As Wall Street posts sharp losses, Washington promotes "stimulus package"

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With major Wall Street finance houses posting tens of billions of dollars in new losses, housing starts declining 30 percent compared to last year, retail sales plunging and unemployment climbing to 5 percent—a two year high—the Bush White House, the Democratic congressional leadership and the Federal Reserve Board chairman all signaled Thursday their support for the passage of an economic stimulation package.

The call for enacting measures to boost the economy came as stocks plunged for the third straight day, with the Dow Jones Industrial Average falling 306.95 points, or 2.5 percent, and the technology-centered Nasdaq composite index down by 2 percent.

The latest market decline brings total losses for the S&P 500—the benchmark list of large publicly traded US corporations—to 9.2 percent since just the beginning of this year.

Analysts attributed the market's plunge to fresh indications that the US economy is sinking into recession and the growing conviction that the government is powerless to stop it.

A report issued by the Philadelphia Federal Reserve Bank Thursday showed factory production in the region contracting far more sharply than anticipated. The study's manufacturing index fell by 20.9 percent—compared to a 1.6 percent fall-off the previous month—hitting the lowest level since October 2001.

The Philly Fed report has served as a barometer of manufacturing activity nationwide, and financial analysts saw the figures as the clearest signal yet that the US is on the brink of or already in recession and that the tightening credit squeeze is spreading beyond the beleaguered housing market to the core of the US economy.

Also fueling the sell-off was the congressional testimony of Federal Reserve Board Chairman Ben Bernanke Thursday. Appearing before a House budget panel, Bernanke delivered a largely boilerplate assessment of the economy, acknowledging slower growth while insisting that the Fed was not forecasting recession. He also assured lawmakers that the Fed would not "ignore" inflation, responding to a Labor Department report this week revealing that wholesale prices shot up 6.3 percent in January, the biggest increase in 27 years.

The Fed chairman's testimony was apparently taken by Wall Street as insufficiently committed to the kind of accelerated and deep cuts in interest rates that are seen as necessary to bail out investors and stave off a market collapse. The market has already assumed that the Fed will enact another half-point cut in short-term interest rates at its next meeting at the end of this month, and there is growing speculation that a .75 percent cut is possible. It would be the first reduction of that magnitude since 1982, in the midst of the brutal tight-money regime imposed under then-Fed chairman Paul Volcker, when interest rates were raised to 20 percent.

The Fed's key rate, which now stands at 4.25 percent, has been cut three times since last September.

In his testimony, Bernanke also issued a carefully worded endorsement for the enactment of a fiscal stimulus package, declaring that it could be "helpful in principle," adding that any such measures would have to be "implemented quickly" to produce any impact on spending.

The Fed chairman's comment followed a flurry of meetings between congressional Democratic and Republican leaders and a conference call Thursday between President Bush and the House and Senate leaders of both parties to discuss the preparation of an economic stimulus package. The White House announced that Bush would deliver a speech Friday to indicate his support for such measures.

Democratic House Speaker Nancy Pelosi held a rare meeting Wednesday with Republican House Minority Leader John Boehner to discuss the drafting of legislation to boost the economy. Afterwards, Pelosi praised Boehner for his "constructive" ideas and repeatedly declared her commitment to a "bipartisan" approach.

According to published reports, what is under consideration is a $100-billion-to-$150-billion economic stimulus package—an amount that represents less than a drop in the bucket in relation to America's $14 trillion national economy and that does not begin to address the depth of the present crisis. The amount would not even cover the increases in gas prices over the last five months, much less the $2.5 trillion in household wealth that will be wiped out by the projected 15 percent decline in home prices.

While neither the Democrats nor Republicans have provided any details as to a proposed package, it appears that what is under consideration is a re-run of the measures enacted in the wake of the September 11, 2001 terrorist attacks, which took place at a time when the economy was already in recession. The heart of the program would consist of the government issuing tax rebate checks amounting to $300 per person or $600 for families. Democrats are also reportedly proposing extending unemployment benefits and increasing food stamp payments.

In the 2001 stimulus package, it should be recalled, the one-time rebate checks merely masked the real thrust of the program, which was the enactment of sweeping tax cuts for the rich and what amounted to a wholesale transfer of wealth to the top income brackets.

There is no reason to believe that the new program will be any different. Republicans in Congress have already indicated that they will seek to couple the proposed measures with the drive to make the 2001 tax cuts—due to expire in 2010—permanent. Whether they are actually joined in the same legislation or enacted separately as part of a bipartisan deal remains to be seen.

In an opinion column published this week in the newspaper *The Hill*, House Republican leader Boehner wrote, “Now as we face an economic downturn, let’s hope that we’ve learned from history and will work in a bipartisan way to make this tax relief permanent.”

Both parties appear to be agreed that the rebate checks to taxpayers should also be joined with tax cuts for big business, including tax write-offs for new investments and business losses.

