Record one-day point fall on Wall Street

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After sustained action to increase liquidity in global markets, combined with appeals to patriotism, US financial and regulatory authorities managed to limit the fall in the Dow Jones and Nasdaq indexes to around 7 percent when Wall Street re-opened on Monday, after its longest period of closure since the 1930s Depression.

But the market, which opened with a rendition of "God Bless America", still experienced a record one-day point drop of 685, amid signs that further falls could come over the next days and weeks. The volume of trading on the NYSE hit a record 2.33 billion shares. This is almost double the 1.24 billion shares traded the previous Monday, and eclipsed the previous volume record of 2.13 billion shares set on January 4 this year.

An hour before the market opened, the US Federal Reserve Board dropped interest rates by 0.5 percent, taking its base rate to 3 percent and pledging to "continue to supply unusually large volumes of liquidity to the financial markets, as needed, until more normal market functioning is restored." But as the Fed statement went on to note: "Even before the tragic events of last week, employment, production and business spending remained weak" and that "for the foreseeable future" the risks are "weighted mainly towards conditions that may generate economic weakness."

The Fed's interest rate cut followed several days of hectic activity in international financial markets. Immediately after the terror attack on the World Trade Center and the Pentagon, the Fed issued a statement that it would inject liquidity into the financial system if necessary, echoing its response to the October 1987 stock market crash. Over the course of the past week the Fed and the European Central Bank have, between them, poured about $300 billion into financial markets by purchasing financial assets from banks and other financial institutions. A currency swap of $50 billion was also undertaken with the ECB to provide dollars for any eurozone banks that may have experienced difficulties.

Following the Fed's decision yesterday, the ECB announced it was also cutting interest rates by half a percentage point. This was something of a surprise, as the ECB had not been expected to act until after the meeting of its Governing Council in 10 days time. In a statement on its decision—the first time it has shifted interest rates between meetings—the ECB said that "uncertainty about the US and world economy has increased" and that events in the US were "likely to weigh adversely on confidence in the euro area, reducing the short-term outlook for domestic growth."

The major action on the regulatory front was the decision by the Securities and Exchange Commission to suspend rules governing purchases of shares by corporations, brokerage firms and mutual funds to prop up stock prices. According to an Associated Press report: "Scores of American companies put out statements promising to back their own stock to prop up prices." Among the largest was a pledge by Pepsi that it would repurchase $2 billion worth of common stock. Bloomberg reported that the buy-back operation by major companies would total more than $10 billion.

While Monday's fall was confined to the range experienced on other markets last week—from 4.8 percent in Tokyo to 12.3 percent in Frankfurt—financial markets could be hit by severe shocks over the next few days.

The airline industry, which was facing mounting problems even before the events of last week, has been delivered a major blow with several companies reportedly on the edge of bankruptcy.

Continental, the fifth largest carrier in the US, announced last week it was cutting 20 percent of its flights, laying off 12,000 workers and would not be able to meet a $70 million payment on aircraft financing, due yesterday. If it cannot meet the commitment within 10 days it will default.

Delta, American Airlines, United and Northwest have all announced cuts of 20 percent in services. They were joined on Monday by US Airways, the sixth largest carrier, which said it would reduce capacity by 23 percent and axe 11,000 workers, comprising 24 percent of its workforce of 46,500. Company chairman Stephen Wolf

said: “The entire US aviation system is in jeopardy, and without decisive actions the future of the system, along with its impact on the nation’s economy, is imperiled.”

The US Congress is considering a $2.5 billion cash injection into the industry, together with a provision for loans of $12.5 billion. But according to one industry analyst, cited by the *Financial Times*, $2.5 billion “would keep a crippled airline industry afloat for less than 30 days.” Some analysts have put airline losses at $4 billion. Credit Suisse First Boston estimates US carriers will lose at least $5 billion, while airline executives have been telling Congress the losses could run to more than $10 billion.

US airlines are not the only ones affected. Virgin Atlantic has become the first European carrier to cut services, announcing it will reduce capacity by 20 percent and axe 1,200 jobs. Sabena, the Belgian airline, has warned it will go bankrupt in two weeks unless unions agree to a “rescue” plan involving the cutting of 1,400 jobs. On a global scale, the International Air Transport Association, which has 250 airline members, has estimated that the immediate revenue losses from last week’s events alone could total $10 billion.

The latest global stock market downturn was triggered, but not created by, the terrorist attack. The slide was already well underway. As the *Financial Times* noted: “Were the US or the world economy strong, the economic consequences of the disaster would have been easily manageable ... The terrorist attacks on New York and Washington may come to symbolise an economic turning point. A week ago, policymakers faced difficult choices. Now they confront the serious possibility of a global recession.”

The British magazine *The Economist* voiced similar sentiments. “[W]hat can be easily forgotten in the aftermath of September 11th is just how bad things were already. World stock markets had already slumped in the early days of September. In spite of the assumption made by economists—and others—that the American economy had just about bottomed out, a stream of disappointing statistics before September 11th was followed by even gloomier ones published after the attacks, but relating to economic activity before them.

“On September 14th, government figures showed the eleventh consecutive monthly fall in industrial production in August—the longest decline since 1960. Industrial production has now fallen by 4.8 percent in the past year; and high-tech output is down 7.2 percent on a year ago.”

Significantly this decline in production has taken place in the midst of one of the most sustained periods of interest-rate cutting undertaken by the Fed. These cuts have failed to revive the US economy because the recessionary tendencies emanate not from falling consumer demand, but from declining investment, which itself is the product of falling profit rates caused by overcapacity.

In the words of an article published in the *New York Times* of August 26: “Balance sheets are now dictating events. And these aggregations of assets and liabilities, whether they belong to a company or a consumer, are in awful shape. Corporate borrowing in recent years has been an unadulterated binge. In 2000, according to the Fed, corporations borrowed $437 billion, almost double the amount raised in 1995. Corporate debt recently stood at 85 percent of gross domestic product, a record high.”

What these figures point to is the artificial character of the so-called “new economy” boom of the late 1990s. The boom was, in fact, largely the result of increased indebtedness.

As the *NYT* pointed out: “As long as capital markets were willing to throw money at companies, they could spend more than they made. Consider how wide the gap had become between what companies spent on projects and what they made in cash flow. That difference, financed by investors and lenders, hit $251 billion at the end of last year. In 1995, it was $100 billion. Now, even as the Fed has cut rates, liquidity provided by investors and lenders is drying up.”

In the same way that a shot of adrenaline can sometimes revive a very sick patient, a fresh injection of funds—via interest rate cuts, the $40 billion of increased government spending and further tax cuts, including on capital gains—may provide a short-term boost to financial markets and even to the US economy. But they cannot overcome the fundamental problems, which were pushing their way to the surface well before the events of last Tuesday.