Wall Street sell-off resumes as Dow enters bear market territory

By Nick Beams
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As the spread of the coronavirus continues to widen, Wall Street's Dow Jones index yesterday fell 1,465 points, 5.9 percent, taking it into bear market territory, having dropped more than 20 percent from its record high on February 12.

The bull-market run that began in March 2009 has ended.

The markets are set to plunge even further today following US President Trump's virulently nationalist address to the nation yesterday evening. He labelled the coronavirus as a "foreign virus" emanating from China and blamed inaction in Europe for "seeding" outbreaks in the US.

The central measure outlined in the speech, which did not provide for any new health care initiatives in the US, was to impose a 30-day travel ban on Europe.

The economic effects of such measures are incalculable and markets immediately responded by falling sharply in Asia and Australia. Futures indexes for the US also dropped.

The driving force of yesterday's plunge, following an upturn on Tuesday, was the deepening of the global coronavirus crisis.

The World Health Organisation declared the virus outbreak to be a pandemic, saying it was "deeply concerned" about its "spread and severity" and pointing to "alarming levels of inaction."

In an indication of the worsening situation in Europe, German Chancellor Angela Merkel told a news conference in Berlin yesterday that 60 to 70 percent of the population "will be infected."

In the US, NBC News, citing two sources, reported that Dr Brian Monahan, the attending physician of Congress and the Supreme Court, told a closed-door meeting of Senate staff that 70 million to 150 million people in the US could become infected.

Another key factor in the renewed market sell-off was the news that as part of its oil price war, launched at the weekend, the Saudi Arabian oil ministry had ordered a lift in production from 12 million barrels a day to 13 million.

This sent oil prices down after a brief upturn following the 25 percent plunge at the start of this week.

Three major oil-producing countries, Algeria, Iraq and the United Arab Emirates are reported to be seeking talks to find a way of halting the market conflict. Oil prices have dropped to $35 per barrel and predictions are it could go even lower.

Together with other oil producing countries these countries face a crisis in their state budgets because of the slump. According to the International Monetary Fund, the three nations pushing for the talks would need oil prices of $92, $59 and $68 per barrel respectively to balance their budgets.

Fatih Birol, the executive director of the International Energy Agency, said: "In some of these countries, it will be almost impossible to finance essential areas like health or education. It could challenge the stability of these countries where oil is the nerve-centre."

The main impact of the oil price slide on the advanced economies is in financial markets, particularly in the US.

Oil and gas companies took advantage of the ultra-low interest rates over the past decade to borrow money hand over fist to finance the expansion of shale oil production on the premise that prices would not fall.

Now they are facing outright bankruptcy or a default on their loans—a significant proportion of which are rated at below investment grade, or so-called junk status. If such defaults are widespread, this could trigger a crisis in credit markets more broadly.

At a White House meeting of major bank chief executives held with Trump yesterday, Citigroup CEO Michael Corbat issued reassurances that the banking system was sound.

"This is not a financial crisis. The banks and the financial system are in strong shape and we are here to help," he said.

Seeking to maintain the fiction that his administration is in control, Trump angrily brushed aside a question from a reporter at the meeting on the lack of action to halt the spread of coronavirus, saying "that's CNN, fake news."

The turmoil may not have produced a financial crisis as yet, but all indicators are pointing in that direction under conditions where the shares of some companies have lost up to 40 and 50 percent.

The rapid plunge points to the fact that, due to the pumping up of stock prices with cheap money over the past decade, there is no basis for determining what constitutes real value.

The plunge could accelerate further. As Mark Haefele, the chief investment officer at UBS Global Wealth Management, commented: "One of the risks in turbulent market conditions is being forced to sell assets to meet liquidity needs."

An article in the *Financial Times* earlier this week pointed to the sharp fall in the shares of major banks and noted they were not immune from the effects of the oil price plunge. Defaults on bonds issued by oil and gas companies are set to rise.

"While the direct exposure of US banks to the oil industry is just 2 percent, according to Autonomous Research, the indirect exposure to adjacent regions and sectors could be significant," it said.

In other words, there could be a situation analogous to that of the 2008 financial crisis.

At first sight it appeared that the sub-prime mortgage bubble did not directly involve the banks. When the crisis first emerged Fed chair Ben Bernanke said it only involved $50 billion. He told Congress in May 2007 that "we do not expect significant spillovers to the rest of the economy or to the financial system."

But when the complex system of financial arrangements underpinning the sub-prime market was unravelled, it became clear the banks were deeply implicated.

There are now growing concerns that a feedback loop will take hold in which the economic effects of the coronavirus and the development of recession around the world lead to more market falls, that in turn deal another blow to the real economy.

Goldman Sachs has said it expects further falls in markets and that "both the real economy and the financial economy are exhibiting acute signs of stress."

Seema Shah, chief strategist as Principal Global Investors, told the *Financial Times* that powerful co-ordinated action was needed to ensure that "this shock does not evolve from a short-lived hit to a prolonged and devastating downturn."

However, the problem facing governments and financial authorities around the world is that the policy levers they have used in the past are having no effect.

Following the announcement of a stimulus package by the Australian government of Liberal Prime Minister Scott Morrison, the Sydney stock market fell further into bear market territory.

There was a similar reaction to the emergency rate cut of 0.5 percentage points by the Bank of England yesterday. London's FTSE 100 index finished the day down by 1.4 percent.

In the statement announcing the lowering of its base rate to just 0.25 percent, the bank said there had been a "marked deterioration" in the outlook for UK growth and indicators of financial market uncertainty had reached "extreme levels." It said activity in the economy was likely to "weaken materially" over the coming months.