economic activity." The *New York Times* on Sunday reported that retail sales were down more sharply than at any time since the 1990-91 recession.

* Auto industry sources said car sales in the first quarter declined to an annualized rate of 15.2 million units, the lowest level in over a decade. Analysts cut their full-year 2008 forecasts to below 5 million units, more than 1 million lower than in 2007.

* The World Trade Organization reported Thursday that world trade growth declined sharply in 2007, increasing by 5.5 percent as compared to 8.5 percent in 2006. The WTO warned that growth in world trade could fall to 4.5 percent this year, the lowest level since 2002.

* Oil prices hit new record highs and US gasoline prices surged, approaching an inflation-adjusted record.

* Producer prices in the US rose in March by 1.1 percent, far higher than projected by economists and nearly four times the

0.3 percent reported in February.

* The US dollar hit new lows against the euro and other major currencies.

* The London interbank offering rate (Libor), a benchmark for loans between major banks, shot up, pointing to a continuation of the global credit crunch that is fueling the contraction in investment, sales and general economic activity.

What accounts for the seemingly irrational response of the stock market to this dismal news? In a basic sense, the answer is to be found more in politics than in economics.

The newfound bullish optimism among major Wall Street players—as transient as it may prove to be—can be traced in large part to the decision by the Fed to rescue Bear Stearns last month and open the Fed discount window for cheap loans to the big investment banks. This move, without precedent since the Great Depression, was taken to avert an imminent collapse of the US and global banking system, and it signaled that the US government would do whatever was necessary—ultimately at taxpayer expense—to bail out Wall Street.

It is this implicit guarantee from the government that has shifted the mood among big market players and institutions from fear and panic to a measure of confidence, bringing with it a new eruption of risk-taking and greed.

As Floyd Norris, the economic commentator for the *New York Times*, wrote on Friday, "... investors are starting to assume that the government stands behind Wall Street. The share prices of investment banks began to recover just after the Fed made it clear the investment banks could borrow from it.

"It appears that the real way we are going to get out of this crisis is to have the government guarantee lots of things. 'The universal cry of the bust is, "Give me a government guarantee," said Alex J. Pollack, a former president of the Federal Home Loan Bank of Chicago who is now a fellow at the American Enterprise Institute... As private balance sheets are cut back to reduce leverage, he forecast, the government's balance sheet will grow rapidly."

The political and social implications of this government rescue operation are far-reaching. In essence, it means that the consequences of the economic crisis precipitated by the reckless pursuit of super-profits on the basis of vastly inflated home values, leveraged buyouts and various forms of speculation and fraud will be borne entirely by the working class, while the big players, CEOs, accounting firms and ratings agencies will emerge relatively unscathed.

Meanwhile, the banks and finance houses will carry out a ruthless process of cost-cutting and job-slashing, which will be mirrored in every other sector of the economy. The US financial industry has already shed 38,000 jobs since last summer, not counting the most recent layoff announcements, and some analysts predict the final toll will reach 200,000.

Big investors are clamoring for just such measures, and are prepared to reward those companies that carry them out. Byron MacLeod, an analyst with Gradient Analytics, said of Citigroup's quarterly report:

"Investors want to see aggressive action at this point. You want to make sure the company really cleans house. The provisions are a part of that. The layoffs are a part of that. They appear to be taking aggressive action, taking the company in line with an ideal structure going forward."

There is no opposition from any section of the political establishment or either party to this blank check for Wall Street. The Fed's massive intervention to shore up the banks has received the endorsement of the Democratic Congress. No congressional investigations of any substance have been launched to uncover the unprecedented scale of fraud and swindling that underlay the banking debacle. No one is being called to account.

In addtion, all three of the candidates vying to succeed George W. Bush in the White House—John McCain for the Republicans, Barack Obama and Hillary Clinton for the Democrats—declared their support for the Fed action, ensuring that the pro-Wall Street policy will continue in the next administration.

The supposed relief measures for desperate families facing foreclosure are derisory. The Senate bill passed this month, dubbed the "Foreclosure Prevention Act of 2008," will do nothing for the hundreds of thousands of families that have already had their homes foreclosed or the millions more who face the prospect. It allocates a mere $100 million for "foreclosure counseling," while providing over $25 billion in tax windfalls over the next several years for home builders, auto companies, airlines and other industries.

The measures taken by the Fed will, in the end, only compound the crisis that is gripping the American and world economy. They can only deepen the crisis of the US dollar, further exacerbate global economic imbalances, and create new speculative bubbles—such as in commodities—in place of the imploded housing bubble. The crisis is rooted in the capitalist system itself, and the attempts to offload its implications onto the backs of the working class must inevitably lead to social and political convulsions.