US cuts interest rates amid fears of global financial collapse

Andre Damon
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The US central bank made its deepest interest rate cut in a quarter of a century Tuesday in an attempt to prevent a two-day wave of sell-offs on world financial markets from sweeping through Wall Street. The Federal Reserve Board announced its decision to cut its target interest rate by .75 percent barely an hour before the New York Stock Exchange reopened following a Monday shutdown in observance of Martin Luther King Day.

The clear aim was to dissuade investors from a panicked run on US equities similar to those seen in Asia and Europe while Wall Street had remained closed. The Federal Reserve tried to assuage the markets by providing a larger than expected cut—.75 percent instead of .50—and introducing it eight days before a regular Federal Open Market Committee meeting scheduled at the end of the month.

It was far from clear that the cut produced the desired effect. The Fed's emergency action gave more the impression of a panicked attempt to stave off catastrophe, confirming the growing conviction that the US economy is sliding into recession, regardless of attempts at either monetary or fiscal stimulus.

Before the start of trading on Tuesday, US stock market futures hit their lowest allowed limits and trading was suspended. They rebounded in response to the Fed's announcement. The Dow initially plummeted almost four percent below Friday's closing value, but regained strength later in the day. It ended the day down by a little over one percent, to a 15-month low. The NASDAQ fell by 2 percent. It was the most volatile day for US stock markets in five years.

Tuesday's emergency Fed meeting implemented the largest rate cut since 1984, and the biggest emergency cut the Fed ever made in between its regular meetings. The Federal Reserve lowered the federal funds rate to 3.5 percent from its initial rate of 4.25 percent, and reduced its discount rate it charges for direct loans to banks to 4 percent.

The cut came after Asian Markets suffered even worse losses on Tuesday, as major indexes fell faster than they did Monday, the worst day for global equities trading since September 11, 2001. The Fed's announcement came after most major Asian markets had already closed. The Australian ASX index fell by 7.05 percent in its greatest single-day loss in over 20 years, and Indonesia's JSX lost 7.7 percent. Hong Kong and China suffered the largest losses, with the FTSE Xinhua 200 and Hang Seng indexes falling by 7.5 and 8.6 percent, respectively.

Indian Markets were again among the most volatile on Tuesday. The Bombay Stock Exchange was shut down for an hour Tuesday after suffering an 11.5 percent drop in the first few minutes of trading. The market ended the day with an overall loss of 5 percent.

The Fed's announcement came in the middle of the European trading day, and led to a rebound after major indexes fell sharply during the morning. The European indexes closed up for the day, with the British FTSE 250 up 3.8 percent and the French CAC 30 regaining 2 percent. The Spanish IBEX 35 ended the day up by 1.69 percent.

The FOMC's official announcement of the rate cut states: "The Committee took this action in view of a weakening of the economic outlook and increasing downside risks to growth. While strains in short-term funding markets have eased somewhat, broader financial market conditions have continued to deteriorate and credit has tightened further for some businesses and households. Moreover, incoming information indicates a deepening of the housing contraction as well as some softening in labor markets."

Despite the Fed's cutting rates lower and faster than expected, Wall Street is still clamoring for more. Jamie Chisholm, Deputy Markets editor at the *Financial Times* noted Tuesday, "apparently, people in the Chicago futures pit were a bit disappointed with the Fed's 3/4 point cut," and would have preferred to see a full percentage point cut. Markets are currently taking for granted that the FOMC will cut the lending rate once again by .50 percent at its regularly scheduled meeting in a week.

The two-day global sell-off signaled a growing realization that the US "credit crunch" that has been developing since last summer, forcing major Wall Street finance houses to write off hundreds of billions of dollars in assets, poses a mortal threat to the functioning of the world capitalist economy as a whole.

The economic myths about the "decoupling" of the so-called emerging markets and even the European Union from the American economy have been dashed by the worldwide stock market debacle. While trade within Asia has dramatically expanded in recent years, its economies are still largely dependent on US imports; much of the new trade consists of exchange in parts and components that are assembled in China, and shipped out to the United States and Europe.

Although Europe is now a larger importer of Chinese goods than the US, there are signs that European growth is also slowing, and there are significant fears about the extent to which Europe's

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financial system is contaminated with bad mortgage debt from the US. Chris Brown-Humes, Markets Editor at the *Financial Times* recently noted in relation to Europe, "We have absolutely no sense of how bad the US housing market is going to get, and we have no sense of how bad the credit losses being suffered by the banks will be."

