

Bush comments fail to halt market roller coaster

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As economic interventions go it must surely rank as one of the biggest failures in history. Since US president George Bush went to Wall Street on July 9 to deliver his speech on the need for improved corporate governance, the stock market has fallen by more than 1,500 points or 16 percent.

Bush has since followed up his Wall Street speech with some off-the-cuff remarks. Last week, indifferent to the fate of millions of ordinary people who have seen their pension and savings funds disappear, he said that America had been on a “binge” and was now suffering a “hangover.”

Then, in another attempt to revive the market, Bush claimed on Monday that corporate earnings were on the rise, price-earnings ratios were improving and that people entering the market were “buying value” rather than entering a bubble. Furthermore, he continued “the fundamentals for economic growth are real.”

All to no avail. In the wake of the \$107 billion WorldCom bankruptcy—the biggest in US corporate history—the previous day, trading opened this week with a more than 200-point fall.

This was followed by a further slide of more than 80 points on Tuesday after a report by congressional investigators revealed that Citigroup and JP Morgan Chase, the two biggest US banks, had helped the failed Enron corporation disguise its debts. Amid concerns that the two banks may be involved in arrangements similar to those at Enron, Citigroup shares fell by 16 percent and JP Morgan by 18 percent.

The falls over the past two weeks have slashed \$1.5 trillion from share values, bringing to more than \$7 trillion the total loss in market capitalisation from the peak in March 2000. According to one estimate, more than \$30 billion has been withdrawn from stock mutual funds in the past nine weeks.

Such is the nervousness in financial markets that Bush’s remarks on the soundness of the economy and good prospects for earnings are being likened by some commentators to the rosy assessments offered by US President Herbert Hoover on the eve of the Great Depression.

According to *New York Times* economics columnist Paul Krugman, Bush would do well to stop trying to talk up the market by extolling the fundamental strength of the economy. It reeks of desperation, stocks are still highly valued compared to earnings and “most important, the fundamentals aren’t actually all that great.”

“Doubts about corporate governance are growing, not fading away. State and local governments are in a desperate fiscal crisis. And even before the sudden plunge in the markets, the data were pointing not to a boom but to a ‘jobless recovery,’ in which the economy grows too slowly to make much if any dent in the unemployment rate. Indeed, the report prepared in support of [US Federal Reserve Board chairman] ... Greenspan’s recent testimony projected no significant decline in unemployment this year, and not much decline next year.”

While share prices are now back to what they were in 1997, there are suggestions that they still have some way to go. According to a report in the *Times*, the US price earnings (PE) ratio is now around 25, well below the peak of 31 in 2000. But this is still higher than the average and well above the low point of 12 seen in the bear markets of 1982 and 1974. The US market would have to fall by a further 30 to 50 percent to reach that level, even if corporate profits begin to recover.

With the US economy recording a growth of more than 5 percent in the first quarter, the claim is sometimes made that the stock market should start to

recover. After all a market fall has never taken place before during a recovery from a recession.

However, opponents of this view point out that the slide in the market is very much an indication that the first-quarter upturn was something of a “false dawn” and the US economy could well be heading for a “double dip” recession that would rapidly turn into a global downturn.

There are some indicators that support this view. The fall in European markets is an indication that more deep-seated problems than US corporate governance are at work. There are also warning signs in financial markets as gold and commodity prices have fallen with the stock markets.

Another indicator is the fall in the Australian dollar—the sixth most traded currency in the world—which has started to slide after moving up against the US dollar in recent weeks. This is taken as a sign of nervousness over global economic conditions because the Australian dollar is generally regarded as a growth currency, rising when commodity prices increase and falling in conditions of recession.

Reassurances that whatever the turbulence in financial markets, the fundamentals of the “real economy” are sound are immediately exposed upon an examination of the connections between the stock market and the economy as a whole.

The most fundamental of all the processes of the capitalist economy is the accumulation of profit. It is here that some of the major problems reside. Figures on the US economy show that after enjoying something of a revival earlier in the decade profit rates began to slide from around 1997. According to one estimate between 1997 and 2000 “the corporate manufacturing profit rate fell by 20 percent” while in the same three-year period “the profit rate for the non-financial corporate sector as a whole fell by 10 percent” [Robert Brenner, *The Boom and the Bubble*, page 209].

Yet this was the period when the share market bubble made its greatest expansion and the US boom reached its greatest heights. Sustained and “healthy” expansion in the capitalist economy is driven on by increasing profits, leading to further investment, improved productivity, higher wages and improved living standards.

The expansion at the end of the 1990s was of a different character. Rather than being fuelled by

increased profits, the increase in the growth rate was only possible because of an historically unprecedented increase in debt. Here the stock market played a key role for it was the rise in equity values that sustained the increased debt, both corporate and private, to finance increased expenditure on both investment and consumption leading to higher growth rates.

Other figures show that the US private sector deficit—the difference between income and expenditure by households and corporations—went through an 11 percentage swing. From a surplus of around 5 percent of gross domestic product (GDP) at the beginning of the 1990s it plunged to an unprecedented deficit of more than 6 percent of GDP in 2000. [See Brenner, page 176]

In the autumn of 1999, at the height of this speculative boom, Federal Reserve Board chairman Alan Greenspan declared: “It is safe to say that we are witnessing, this decade in the US, history’s most compelling demonstration of the productive capacity of free peoples operating in free markets.”

Actually the “boom” and the collapse that has followed is the most “compelling demonstration” of the growing instability of the world capitalist system.

Starting with the crisis of the British pound and the Scandinavian banking system in 1992, the past decade has seen: the US bond market crisis of 1994, the Mexican peso and banking crisis of 1994-95, the plunge of the US dollar to record lows in 1995 and its subsequent escalation, the Asian financial crisis of 1997-98, the collapse of the US hedge fund Long Term Capital Management in 1998, and the stock market bubble of the late 1990s, culminating in one of the most severe bear markets in history.

Moreover, the amplitude of economic events is growing. The past months have already seen the largest sovereign nation default in history (Argentina) and the two biggest-ever corporate collapses, Enron and WorldCom. The continued slide in financial markets indicates that there are further shocks to come.



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