

# Election turbulence adds to US economic worries

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Continued uncertainty over the outcome of the presidential election has added to the volatility of US stock markets amid fears that the financial processes that have sustained the boom are coming to an end.

In the week of the election itself the technology-based Nasdaq index lost 12.2 percent while the Dow was down by 2 percent. The Nasdaq is now down by about 40 percent since its high of last March and last week dipped below 3,000 for the first time since November last year.

The fragility of the market was underscored by plunge in the shares of Dell Computer. After reporting an expected growth of 20 percent next year, well below its previous estimate, the share price promptly dropped by 19 percent, dragging down other high-tech stocks with it. Dell is now down 62 percent from its high, WorldCom 75 percent, the wireless leader Qualcomm 63 percent and Cisco Systems has fallen by 39 percent.

In addition to the prospects of increased political turmoil in the aftermath of the election, whatever its eventual outcome, the stock market is being shaken by a series of factors which point to major economic and financial problems immediately ahead.

Overall the US economy is slowing down under the impact of higher interest rates, increased oil prices and slackening consumer demand. High-tech industries are reporting reduced earnings expectations, the increasing indebtedness of the US economy is causing a concern and there is a growing list of failed dot-com companies.

As the *Financial Times* noted in an article published on November 13 “technology stocks have been hit by fears of a glut in the production of semi-conductors and pessimism about the prospects for the telecom industry” which is “laboring under the burden of commitments to capital spending on wireless, broadband and other infrastructure.”

With clear signs of a slowdown, if not yet a recession, attention has been focused on the extent to which the US

economy has become increasingly dependent on the inflow of international capital.

The trade deficit on goods and services climbed steadily from \$15.9 billion in January 1999 to \$30.4 billion by March 2000, at which level it has remained more or less stable. However further increases could take place over the next few months both as a result of the appreciation of the US dollar (which increases competitive pressures on US exports) and increased oil prices.

And with an overall balance of payments deficit now running at around \$400 billion a year, and threatening to reach 5 percent of gross domestic product next year, the US is dependent on a capital inflow of more than \$1 billion per day to finance its debts.

This is already leading to serious imbalances in the world economy. The IMF has forecast that the US current account deficit for this year will more than exceed the combined surpluses of Japan, the euro-zone and the East Asian economies. So great is the inflow of capital, it is estimated that two out of every three dollars available for international investment finds its way into America.

Much of the capital inflow has been used to finance mergers and acquisitions. According to Federal Reserve statistics net foreign merger and acquisition purchases of US companies rose from \$13 billion in 1997 to \$152 billion in 1999 and are running at \$86 billion so far this year.

Other figures show the growing dependence of the stock market on foreign capital inflows. According to an article in the *New York Times* of November 12: “The Securities Industries Association estimates that foreign investors' net buys of United States stocks could exceed \$194 billion this year, up from \$107.5 billion last year. That the overall market has fallen in spite of such buying shows how vulnerable stock prices are to falling foreign demand.”

The dependence of stock markets on continued foreign capital inflows has prompted discussion of a so-called

“nightmare scenario” in which foreign investors withdraw their money, leading to a sharp decline in the value of the dollar, triggering a hike in interest rates, a further decline in markets, leading to a recession.

While the flow of funds into the US is helping to sustain the stock market and prevent a balance of payments crisis, it is causing strains in other parts of the world.

Some of those strains became apparent last week when the International Monetary Fund announced that it was adding “significantly” to a \$7 billion line of credit to Argentina following the announcement by President de la Rúa of a series of government cuts aimed at convincing investors of its capacity to repay \$20 billion in foreign loans falling due next year.

Having instituted a currency board under which the peso is tied to the US dollar, Argentine exports have been adversely affected by the rise in the US currency on world markets. And on top of that the general tightening in financial markets, partly resulting from the flow of funds to the US, has caused nervousness among foreign investors.

In the *Financial Times* of November 14, global economics commentator Martin Wolf posed the question as to whether an Argentine default, devaluation or both could “trigger a worldwide financial crisis” like that which followed Russia's devaluation and default in August 1998. “The answer should be ‘no,’” he wrote. “But stresses now appearing within the structure of the world economy are making life hard for vulnerable emerging market economies.”

While an Argentine default, he noted, could act to turn the present rumblings into a “serious crisis” there was no need for this to happen so long as the US economy avoided the “feared hard landing.” But there are growing signs in the US pointing to such an event, as the political turbulence generated by the election adds to the underlying financial and economic concerns.



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