"What is notable is that there is not a single sector in Europe that is above the water at the moment," commented *Financial Times* Investment Editor John Authers.

Now international analysts are referring to the "American contagion," much as they referred to the "Asian contagion" during the financial crisis that gripped much of East Asia beginning in 1997.

Signs of the deepening crisis in the US continued to mount even as the Fed carried out its emergency intervention. Bank of America Tuesday reported fourth-quarter losses of $5.44 billion, due in large part to write-offs of subprime-related securities. Likewise, Wachovia said its earnings fell by almost half. The bank wrote down some $1.7 billion in bad debt and allocated a further $1.5 billion to cover additional defaults.

The sharpest concern underlying the Fed's emergency rate cuts was a potential collapse of Wall Street's bond insurance market. Ambac Financial, a large bond insurer, reported a loss of $3.26 billion on Tuesday and announced that it would be making a $5.21 billion write-down. The firm recently lost its AAA rating amid fears that it might default on its debt. ACA, another bond insurer, only managed to avoid bankruptcy recently as major banks intervened yesterday to prop it up. Companies like Ambac and ACA, referred to as monoline insurers, secure an estimated $2.4 trillion in debt worldwide.

Analysts have speculated that a default by Ambac could lead other bond insurers to follow suit, potentially setting off a worldwide cascade of defaults. "The biggest near-term risk to all credit—and with it all asset classes around the world—seems to be from the potential unraveling of the monoline sector," Jim Reid at Deutsche Bank told the *Financial Times*. "The downside risk could be extreme."

The panic in the worldwide equities markets has unfolded in response to the growing threat of a massive readjustment in the world economy—including a sharp devaluation of the dollar and a permanent fall in US consumer spending.

Neither the Fed's actions, nor the Bush Administration's puny fiscal stimulus package, will be enough to prevent a US recession.

Although the rate staved off—at least for a day—a panic on Wall Street similar to those seen on stock exchanges in Asia and Europe on Monday, markets are almost unanimously pricing in a recession in 2008, regardless of what the Fed does. Currently, the Fed's first priority is to bail out the banks and stabilize the financial system by injecting massive amounts of liquidity. Monetary policy, however, cannot ward off a coming recession because the present crisis is not ultimately rooted in financial institutions' inability to borrow, however important this problem may be in the short term for preventing a market collapse.

What is involved is not a conjunctural financial downturn, but rather a systemic crisis of the world capitalist system that finds its sharpest expression in the decline of the global position of American capitalism.

Underlying the present financial turmoil is the unraveling of economic processes bound up with financial speculation that has been developing over the course of some three decades. From the early 1980s, responding to the protracted decline in the profitability of US manufacturing, the American ruling class embarked upon a relentless assault on the wages and basic rights of the working class, thereby effecting a wholesale redistribution of social wealth upward to the financial elite. This was combined with a turn away from production—except in those areas offering the lowest labor costs and highest profitability—and towards an economy continuously more dependent upon financial speculation, parasitism and outright fraud.

As the present worldwide stock market crisis has made clear, the decline of US capitalism has robbed it of the ability to sustain the world markets, but left it with sufficient negative weight to drag the rest of the world economy down with it.

The immediate credit crisis stems from mounting consumer insolvency, which is in turn rooted in the massive amounts of debt taken on by workers in response to the fall in their wages and rising costs of living.

The unsustainable process of household debt accumulation began to unravel in 2005-06, when housing prices began to fall and homeowners defaulted on their mortgages in record numbers. In recent months, increased default risks have spread into other areas of consumer debt, with banks increasing their provisions for future defaults, in some cases by as much as an order of magnitude.

The drive by the US ruling class to systematically impoverish the vast majority of the population to the point where they cannot afford to pay their debts is producing an economic readjustment on a scale not seen in decades. The present social order offers no avenue to ward off such a catastrophe, since the scale of debt forgiveness, job creation programs and income support necessary to avert recession cannot be implemented without a sweeping redistribution of wealth from the super-rich to the vast majority of the population.

Such a solution can arise only out of the independent political mobilization of the masses of working people in a conscious struggle for the socialist transformation of the present world economic system.

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