Stock markets fall as global recession takes hold

By Patrick O’Connor
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Stock markets in the US and Europe fell sharply yesterday amid mounting evidence that the US economy is entering into a severe recession.

On Wall Street yesterday, the Dow Jones Industrial Average declined by 7.8 percent, or 733 points, the index’s second largest one-day point drop. Of the 30 Dow industrials, only Coca-Cola finished marginally higher after it released better than expected profit figures.

The Standard & Poor’s 500 Index fell even more sharply, by 9 percent, while the technology-based Nasdaq declined 8.4 percent. Shares on these indexes were almost uniformly lower, with declining stocks outnumbering advancing ones by 8 to 1 on the Nasdaq.

Yesterday’s Dow Jones decline largely erased Monday’s one-day rise of 936 points, which followed the previous week’s unprecedented 18 percent fall. Monday’s rebound had been driven by the Bush administration’s announced extension of the $700 billion bailout of Wall Street, with up to $2.25 trillion in public money allocated to prop up the major banks and financial firms.

Yesterday’s downturn on the markets indicates a growing awareness that the bailout will not prevent the US from sliding into recession. Consumer spending is sharply down, job losses are mounting, business confidence remains low and critical US export markets in Europe and other regions are under threat as world growth stalls. None of the Bush administration’s measures addresses the underlying crisis of American capitalism.

“Everything the government has done is not going to prevent further deterioration in the economy,” Stuart Hoffman, chief economist at PNC Bank, told the New York Times.

“To some degree, we’ve moved on from the old crisis to the new crisis,” said Howard Silverblatt, a senior index analyst at Standard & Poor’s. “The credit crisis has been addressed to some extent, but now there’s the recession, unemployment, and rising manufacturing costs in the pike.”

The US Commerce Department’s report on September retail sales, released yesterday, found that sales had decreased by 1.2 percent. This was nearly twice the decline anticipated by economists and marked the third consecutive month in which consumer spending decreased.

Indicating the extent to which the financial crisis has hit working people, the fall in consumer sales especially affected auto retailers, with car sales down 3.8 percent, as well as department stores and shopping malls. In response, shares values yesterday declined for Wal-Mart (6.3 percent), Target (8 percent) and Staples (7.7 percent).

The Federal Reserve also released its “beige book,” a regular survey of businesses around the country, which found that spending has declined in all 12 metropolitan areas covered in the report. Retailing, auto sales and tourism declined in most districts, while housing and construction “weakened or remained low,” the report stated. Businesses said they “had become more pessimistic about the economic outlook.”

Other negative indicators included a measure of New York manufacturing, which recorded its lowest level since the index commenced in 2001.

In a separate announcement, New York’s chief financial officer, Comptroller William Thompson, estimated that the financial crisis could see 165,000 jobs lost in the city, including 35,000 in the financial sector alone. The forecast of 165,000 job cuts is more than double the amount Thompson anticipated in July. He said the revised estimate reflected “the spread of the economic troubles to other industry sectors as the nation slips into a general recession.”

Thompson’s statement was one of several which warned of an imminent rise in the level of unemployment. On Monday, Bill Gates of Microsoft said he expected a “fairly significant recession,” leading to a jobless rate of 9 percent. Gates issued this statement even before the value of his company’s shares declined by a total of 11 percent on Tuesday and Wednesday. Other tech stocks also fell sharply yesterday, including EBay (14 percent) and Dell (11 percent).

The specter of the Great Depression

Janet Yellen, president of the Federal Reserve of San Francisco, acknowledged in an address delivered to Silicon Valley executives that the US was officially in recession. She cited recent Fed data showing the economy was weaker than expected in the third quarter, “probably showing essentially no growth at all,” while for the fourth quarter “an outright contraction [is] quite likely.” She concluded, “Indeed, the US economy appears to be in a recession,” adding that she thought
Notably, Yellen’s speech was not publicized on the Fed’s central web site. Federal Reserve Chairman Ben Bernanke struck a somewhat different note in a speech yesterday before the Economic Club of New York. Trying to reassure the markets, Bernanke again promoted the bailout, hinted that interest rates may be cut further later this month, and insisted that policy makers have learned from the Great Depression and have avoided the “critical errors” made by their counterparts in the 1930s.

