Stocks plunge amid fears of world slump

Patrick Martin
5 September 2001

In a plunge which revealed growing fears of full-blown global recession, US stock markets hit their lowest point in four months last week. The Dow-Jones Industrial Average fell for four consecutive days, closing below 10,000, while the Nasdaq composite index fell below 1800. Neither index had been that low since April 9. The Nasdaq index has collapsed 64 percent from its 2000 peak; the Dow has fallen 15 percent.

The 171.32-point drop on August 30 left the Dow down more than 500 points for the week, though there was a slight recovery in Friday's trading. The Nasdaq fell another 3 percent, dragged down by a negative sales report from Sun Microsystems, which warned of rapid deterioration in the European and Japanese markets. Sun stock fell 17 percent on August 30 alone.

The Wall Street events sent global stock markets down over the weekend. European stock prices fell 2 percent Friday despite an announcement by the European Central Bank that it was lowering interest rates by a quarter point. The ECB was acting in response to reports that the German economy did not grow in the second quarter of the year, while the Italian and Belgian economies actually contracted.

In its decision to cut interest rates, the ECB cited the American slump as a major factor. Bank President Wim Duisenberg said, "The slowdown in economic growth emanating from the slowdown in the United States is larger, deeper and lasting longer that had been anticipated earlier." At a news conference, Duisenberg said the ECB had not underestimated the impact of the US slowdown, but did underestimate its length and severity. "We, obviously, together with US authorities, tended to be too optimistic," he said.

The European stock slide continued Monday and Tuesday, amid further news of economic decline. In London, the Chartered Institute of Purchasing and Supply reported that British manufacturing fell in August for the sixth consecutive month. The stock price of Germany's largest software maker, SAP, fell 6 percent Monday on news it would issue a profit warning.

Asian markets are also falling, led by the Tokyo stock exchange, which has hit new record lows nearly every day. The Japanese decline is driven by layoffs of unprecedented dimensions at the country's blue chip corporations—Fujitsu, Hitachi, Toshiba, Matsushita Electric, Nissan, Mitsubishi, Mazda and Isuzu have all announced cuts ranging from 4,000 to 20,000 jobs.

On Monday, September 3, the Nikkei stock average fell for a fifth consecutive day, losing 303.83 points, and hitting 10,409.68. There is a real prospect that the Nikkei average could fall below the level of the Dow—an astonishing reversal of fortune for Japanese capitalism. Just over 10 years ago, the Nikkei was closing in on 30,000 and the Dow was below 3,000.

The *Los Angeles Times* reported September 4 that there are growing fears among financial analysts of a sell-off by stock mutual funds, as small investors, frightened by the Nasdaq collapse, begin to pull out of the broader market. Bank of America Securities market strategist Tom McManus warned of a possible "September storm," noting the rash of fresh corporate profit warnings amid the struggling economy and dismal market performance. The average US stock fund is down more than 13 percent this year, on top of a 2 percent drop last year. Some widely held funds are down by far more. The Janus Fund has lost 25 percent so far this year, while Fidelity Growth Fund has fallen 26.5 percent. For stock funds overall, the back-to-back losses in 2000 and 2001 are the first since this form of investment became widely popular.

The chief trade group for the mutual fund industry reported August 30 that stock funds experienced net withdrawals of $1.2 billion in July, the first monthly outflow since March. Stock funds hold $3.6 trillion in assets and are the largest single investor on Wall Street, accounting for one fifth of all shares. More than half these assets represent the investment of IRAs, 401(k)s and other private pension plans on which tens of millions will depend for their retirement income.

After the October 1987 market crash, stock funds suffered net outflows in 16 of the following 18 months, totaling 12 percent of their pre-crash assets. A withdrawal today on that scale would remove more than $400 billion from the market, 13 times the outflow in 1987, with incalculable consequences for the financial system.

BusinessWeek magazine, in an assessment of small investor psychology entitled “The Mood Now,” lamented the apparent end of “a virtuous cycle of prosperity that soothed deep-seated social ills even as it appeared to defy the laws of physics—and economics.” The magazine expressed seeming amazement that no full-fledged financial panic has yet developed:

“The public’s refusal to push the panic button comes in the face of some stiff economic shocks. The collapse of the tech-stock bubble wiped out an estimated $5 trillion in paper wealth. Personal debt has been rising by an average annualized rate of 8.2% a month since last October. Manufacturing hit the skids 10 months ago—and stayed there. At a particularly inopportune moment, energy prices took off. And in a drama that is still playing out, the corporate-profit drought is leading to tens of thousands of layoffs.”

The business journal dismissed the tax cuts pushed through by the Bush administration, writing, “The rebate checks are not much more than pocket change—$40 billion, or 0.4 percent of GDP.” Another yardstick demonstrates the insignificance of this financial stimulus: major corporations have already announced the suspension of expected bonuses for white-collar and middle management totaling over $30 billion—three quarters of the value of the tax rebate.

Meanwhile the US government has sharply reduced its estimate of the growth of labor productivity, revising it downward from an annual rate of 3.4 percent in 1999 and 2000 to only 2.6 percent. This seemingly small difference has great social and political significance, since the claims that the United States has entered the era of a “new economy” were based on estimates of an acceleration of productivity growth from the 1.4 percent which prevailed from 1975 to 1995 to a figure more than two and half times as large.

Both the policies of Federal Reserve Board Chairman Alan Greenspan and the budget estimates prepared by the White House and the Congressional Budget Office depend ultimately on the projected growth in productivity. A downward revision of productivity growth on the scale of that announced by the Commerce Department would cut nearly $1 trillion from the projected surplus over the next decade.

The *New York Times* noted that the productivity figures called into question the reality of the financial boom of the past five years: “now that the boom has collapsed into sluggish growth, productivity’s contribution to that prosperity is uncertain. The revised productivity figures suggest that temporary factors—an exuberant stock market, excessive business investment, a surge in debt-financed consumer spending, for example—all played important roles.”

In other words, the boom was largely based on financial speculation, buttressed by dubious statistics and phony bookkeeping, designed to convince the public that markets would always go up and never down.