As the *Washington Post* reported Thursday, the prospect of an economic stimulus program has set off a virtual feeding frenzy among corporate lobbyists. “Meanwhile, lobbying groups for industries as varied as high technology and hotels are clogging the reception rooms and e-mail inboxes of senior lawmakers, pressuring them to include the groups’ favorite benefits in a stimulus package,” the paper reported. “Small businesses are seeking to write off new equipment faster. Large businesses are appealing for lower tax rates. And home builders are pleading to offset their taxable income in years past with the losses they are suffering today.”

Whatever the final configuration of the legislation, it will do next to nothing to alleviate the crisis confronting millions of American working people facing the loss of foreclosed homes, the destruction of jobs and the steady erosion of their living standards.

More fundamentally, the minor boost in consumer spending that such a stimulation package would supposedly produce would do nothing to reverse the accelerating economic meltdown that is spreading throughout the world’s financial markets. That also was reflected in the sell-off on Wall Street Thursday.

A survey of the series of economic shocks that have emerged over the last several days makes clear the magnitude of the crisis and the utter inadequacy of the measures proposed in Washington.

On Thursday, Merrill Lynch announced $10 billion in losses for the fourth quarter of last year. It also was forced to write down $14.6 billion in assets, some $11.5 billion of which were related to Collateralized Debt Obligations, which consist of mortgage debt aggregated into bundles, then sliced up and resold in the form of securities. Merrill was the biggest dealer in such assets. The firm’s losses were three times greater than expected.

Merrill’s losses followed those of Citigroup, which announced Tuesday that it will write down some $18 billion in bad mortgage debt and will be laying off an additional 4,000 workers on top of the 17,000 layoffs it announced last spring. JP Morgan Chase followed suit on Wednesday, but with a smaller, $1.3 billion write-down.

Citigroup lost a total of $9.38 billion in the fourth quarter, and is seeking to issue some $12.5 billion in preferred stock to offset the losses. The principal buyers are the government-owned Singapore Investment Corporation, which will buy $6.88 billion, the Kuwaiti Investment Authority, and Saudi Prince Alaweed bin Talal. Citigroup’s losses amounted to twice what had been expected by financial analysts. Merrill Lynch is also seeking to bail itself out by issuing some $13 billion in preferred stock, with the aim of selling it to state-connected investors in the Middle East and Asia.

The report of Merrill Lynch’s write-downs came on the same day as the Commerce Department released data showing housing starts and new building permits had fallen by 30 percent since last year, the largest annual drop since the beginning of the 1980 recession. The data indicates that builders are retrenching sharply in response to the drop in housing demand. Home prices have fallen 6 percent over the year ending in October 2007.

The downturn in the real estate market, which began in 2006, has wiped out sizable portions of homeowner equity and made it impossible for many homeowners to pay the risky mortgages lenders had encouraged them to take out. The downturn led not only to an exponential increase in foreclosures, but to a rise in personal bankruptcies and defaults on credit card debt. Banks are already beginning to take account of this. To give one example, JP Morgan raised its provision for losses in retail financial services, such as home equity loans, to $1.1 billion for the coming year, up from $169 million last year. The banks observed that many people were tottering on the edge of insolvency in 2007, and expect large numbers of them to fall off in 2008. The provision for credit card losses was also increased by 40 percent to $1.8 billion.

The past few days have brought more unfavorable news on both inflation and consumer spending. According to figures released Tuesday by the Commerce Department, seasonally adjusted retail spending fell by 0.4 percent in December, indicating that the housing crisis, together with the recent short-term rise in consumer prices and unemployment, led people to reduce their discretionary spending. In 2007, retail spending grew at the slowest rate since the 2003 recession. This follows last week’s announcement that unemployment rose from 4.7 percent in November to 5 percent in December.

This reduction in consumer spending has been exacerbated by high rates of inflation on food and energy. Both the Producer Price Index (PPI) figures released Tuesday and Consumer Price Index (CPI) figures released Wednesday point to significant inflationary trends. The PPI, which is particularly sensitive to food and energy prices, rose by 6.3 percent in 2007, the largest annual increase in over 25 years. By comparison, the same index registered a 1.1 percent increase in 2006. Consumer price index data released Wednesday paints a similar picture. The figures show that consumer prices rose by 4.1 percent over the whole of 2007, the highest rise since 1990. CPI inflation figures in December were higher than predicted, coming in at .3 percent instead of the expected .2 percent.

The recent figures point to a serious possibility of stagflation, raising the prospect that attempts to use monetary policy to combat recession will only intensify inflationary pressures. Concurrent with the danger of inflation, the Fed’s credit easing policy is tending to exacerbate the depreciation of the dollar relative to other currencies.

As Citigroup, Merrill Lynch and other finances houses were announcing their staggering losses for the last quarter, Wall Street released one other telling figure. Bonuses paid out for the five biggest financial firms topped a record $39 billion in 2007, the vast bulk of this fortune going to a relative handful of top executives. They pocketed these immense sums even as their shareholders suffered losses of more than $80 billion and as they prepared the wave of mass layoffs that is now beginning to sweep through the finance industry.