US stocks plunge, job cuts spread

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Stocks plummeted yesterday amid worsening expectations for financial firms and record oil prices. The Dow Jones Industrial average fell 358 points, or three percent, to its lowest level since September of 2006. All 30 stocks in the index posted declines, with Dow closing at 11,453.42, down more than 2,500 points since its all-time high last October.

The broader S&P 500 lost 39 points, or 2.9 percent, while the technology-focused NASDAQ index fell nearly 80 points, or 3.33 percent, its worst one-day drop since January. Stock indexes throughout Europe and the Americas fell past their low points during the Bear Stearns crisis in March.

Financial stocks were the first to fall, as investors became convinced that more losses and write-offs and were on their way. Citigroup led the rout, falling by 6.3 percent after Goldman Sachs recommended that its clients sell the bank's stock. Goldman reported that it expects Citigroup to announce about $9 billion in write-offs in the second quarter.

General Motors stock plummeted after Goldman downgraded the company's outlook, falling 11 percent to its lowest levels since 1955. The firm faces a very poor outlook as gas prices have skyrocketed and consumers have stopped buying highly profitable sport utility vehicles. GM's SUV sales have dropped 27 percent.

The latest fall was the consummation of a month of rapid economic deterioration. The Dow has fallen over nine percent this month, in what Bloomberg.com called "the worst June since the Great Depression." Oil hit a new record of $140.39, rising $5.84 in one day.

There were reports in the financial press of widespread concern in the market that GM might be unable to raise sufficient capital and would be forced to default on some debts or even file for bankruptcy. Reuters quoted one financial analyst declaring, "The market is back to pricing some bankruptcy risk" for the largest US automaker.

These fears are directly measurable in the credit default swap market, where the cost of insuring against a GM default rose to 33.5 percent upfront. According to a Reuters report, this is the equivalent of a market expectation that there is a 25 percent chance of a GM debt default this year, and a 75 percent chance of a GM debt default in the next five years.

The same market required 30.5 percent upfront for Ford Motor Company debt, which translates into a 22 percent chance of default this year and a 70 percent chance of default by 2012. GM's position in the credit default swap market is now worse than it was in 2005, when its debt rating was cut to junk bond status. The Fitch credit rating service cut both GM and Chrysler's rating Wednesday.

Firms relying on discretionary consumer spending were especially hard hit. Nike and mobile device manufacturer Research in Motion forecast lower growth and slimmer profits in the coming period. Markets responded by pushing their prices down by 9.8 and 13.26 percent, respectively.

Meanwhile the broader corporate outlook has continued to deteriorate. Bloomberg expects profits for the S&P 500 firms to grow by only 6.6 percent this year, compared to a predicted profit growth of about 15 percent six months ago.

The declining outlook for consumer-oriented firms comes despite the fact that the weak dollar has made US exports more competitive. US growth has thus far avoided falling into negative territory in large part due to the stimulative effects of the dollar decline on US exports.

Recent job cut announcements, particularly in the airline sector, formed the background of Thursday's selloff. United Airlines announced this week its plans to lay off 950 pilots and reduce its fleet by 100 aircraft. The pilots represent about 15 percent of its total cabin crew. The layoffs follow last weeks anouncement that the airline would remove some 1,500 salaried positions.

United Airlines posted a $537 million loss in the first three months of the year. Since then, fuel prices have increased by over 30 percent, and second-quarter losses are expected to be significantly higher. The airline expects to cut its capacity by about 10 percent year-on-year by the fourth quarter.

A recent survey by airlineforecasts.com, an airline investment consultancy, warned that, given current oil prices, the U.S. airline industry would see job cuts of between 75,000 and 85,000. Some 11,500 would be pilots.

Meanwhile American Airlines and its smaller affiliate, American Eagle, announced that they would eliminate routes between a number of hub cities. Last month, American announced that it would cut its capacity by 11-12 percent from 2007 levels. Delta and Northwest Airlines, which are scheduled for a merger, are each planning to trim copacity by a similar amount, while United and US airways are cutting even further. They plan to get rid of 17 percent of their workforces in the coming period.

Airlines posted a net profit last year for the first time since 2000. But the combined effects of exponential commodity price increases and slowing economic growth are setting up airlines for record losses this year. According to the Air Transport Association, airlines could lose as much as $2.3 billion this year, based on a projected oil price of $106 per barrel. Crude prices have by now significantly exceeded this value and show no signs of slowing down. The seven largest airlines announced operating losses of 5.2 percent in the first quarter, down from a profit of 2.5 percent in the same period last year.

The credit crisis has already taken its toll on the financial workforce, and the deepening of the crisis will bring with it even more layoffs. Financial firms have sent out some 83,000 pink slips over the past year, and the *Financial Times* reports that layoffs could be double that figure during the next year.

There were other negative numbers announced this week. The consumer confidence index published by the Conference Board fell to 50.4 in June, down from 58.1 in May, its lowest point since January and February 1992.

Standard & Poor’s Case-Shiller home price index, released Tuesday, showed home prices falling in all 20 of the metropolitan areas surveyed. Mortgage defaults and foreclosures continue to rise.

The conditions are accumulating for a dramatic contraction in the US economy, with enormous consequences for the world economy as a whole. The inexorable run-up in gas prices is hitting both consumer and business spending. This is exacerbated by inflation in other commodity prices and the disruption of credit markets, which has made it more difficult for businesses to borrow.

The sharp fall in stock prices in June has already offset whatever stimulative effect was produced by the federal tax rebates. By driving down interest rates, mailing out $1,200 rebate checks, and guaranteeing de facto that the US government would bail out struggling banks, the Fed and the Treasury were able to engineer a temporary respite in the downturn. But this has proved ephemeral.