

Wall Street tumble: a warning of things to come

Nick Beams
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The fall in Wall Street's Dow Jones industrial average of nearly 300 points on Tuesday is a sign of underlying problems which have been building up in the US and world economy.

The drop in the index of 3.41 percent took the market to 8487.31, or 9.1 percent below its peak of 9337.97 on July 17. It was the third-largest point decline in history, with the volume of shares traded the second-largest ever.

The turn in the market appears to have been triggered by falling profit expectations and fears that the consumer spending-led growth in the economy is coming to an end. Expectations of double-digit increases in profits for the second quarter have been dashed with companies reporting increases of between 4 and 6 percent.

A series of economic indices reveal a rapid slowing of the US economy, with predictions that it may even experience negative growth before the end of the year.

Last Friday, figures released by the Commerce Department showed that the economic growth had slowed to 1.4 percent in the second quarter, down from the 5.5 percent growth rate reported for the first three months of the year.

The growth figure was higher than expectations, largely because of consumer spending was still running at an annual rate of 5 percent. But there are signs that the so-called 'virtuous circle'--in which rising stockmarket prices fuel consumption spending and economic growth, leading to further rises on Wall Street--is coming to an end.

Consumer spending in June increased by 0.6 per cent, while incomes rose by only 0.2 per cent. The household savings rate for the month fell to just 0.2 per cent. The savings ratio for the June quarter was just 0.6 per cent--the lowest since the Great Depression.

These figures express a general trend. According to an analysis by British economist Wynne Godley, published in the *Financial Times* of July 17, the combined deficit of the US personal and corporate sectors has been running at a record level of about 3 percent per annum. In other words, the expansion of the US economy over the recent period has been financed by a build up of debt.

Other figures point to a downturn. This week, the National Association of Purchasing Management said that its July index fell to 49.1 from 49.6 in June. A reading below 50 represents a contraction in economic activity.

According to the senior economist at Merrill Lynch, Gerald Cohen, the weaknesses in the economy exhibited in the June second quarter were extending into the third quarter and 'deflationary pressures are increasing.'

Underlying the downturn is the slump in Asian markets, the destination for a quarter of all US exports. The trade deficit is running at record levels of around \$15 billion per month and is calculated to have taken between 2 and 2.5 percentage points off the US growth rate.

A further factor in the market downturn are the signs of growing militancy in the US working class. Last month Federal Reserve Board chairman Alan Greenspan cited the General Motors strike as an indication that 'increasingly confident workers might place gradually escalating pressures on wages and costs.' While the GM strike was betrayed by the UAW bureaucracy, the conflict at Northwest Airlines, where pilots are set to strike August 29 and machinists voted by more than 80 percent to reject a settlement negotiated by their union, indicates that threats to 'investor confidence' have by no means abated.

While it impossible to predict the daily fluctuations in the market, the continuous increase in share values is clearly unsustainable in the long term. The market value of US equities has reached 160 percent of gross domestic product, twice the ratio in 1995 and four times that of the early 1980s.

Other economic statistics point to the unsustainability of the seemingly endless 'bull market.' A study published last month by the British firm Lombard Street Research details 'a very serious macroeconomic disequilibrium' in the United States, pointing out that on present trends the expected deficit on the current account of the US balance of payments in 1998 of \$230-\$250 billion will be the largest the world has ever seen.

'The scale of the deficit,' the report stated, 'would be remarkable even if the USA were a remarkable creditor nation. But, in fact, foreign-owned assets in the USA exceeded the USA's foreign assets by over \$1300 billion at the end of last year.'

It estimated that US net debt could be almost \$2000 billion by the end of the year 2000, requiring a 'drastic wrench to the growth pattern enjoyed over the last six years' in order to prevent 'external debt running out of control.'

Longer term market trends indicate that a decline has been in the making for the past 12 months. Since the Dow reached the level of 8200 last August the growth in market capitalisation has dropped to an annual rate of around 13 percent, less than half the rate during the past two and a half years.

The narrow base of the increase in the past year is indicated by the fact that only one third of stocks have been showing clear upward trends. While the S & P index has risen by 22 percent this year, a third of this increase has been attributable to just seven stocks.

And it seems that those in the upper echelons of the financial institutions and corporations are already organising their exit strategies. The New York correspondent for the *Sydney Morning Herald* reported on Monday that: 'According to *Vickers Weekly Insider*, which monitors corporate insiders trading in their own companies, executives in big companies are selling rather than buying shares.'

For millions of working class and middle class families, who have been forced to invest in shares in order to try and provide for their health, education and

retirement, a collapse of the market threatened to wipe out their life savings. The scope of the potential social devastation is indicated by the fact that by the end of this year it is estimated that savings invested in mutual funds--one of the main sources of share boom--will outstrip the funds held by banks.

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