These platitudes fell flat, however, with many on Wall Street unnerved by the fact that the Fed chief was now openly discussing the Great Depression.

Peter Cardillo, chief market analyst at Avalon Partners in New York, told the Wall Street Journal that he found Bernanke’s comparison of the current crisis with the 1930s “particularly worrisome.” “How can the market not react to that?” he declared. “Look at what he’s saying!”

While Bernanke insisted that he was confident the economy would emerge from the crisis with “renewed vigor,” his speech presented a dire prognosis. “Stabilization of the financial markets is a critical first step, but even if they stabilize, as we hope they will, broader economic recovery will not happen right away,” he said. “Economic activity has been decelerating even before the recent intensification of the crisis... Ultimately, the trajectory of economic activity beyond the next few quarters will depend greatly on the extent to which financial and credit markets return to more normal functioning.”

It remains to be seen whether the Bush administration’s measures manage to revive the “normal” financial parasitism that has come to dominate the US economy.

“Blue chip” financial stocks were among those sharply down on Wall Street yesterday, with Citigroup and American Express each declining by about 13 percent. An influential bank analyst at Oppenheimer & Co contributed to the sell-off by warning that US banks were not “out of the woods” despite Bush’s bailout.

A significant factor in yesterday’s Wall Street sell-off was the activity of hedge funds, which were forced to sell stock to raise cash to meet margin calls from their brokers. Such forced selling by major investors further depresses share prices, in turn lowering the value of the collateral that backs the outstanding loans of financial firms, thereby precipitating more margin calls from their creditors. The result is an accelerating downward spiral on financial markets.

There is also the outstanding question as to how the bailout is to be paid for. On Tuesday, the Treasury reported that the federal government ran a budget deficit of $454.8 billion in the 2008 fiscal year, up from $161.5 billion in 2007. According to Bloomberg.com, Morgan Stanley chief economist David Greenlaw has predicted the shortfall may increase to about $2 trillion once the full extent of the bailout is realised. This would be the equivalent of approximately 15 percent of US gross domestic product—more than twice as large as the post-World War II record deficit of 6 percent of GDP recorded in 1983.

In his speech in New York, Fed Chairman Bernanke pointed to another serious danger to the US economy—slowing economic growth in major trading partners, which will almost certainly result in lower US exports.

Developments in Europe yesterday confirmed these fears. The major share markets suffered sharp declines, with the London FTSE 100 index down 7.2 percent, the French CAC-40 6.8 percent lower, and the German DAX down 6.4 percent.

The fall in British markets was triggered in part by the release of unemployment figures showing the official jobless rate for the three months from June to August at 5.7 percent, up from 5.2 percent in the previous quarter. An additional 164,000 people joined the ranks of the officially unemployed, the biggest quarterly increase in 17 years. According to the Financial Times, many forecasters expect the jobless rate in Britain to rise above 7 percent in the coming year.

Slowing world growth is reflected in falling demand for commodities, leading to lower prices. The Reuters-Jefferies CRB index, an index of world commodity prices, fell to a two-year low yesterday, down almost 40 percent from July’s record high. Over the past three months, the prices of crude oil, platinum, steel, copper and zinc have slid by 35-45 percent, while agricultural commodities including soy and corn have declined by more than 50 percent.

Rio Tinto has announced it is cutting production at some of its aluminum smelters in response to slowing Chinese growth. Rio Tinto chief executive Tom Albanese declared that the Chinese economy “is pausing for breath after spectacular GDP growth.” Shares in the mining giant plummeted by 16 percent in response to the announcement. Other energy and commodity firms’ stock also fell yesterday, including Alcoa (down 12.8 percent) and Exxon Mobil (14 percent).

The financial crisis has brought to a head the underlying contradictions which have been wracking the capitalist system over an entire period. Notwithstanding the desperate hopes of policy makers in Europe, Asia, and other regions, a severe and protracted recession in the US will inevitably trigger a major downturn in the world economy.

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