# US recession fears provoke continued market turmoil

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The US stock market experienced its most volatile trading since 2002 on Wednesday, opening in near panic and plummeting more than 300 points before a late day rally that brought the Dow Jones up by 2.5 percent, erasing the sharp decline of the past three days. The SEP 500 rose by 2.53 percent, and the NASDAQ by 1.05 percent.

Wall Street's roller coaster ride followed the rebounding of Asian stock markets and a sharp fall on European markets, as fears of a US recession continued to dominate the affairs of global capitalism.

Much of the American markets' rally was attributed to reports that regulators are arranging a bailout of crisis-stricken bond insurance firms MBIA and Ambac. New York Insurance superintendent Eric Dinallo met with Bank executives Wednesday to attempt to raise $15 billion in capital for the struggling insurers. The markets had been gripped by a growing fear that a default by the bond insurers would ripple through the rest of the finance sector, setting of a cascade of credit downgrades and a potential financial collapse. Shares in both MBIA and Ambac shot up by 10 percent Wednesday as investors hoped to benefit from a possible capital injection.

European stock markets took another sharp fall Tuesday, after Jean-Claude Trichet, president of the European Central Bank, made it clear that he did not intend to follow the Federal Reserve's lead in implementing sharp rate cuts. European markets mostly erased yesterday's recovery after Trichet's speech. The German DAX suffered a 4.88 percent fall Wednesday, the steepest out of the major European indexes. The French CAC-40 and Spanish IBEX 35 also lost over four percent. The British FTSE 100 fell by 2.28 percent, while the Russian RTS also plunged by 3.9 percent.

Asian stocks rallied after dropping as much as 14 percent over the previous two days. Hong Kong's Hang Seng index recovered by 10.72 percent on Wednesday, after falling 5.5 percent on Monday and another 8.7 percent on Tuesday in its largest two-day loss since the Asian Financial Crisis of 1997-98. Japan's NIKKEI index was up by 2.04 percent, and the Australian ASX broke its 12-day losing streak, closing the day up by 4.35 percent. The Federal Reserve announced Tuesday's .75 percent rate cut after the Asian markets had closed, and today's rally came largely in response to the announcement.

A number of analysts had previously called for coordinated action between the US and European central banks to prop up credit markets and avoid recession, but this is proving impracticable, as banks on the two continents seem to be operating with different goals. While central banks of both the US and Europe are under pressure from concurrent inflationary and recessionary tendencies, they put different relative weights on which to fight.

The European Central Bank, facing higher inflation, is aiming to keep rates higher, while the Fed, facing imminent prospects of a US recession and banking collapse, has engaged in what many have described as a panicked slashing of interest rates. Inflation in Europe is currently at 3.1 percent, far above the ECB's target of under 2 percent. "In demanding times of significant market correction and turbulences, it is the responsibility of the central bank to solidly anchor inflation expectations to avoid additional volatility in already highly volatile markets," ECB president Trichet said on Wednesday. Bank of England Governor Mervyn King also made it clear on Tuesday night that he did not favor sharp rate cuts, even while warning that the British economy faced a period of slower economic growth. Leaders at the Bank of Japan expressed similar sentiments.

On Tuesday, markets were pricing in a quarter-point rate cut by the ECB by May, and, despite Trichet's hawkish speech, the expectation of rate cuts remains. The European economy grew at 2.6 percent in 2007, and the new estimates by the European Central Bank predict a growth rate of 1.8 percent in the following year, down from the November estimate of 2.2 percent. There have been a number of critics within the bank who say that even this new estimate is unreasonably high.

Meanwhile, the Federal Reserve's decision to sharply cut interest rates at its Tuesday emergency meeting has been under attack from all sides. The politicians, business leaders and analysts gathered at the World Economic Forum in Davos had mostly unkind things to say about the Fed's reaction to the crisis. In its coverage of the event, The *Financial Times* noted, "In one session, almost 60 per cent of the delegates voted in favour of a motion saying central banks had lost both their focus and control with respect to economic governance."

Stephen Roach of Morgan Stanley called the Fed's response "a dangerous and reckless and irresponsible way to run the world economy," denouncing it as "market-friendly action." He commented, "Is that the way to run a central bank?" The billionaire investor George Soros raised similar criticisms, implying that the sharp cut amounted to a panic response.

A number of critics denounced the Fed's moves on the grounds that it would do little to prevent a US recession. Joseph Stiglitz, a Nobel prize-winning economist, criticized the Fed for responding to the downturn "too late". Moreover, he warned, with the housing market expected to fall even further and a credit crisis rooted in systemic problems, the Fed's attempt to avert recession with rate cuts would be as effective as "pushing on a piece of string."

"The system which supported the US credit markets has collapsed," Yuuki Sakurai, an executive at Fukoku Mutual Life Insurance in Tokyo told the *New York Times*. "Merely easing rates will not solve the root problem."

George Soros wrote along similar lines in a *Financial Times* column Wednesday, saying that inflationary trends are likely to undermine the Fed's ability to regulate the economy through monetary policy. "Until recently," he said, "investors were hoping that the US Federal Reserve would do whatever it takes to avoid a recession, because that is what it did on previous occasions. Now they will have to realise that the Fed may no longer be in a position to do so. With oil, food and other commodities firm, and the renminbi [China's currency] appreciating somewhat faster, the Fed also has to worry about inflation. If federal funds were lowered beyond a certain point, the dollar would come under renewed pressure and long-term bonds would actually go up in yield. Where that point is, is impossible to determine. When it is reached, the ability of the Fed to stimulate the economy comes to an end."