Stock markets take a "fundamental" hit

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Over the past few years, the growing storms in global financial markets have generally been accompanied by the soothing mantra from media pundits and market analysts that, whatever the immediate economic problems, the "fundamentals are sound."

However, in the case of the latest downturn, which hit Wall Street on Monday and spread rapidly around the world, it is clear that the "fundamentals" of the world capitalist economy, above all falling growth and profits, are the source of the turbulence.

On Wall Street, the Dow Jones index and the more broadly based S&P index both went down by more than 4 percent, while the technology based Nasdaq dropped by more than 6 percent. The S&P index is now 22 percent down from its peak a year ago, indicating Wall Street has officially entered a "bear market," defined as a 20 percent decline. The Nasdaq is down 62 percent from its all-time high of more than 5,000, falling to below 2,000 on Monday.

Monday's big sell-off was clearly triggered by a stream of reports from major corporations, in particular those involved in communications and high-tech, warning of lower profit expectations and declining sales. The world's leading computer chip manufacturer Intel set the ball rolling last week when it announced that revenue for the first quarter would be down by 25 percent, compared with an earlier warning of 15 percent, and that it would be cutting its workforce by 5,000 over the next nine months.

But it was Cisco System's announcement late on Friday, after trading had finished, that it was cutting its permanent workforce by 5,000 and the accompanying warning by chief executive John Chambers that the cuts were attributable to "initial signs of [the US] slowdown expanding to other parts of the world," that pushed markets over the edge.

The total loss in paper profits of almost half a trillion dollars has strengthened fears that the stock market plunge is sure to lead to further contractions in US consumption and investment spending, sending the economy into recession. The only question now appears to be, how deep?

And the bad news on profit results and job cuts continues. On Monday, the world's number two cellphone manufacturer, Motorola, announced it was cutting another 7,000 jobs, on top of the 9,000 it eliminated last December. The Swedish telecom equipment manufacturer Ericsson warned that it would make a loss in the first quarter, rather than break even as it previously expected, and that sales would be flat or even down, instead of increasing by 15 percent.

In a statement the company said "slower growth" was affecting all its operations with "customers in the United States in particular ... postponing capital expenditures."

Overall, profit forecasts are being revised down. The *Washington Post* reported that since December, analysts have "chopped in half, to 5 percent, their projections for average earnings growth in the third quarter." The estimate for the current quarter is a loss of 5.2 percent compared with the 11 percent growth projected last November.

The Wall Street plunge quickly spread around the world. On Tuesday, the Japanese stock market fell to levels not seen since 1984, as the Nikkei index went below 12,000 compared to its level of 39,000 at the peak of the boom at the end of the 1980s.

Asian markets fell by 3 percent in the wake of the Wall Street decline. According to a report in the *Australian Financial Review*, markets were "showing signs of panic", although a "return to the collapse of 1997-99 is unlikely."

In many ways, however, the situation is more serious than three years ago. Then the Asian economies were supported by the continued boom in the US economy. Now they are being hit from two sides at once.

In the words of Goldman Sachs vice chairman Robert Hormats: "Asia is now facing two shocks: one, the decline of purchases by US companies and consumers of high-tech equipment and components; and two, the further deterioration of Japan, which even today remains the largest source of capital and the largest market for raw materials and finished goods in Asia."

The dependence of the Asian economies on the US is highlighted by the following figures: export sales to America account for 24 percent of the Gross Domestic Product of Malaysia, 20 percent of Singapore's GDP, 16 percent for the Philippines and 12 percent for both Thailand and Taiwan.

The downturn in global stock markets is giving rise to expressions of concern in the financial press. In an editorial published on March 10, the first anniversary of the Nasdaq peak, *The Economist* noted that markets around the world are on average at least one-fifth below last year's high. "Over the past year, around $4 trillion has been wiped off the value of American shares alone, a sum equivalent to 40 percent of the country's GDP. The collapse in share values after the stock market crash of 1987 was only half as big, at 20 percent of GDP."

The editorial went on to point out that total global market capitalisation was $35 trillion last year, representing 110 percent of global GDP, as compared to 40 percent in 1990.

Inasmuch as stock market valuations must, in the final analysis, be based on claims to profits and assets, this figure points to the increasingly fictitious character of share values. That is, their real asset backing is only a fraction of their purported paper value.

But this does not mean that the share market has played no role in the functioning of the "real" economy. On the contrary, rising share values have been central to the high-tech investment boom in the US where venture capital has provided much of the start-up funds to launch new technologies. The providers of this capital are then returned their funds many times over through the inflated share values of an initial public offering (IPO) by the high-tech company they have helped create.

With the fall in markets this process has all but ended. Venture capital is reluctant to launch new projects under depressed market conditions where it cannot even be assured of the return of its initial outlay, let alone the high profits of the past.

Much commentary in the recent period has centred on the impact of the stock market downturn on consumer spending, via the so-called wealth effect. But the fall in the market could have an even more severe impact on new business investment, particularly in high-tech, which has played such a central role in boosting the US growth rate.

A crucial interaction between the markets and the larger economy is also being played out in Japan. There the banks hold about 6 percent of their assets in shares. With the growth of bad debt, the banks need to sell shares at a profit to make up for shortfalls on their loan portfolios, with the break even level on the Nikkei estimated to be between 12,500 and 13,000. With the index below 12,000, reports are starting to appear that some major banks could go under.

The continued decline of Japan and the inability of the government to undertake measures to boost the economy are provoking comments that the Japanese boom and collapse of a decade ago may in fact have been the forerunner of what is now taking place in the United States.

The Economist, among others, has pointed to recent remarks by former US treasury secretary Lawrence Summers pointing to the fact that the US business cycle is not so much "new" but rather a repeat of what took place in the first half of this century, and bears a resemblance to Japan in the 1980s.

According to this analysis, the post-war recessions have all been preceded by a period of rising inflation which the Federal Reserve Board has moved to end by lifting interest rates, thereby pushing the economy into recession. But on this occasion there is no sign of increased inflation. Rather, the characteristic feature of the US economic cycle has been the upsurge in business investment—it has jumped from 9 percent of GDP to 15 percent over the past decade—which has now resulted in overcapacity and consequent pressures on profit rates.

While one would not expect acknowledgement from Summers or any other economist putting forward such views, their analysis does point to the fundamental contradictions of the capitalist economy laid bare by Marx. The upsurge of technological innovation and the resultant increase in productive capacity have come into conflict with the profit system on which the capitalist economy is based. It is these "fundamentals" which are starting to find their expression on global financial markets and in the world economy as a whole.