

Stock market fall: More than a business cycle downturn

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The continued fall in world stock markets, led by the slide on Wall Street, has prompted concerns in the financial press that a global recession is on the way and that much more is involved than a downturn in the business cycle which can quickly be reversed by interest rate cuts.

On Tuesday, Wall Street again fell sharply. The Dow dropped 3 percent and the technology-based Nasdaq index 6 percent, or below 1,700, compared to its high of more than 5,000 in March 2000. The fall was prompted by continued negative reports on company profit expectations, particularly by software and telecommunications companies.

The downturn, which has pushed the Dow close to a “bear market”—defined as a 20 percent decline from its peak—is particularly significant because it has occurred in the face of three interest rate cuts, each of 0.5 percentage points, by the US Federal Reserve Board since the start of the year. The Fed has been cutting interest rates even harder than it did in the latter part of 1998 in response to the Russian default and the collapse of the hedge fund, Long-Term Capital Management.

But still the market has continued to fall, and it is this decline which is sparking increasing fears that powerful recessionary tendencies are now at work.

In an article published on March 22, the *Economist* noted that of the 40 markets tracked by the magazine, some 32 fell again in the wake of the most recent interest rate cut by the Fed. It pointed out that some economists now believe that “a new form of financial contagion is spreading, via stock markets, in a way similar (if slower) to that in which Asia’s financial crisis infected one economy after the other.”

The magazine explained that the \$10 trillion loss in paper wealth over the past year, equivalent to about 30 percent of global gross domestic product, was a record. In another comment published on the same day, it asked whether the world could be headed for its first global recession since the 1930s, pointing out that even in the crisis of the mid-1970s, global GDP still increased.

At the *Financial Times*, global economics columnist Martin Wolf warned in an article published on March 27 that falling US markets and weak Japanese demand could generate a global recession.

The comment, entitled “A chasm opens,” began as follows:

“Let us, for a moment, peer into the abyss. How deep could the fall of the world economy turn out to be if my moderately optimistic analysis of three weeks ago proves to be wrong? What, in other words, is the worst that a reasonable person might fear? The answer, alas, is disturbing. Big shifts in the desired balance between savings and investment in the US and Japan could conceivably generate a global slump.”

Wolf pointed out that even after the latest falls, the US stock market was still overvalued, having only now fallen back to its two previous 20th century peaks in 1929 and 1967. In other words, there is still a long way to go.

More significant than the stock market, according to his analysis, is the rise in the private sector financial deficit in the US—the excess of spending by consumers and businesses over income. This is now equivalent to 6 percent of GDP, some 11 percentage points below its level in the last recession and 8 percentage points below its long-run average. What happens if spending and income return to a more normal pattern?

“Suppose then that a vicious circle of tumbling wealth, declining investment and increased household saving were to push a disillusioned private sector back to the spending and savings patterns of the early 1990s. That would cut net demand by some 10 percentage points of US GDP. If it were to occur swiftly, the impact would be devastating.”

According to Wolf, the dangers for the world economy arising from the unprecedented situation in the United States are compounded by the fact that the easing of monetary policy in Japan is likely to bring about a depreciation in the value of the yen, leading in turn to an increase in the current account surplus and a further drop in global demand.

Another writer for the same newspaper warned that as the stock market continued to fall the “American model capitalism appears set for the kind of global reassessment that was visited on the Asian miracle after the currency and financial crises of 1997-98.”

The US magazine *BusinessWeek* has also been examining the mounting signs of recession in the global economy. In the cover story of its April 2 Asian edition, entitled “The Big Chill” it pointed out that previous optimism over the recovery of the Asian economies was “reverting to long-term pessimism,” particularly in the light of the stagnation in Japan and the fall in

the value of the yen.

“Many of the economies of East and Southeast Asia,” the article noted, “are reeling from a triple blow: First, the US slowdown is putting a dent in the exports that have kept Asia going since the crisis. Second, Japan is yanking investment from the region, and now there's a yen threat.”

