Recession takes hold in US

Barry Grey 15 April 2008

The US stock market plunged Friday on news that General Electric's first-quarter 2008 profits fell far below the company's projections. Long considered among the most gilt-edged of stocks, GE shares fell 13 percent, their sharpest one-day drop since the stock market collapse of October 1987.

The announcement that GE's first-quarter earnings were down 5.8 percent stunned Wall Street, which was confident the company would meet its earlier projections since it had reaffirmed those predictions only weeks before, on March 13. GE Chairman Jeffrey R. Immelt attributed the profit decline, mainly the result of large write-downs of assets in its financial business, to the intensification of the credit crunch in the wake of the collapse of Bear Stearns on March 14.

"The last two weeks in March were a different world in financial services," GE Chairman Jeffrey R. Immelt said in a conference call to investors.

However, the company also saw profits fall in its healthcare and industrial branches. GE cut its forecast for all of 2008. The one-day stock decline wiped out \$44 billion in share values.

GE's results shook the financial markets because they indicated that the impact of the housing and credit crisis was spreading beyond the housing and banking sectors to broader parts of the US economy. GE's report came at the beginning of the first-quarter earnings report season, and seemed to confirm the worst fears on Wall Street that profits will drop sharply nearly across the board.

These fears were compounded by the earnings report earlier in the week by the aluminum giant Alcoa, which said high energy costs had helped push its profits down 54 percent in the first quarter. Also last week, United Parcel Service said its quarterly results would be as much as 12 percent below expectations because of rising fuel costs and falling package shipments.

The Dow Jones Industrial Average fell 257 points, or

2 percent, on Friday. The Standard & Poor's 500 Index also fell 2 percent, and the Nasdaq Composite Index plunged by 2.6 percent.

Also on Friday, a report issued by the University of Michigan on US consumer confidence augured a rapid slowdown in the American economy. The index, measuring consumer sentiment this month, fell by 6.3 points to 63.2 points, the lowest level since March of 1982, when the country was in the grips of the most severe downturn since the Great Depression.

Underscoring the growing pessimism and economic distress within the US population, a Pew Research Center report found that the percentage of Americans saying they are better off than they were five years ago is at its lowest level in 44 years of polling.

On Monday, the Commerce Department reported a mere 0.2 percent increase in retail sales in March, underscoring the slump in consumer spending, which accounts for more than two-thirds of the US economy. Americans actually spent less on furniture, clothing and appliances in March, and overall sales registered a slight increase only because of soaring prices for gasoline and food.

These developments coincide with the release of the International Monetary Fund's World Economic Outlook report, which projects a sharp decline in both US and global economic growth.

This week, major US banks and finance houses publish their quarterly earnings reports, and they are expected to show continuing huge losses from mortgage-backed securities and other speculative investments that have gone bad. Analysts expect JPMorgan Chase to report a near-halving of its profits.

Far worse is anticipated in the reports from Citigroup, the largest US bank, and investment bank Merrill Lynch. The former is expected to report more than \$10 billion in additional write-downs and the latter more than \$7 billion in new losses. These markdowns come

up top of billions already reported since the eruption of the credit crisis last summer.

At Citigroup, analysts anticipate a net loss for the first quarter of \$5.7 billion, after a \$9.8 billion net loss in the final quarter of 2007. Merrill Lynch is also expected to report its second consecutive quarter in the red, with an estimated first quarter loss of \$520 million.

Last week, Washington Mutual, the biggest US savings and loan company, obtained a \$7 billion cash infusion to ward off possible collapse by selling shares of its stock to investors at a steep discount. On Monday, Wachovia, the fourth largest US bank, announced a first-quarter loss of \$393 million, confounding analysts who had predicted a profit. The bank also announced a 41 percent cut in its dividend and said it would raise \$7 billion in capital by selling its stock at a discount.

Tens of thousands of jobs in the financial services industry have already been eliminated over the past eight months, but the carnage has only begun. Wall Street firms are estimated to have cut over 34,000 jobs, but according to one financial research company a total of 200,000 jobs just in the commercial banking sector could be cut over the next 12 to 18 months.

Analysts at Celent LLC issued a report last Tuesday saying they expected US commercial banks to eliminate 200,000, or ten percent, of their 2 million jobs. This does not count tens of thousands of job cuts likely to be carried out by investment banks and other financial companies.

Citigroup alone is drawing up a cost-cutting plan that could involve the elimination of over 25,000 of its 370,000 employees. Merrill Lynch is expected to slash more than 2,000 jobs.

And the job-cutting is spreading to other sectors of the economy. Last week, the Silicon Valley chip-maker Advanced Micro Devices announced it would cut 1,650 workers, about 10 percent of its work force. Google said it would eliminate 300 jobs from the US operations of DoubleClick, an advertising technology company it recently acquired.

The downward spiral in economic activity is being fueled by the banking crisis, which has resulted in a sharp contraction in lending. Stocks and corporate profits boomed following the 2000-2001 recession on the basis of cheap and plentiful credit, which was itself largely based on vastly inflated housing values and

financial speculation.

Now, the credit crunch is hitting growing sections of the economy, slowing capital investment, driving down profits and leading to higher unemployment, a wave of home foreclosures and economic desperation for millions of working class families. The slump in consumer spending and fall in home values, in turn, deepen the financial crisis of the banking system.

The consulting firm Greenwich Associates reported that of 293 large companies surveyed world-wide, most are suffering from tightened credit conditions. Among US companies, 63 percent said they were paying more for bonds and revolving credit, and 62 percent were paying more for loans.

This downward spiral has battered hopes on Wall Street that the economic turmoil could be limited to a few economic sectors and that stock prices, which have fallen 13 percent since their October, 2007 high, could revive.

According to an article in the *Los Angeles Times*, estimated first quarter profit growth for the tech sector of the S&P Index has fallen from 14 percent on January 1 to 7 percent now. The industrial sector is expected to post growth of just 1 percent, down from an estimated 8 percent on January 1.

For the S&P 500 as a whole, first quarter earnings are expected to be down 14 percent from a year earlier, largely because of continuing losses at financial companies.

But the results posted by GE and Alcoa suggest that profits could take an even bigger hit.

Another stark indicator of the downward trajectory in both the US and other countries was provided Friday by the International Energy Agency, which made its biggest reduction in world oil demand growth estimates in seven years. It cut its projection of world oil demand growth by 35 percent from its January estimate.



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