Global markets plunge on fears of deflation and depression

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Further multibillion-dollar losses hit share markets worldwide over the past two days, driven by fears that a deflationary spiral could lead to global depression. While government and media commentators are still attempting to assure the public that there could be no repeat of the 1930s, the money markets are telling a different story.

Within the pages of the financial press, it is now being openly conceded that, for all the official assurances, every government intervention and bid for international coordination has failed to stem the economic meltdown. In the *Wall Street Journal* yesterday, Peter A. McKay observed that, "government is running out of ammunition to stabilize the financial system and the economy."

In a similar vein, John Durie wrote in the *Australian*: "The word is finally out—NOTHING IS WORKING—and, as a result, global stock markets are in freefall." Durie noted that the US administration and the Chinese leadership had each committed close to $1 trillion to rescue packages "and the world is still sinking".

The rout continued when the CEOs of General Motors, Ford and Chrysler, as well as United Auto Workers (UAW) union bosses, failed to win US congressional backing for an unprecedented $25 billion bailout of the Big Three to avert collapse. After two days of talks in Washington, the bailout was rejected, at least in its initial form, despite all the participants, including the UAW, agreeing that autoworkers' jobs and conditions must be further shredded in any rescue package.

On top of falls of more than 5 percent on Wednesday, US shares crashed at the end of the day Thursday, after earlier rising briefly on rumors of an auto agreement. By the end of a roller-coaster day, the Dow Jones industrial average had fallen almost 445 points, or 5.6 percent, to 7,552.29. The Standard & Poor's 500 Index plunged further, losing 54.14 points, or 6.7 percent, to 752.44—its lowest level in more than 11 years.

The wild swings expressed elements of sheer panic and instability. On Wednesday, the Chicago Board Options Exchange Volatility Index, known as Wall Street's fear gauge, shot up 10.1 percent to 74.45, which indicated mounting distress.

Fueling the sell-off were concerns that the recession could not only be deeper and longer than previously feared, but could also enter what Sheryl King, senior US economist at Merrill Lynch, termed "a corrosive deflationary phase." Deflation is seen as a precursor to depression, because falling prices can generate an ever-downward spiral of corporate losses, production cuts, mass layoffs and reduced demand.

As has been the case for the past 16 months, the US remained the epicenter of global turmoil, with new data showing accelerating job losses, plunging housing construction, falling consumer prices and crises afflicting financial giants such as Citigroup and GE. Minutes from the last Federal Reserve policy meeting predicted economic contraction at least until the end of the 2009. "It's a perfect economic storm, which is a combination of an ordinary recession, housing collapse, the credit crisis and major asset deflation," Barry Ritholtz, Fusion IQ's CEO and director of equity research, told journalists.

The global dimensions of the slide into slump were highlighted by Japanese Finance Ministry data reporting that exports from the world's second-largest economy declined 7.7 percent in October from a year earlier, their biggest drop in almost seven years. Underscoring the dependence of Japanese and Asian capitalism as a whole on the US market, the results helped send Asian stocks into a tailspin for a second successive day yesterday.

Tokyo's benchmark Nikkei shed 570.18 points to 7,703.04, its lowest close since October 28—the day it touched a 26-year intraday low of 6,994.90. It was its biggest one-day percentage loss since October 22. So far, the Nikkei has lost 9 percent this week and 10 percent this month. Economists now predict another three quarters of contraction in Japan's economy, bringing the sequential decline to five straight quarters, the longest on record.

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Battered by deeper mining and financial falls, Australia's S&P/ASX 200 ended 4.2 percent lower at 3,252.90, its lowest closing level since early 2004. Hong Kong’s Hang Seng Index closed 4.3 percent lower at 12,264.34. South Korea's Kospi ended down 6.7 percent at 948.69, marking its eighth straight losing session.

European stocks also fell as fears of a deepening recession hammered shares in banks and raw material producers. The FTSEurofirst 300 index of top European shares closed at 781.06 points, its lowest close since April 2003, with the losses led by the firms most exposed to the economy, like mines and banks, which were shaken after Citigroup shares tumbled and investors questioned the US bank's survival prospects.

ArcelorMittal the world's top steelmaker, dropped 12.4 percent. Aviva, the UK insurer that had £359 billion of assets under management at the end of June, dropped 15.5 percent. With oil futures skidding under $50 a barrel, producers including Royal Dutch Shell and utilities such as E.On dropped sharply.

Underscoring the grim trends, job cuts of between 1,400 and 2,700 each were announced on Thursday by AstraZeneca, Rolls Royce, Sandvik and Peugeot Citroen. In Britain, BAE Systems, building materials manufacturer SIG and investment firm Fidelity International also announced significant job cuts. British retail sales fell by another 0.1 percent in October.

It was the US, however, that continued to produce the worst news. The number of US workers filing new claims for jobless benefits rose by a larger-than-expected 27,000 last week to their highest level in 16 years, the Labor Department reported. Initial claims for state unemployment insurance benefits were a seasonally adjusted 542,000 in the week, from a revised 515,000 the previous week. That was higher than analysts' forecast for a reading of 505,000 new claims. Continuing claims stood at 4.012 million in the week ended November 8, the latest data available, up from 3.903 million the prior week and the highest since December 1982.

Minutes from the Federal Reserve's policy meeting showed, some officials believe, that unemployment could go as high as 8 percent by next year. (The official jobless rate reached 6.5 percent in October.)

The minutes revealed concerns of a deflationary spiral that the Fed would lack the power to counteract because interest rates are already so low. Such a development “would pose important policy challenges,” the Fed said. Further stoking those fears, consumer prices fell by 1 percent in October, the steepest drop since the government began monthly records in 1947, a Commerce Department report showed on Wednesday.

Housing figures were also bleak. US builders commenced homes at an annualized rate of 791,000 in October, the lowest number since the Census Bureau began tracking housing in 1959 when there were about 50 percent fewer households nationally. In September, there were 394,000 unsold new homes and more than 4 million existing homes on the market (many of the existing homes were foreclosed properties). Each number represents about 10 months of inventory

There were signs that the financial implosion is far from over. Citigroup shares sank 24.2 per cent to $4.85 yesterday, on top of a 23 percent fall the day before, after the bank took on more than $17 billion in dubious assets from structured investment vehicles. Citi also shut another hedge fund, which once had more than $4 billion in assets. The fund has since dwindled to less than $60 million, while its debt is about $880 million.

General Electric is to shrink GE Capital, a major provider of consumer credit, in a move that could lead to $2 billion in cost cuts, the sale of $90 billion in highly leveraged assets and thousands of redundancies among its 75,000 employees. JPMorgan Chase plans to cut 10 percent of its investment banking staff, or about 3,000 employees.

While these financial giants struggle to stay afloat by offloading their toxic liabilities, it is increasingly clear that world capitalism is experiencing a fundamental breakdown on the scale of the Great Depression of the 1930s, threatening to devastate the livelihoods and social conditions of hundreds of millions of working people on every continent.

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