A weak yen means declining export markets for Japan's competitors in the rest of the region. For example, nearly half of Korean exports in chips, telecommunications and steel, compete directly with Japanese goods.

East Asian economies are not only being hit by cuts to their export markets, but by a “dearth of foreign investment.” According to *BusinessWeek*: “Private capital flows have contracted in Indonesia, Malaysia, and Thailand for three years running. This year they will probably fall again. Multinational manufacturers are cutting back.”

In an article on the US economy in its April 9 edition, it pointed to the fundamental reason why interest rates cannot be expected to bring about a recovery—the existence of overcapacity in every sector of the economy.

“After years of frantically investing to build up the human and physical capacity to keep pace with soaring growth, the US economy is struggling with overcapacity as far as the eye can see.”

Manufacturing, for example, was running at 78.1 percent of capacity in February, its lowest point for nine years. Operating levels at semi-conductor plants that were previously close to 100 percent are now down by 20 percent and still falling.

According to figures collected by the Federal Reserve, semi-conductor makers, computer companies and communications equipment companies increased factory capacity by almost 50 percent last year. The slowdown is being felt world-wide with the three biggest chipmakers in Taiwan now operating at 70 percent capacity compared to 95 percent a year ago.

In the world auto industry manufacturers are selling only 74 percent of the 70 million cars being produced each year. Such is the scale of unused facilities, that world demand could still be met even if the entire US car industry were shut down.

Manufacturing and hi-tech industries are not the only area of over-capacity. As the article pointed out, retailing has vastly over expanded in the expectation of a continuing consumer boom with the area devoted to retail sales growing at five times the rate of population increase over the past eight years.

While various sections of the financial media point to some of the tendencies at work in the global economy, and even provide some insight into their operation, one will search in vain for an overall analysis of what is taking place.

Questions as to why the “boom” and the “new economy” have undergone such a rapid transformation, and what are the underlying driving forces of the global economy are rarely, if ever, addressed. This is because the whole of bourgeois economics, and its articulation in the mass media, starts from the proposition that capitalism and the free market are the

highest and indeed only possible form of social production. Consequently, this outlook deals with crises and recessions not as an expression of essential tendencies of the profit system, but rather as aberrations.

However, even a brief examination of the past decade reveals the interconnection between the economic boom and the global crisis now unfolding.

At the beginning of the 1990s, the investment in Asia, which led to the so-called “Asian miracle,” was the outcome of attempts by multinational corporations to overcome falling profit rates in the major capitalist countries.

So significant was this investment that it has been estimated that in the first half of the 1990s, between one third and one half of the growth in the world economy was accounted for by the East Asian region. What is remarkable about this figure is not so much what it says about the Asian expansion, but the lack of growth in the rest of the world.

The Asian crisis of 1997-98 was attributed to causes such as faulty banking systems, inadequate regulation, and investor panic. All these factors no doubt played a role. But above all the crisis reflected the growth of overcapacity in the world economy as a whole and the tendency to recession.

This tendency was then masked for a period in the “boom” generated by the flood of funds into the US following the Asian and Russian financial crisis as investors sought a so-called safe haven and the greater profit opportunities available in the US stock market. But while the stock market went to ever-higher levels, profits had peaked by about 1997.

Now the underlying recessionary tendencies that erupted in the Asian crisis have re-emerged—this time in the US and Japan, which together make up some 46 percent of global output.

And the form of the crisis itself raises far-reaching political questions. There is no question that changes in technology and communications over the past period have resulted in vast increases in productive capacity and labour productivity. But, as a growing number of reports in the financial media now point out, this very expansion is giving rise to a crisis.

The logic of the capitalist profit system dictates only one response: the shutdown of whole areas of production, the sacking of millions of workers and the imposition of poverty. Yet the very fact that this situation is the result of an expansion of the productive forces points to the need for a fundamental reorganisation of the world economy in order to meet human need, rather than the rate of return on capital.



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