

# Stock market gyrations reflect fears of protracted global slump

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Stock markets in the US and internationally declined sharply Monday before recouping some of their losses on Tuesday. The volatility reflects concerns that despite recent gross domestic product (GDP) growth registered by several major economies, the global economic crisis continues to deepen.

The US Dow Jones Industrial Average index fell 0.8 percent Friday and another 2 percent Monday, before recovering somewhat with a 0.9 increase yesterday. Standard & Poor's 500 index was up 1.0 percent yesterday after declining 2.4 percent Monday.

A similar trend was evident on world markets. On Monday, China's Shanghai Composite index fell 5.8 percent—its largest one-day decline since November last year, Japan's Nikkei 225 fell 3.1 percent, the German DAX lost 2 percent, France's CAC 40 fell 2.2 percent, and London's FTSE 100 declined 1.5 percent. These markets clawed back some ground yesterday, but all remain lower for the week.

The volatility coincided with Germany, France, and Japan reporting positive second quarter GDP growth. Many economists are also anticipating that US GDP will return to positive territory in the third quarter, in part due to the government's "cash for clunkers" subsidy for new car purchases.

"Markets are reflecting fears the world economy will have trouble weaning itself off government stimulus," the *Wall Street Journal* commented. Several economists noted that the return to positive GDP growth is due to coordinated multi-billion-dollar fiscal stimulus measures, rather than any rebound in private sector economic activity. There are widespread fears of a renewed downturn once the stimulus impact ends.

International Monetary Fund chief economist Olivier Blanchard warned that while there are signs of a "nascent recovery," fiscal stimulus in most advanced economies cannot continue much longer because of mounting public debts. "The world is not in a run-of-the-mill recession," he stated in a feature article for the IMF's *Finance and Development* magazine. "The turnaround will not be simple. The crisis has left deep scars, which will affect both supply and demand for many years to come."

Blanchard emphasised that there was little prospect of a

return to the "old growth path," and that the positive GDP forecasts for many advanced economies in the next few quarters "will not be quite strong enough to reduce unemployment, which is not expected to crest until some time next year."

The IMF economist explained that a major reorganisation of the world economy remained necessary. China and other countries with large current account surpluses must lower net exports and boost growth through domestic demand, while the US and other advanced economies have to engineer "a shift from domestic to foreign demand"—that is, a permanent reduction in the populations' consumption levels.

These shifts will be accompanied by the elimination of wide sections of industry in the leading capitalist countries. Blanchard stated: "Changes in the composition of world demand, as consumption shifts from advanced to emerging economies, may require changes in the structure of production."

The IMF economist warned of the possibility that in the US, "fiscal deficits might be maintained for too long, leading to issues of debt sustainability, worries about US government bonds and the dollar, and causing large capital flows from the United States." Blanchard insisted that the only way this scenario can be avoided, in the event further stimulus spending is required, is if "structural measures are taken to limit the future growth of entitlement programs—whether from rising health care costs or from the effect of ageing populations on retirement costs." In other words, bedrock social programs must be gutted.

These conclusions point to the fact that whatever the immediate fluctuations on the world's stock markets and ups and downs of business activity, there is not going to be a return to the pre-crisis status quo. The old regime of capital accumulation—based on shifting manufacturing production from advanced economies to low-wage platforms, the explosive growth of financial parasitism, and promotion of debt-fuelled consumption—has broken down. In its place, the financial elite in the US and internationally is attempting to engineer a new equilibrium by advancing a sweeping restructuring agenda involving the further destruction of "excess" productive capacity, elimination of countless jobs, and a permanent

reduction in the living standards of the working class.

In this context, official discussion of a nascent economic recovery takes on an unreal character. Unemployment rises, consumer spending continues to decline, private investment remains depressed—and yet many leading US stocks have rebounded from record lows recorded last March. This is largely because corporations have been able to slash costs further than revenues have declined.

Computer giant Hewlett-Packard, for example, yesterday reported making a \$1.6 billion quarterly profit, despite seeing sales decline by 2.1 percent on an annualised basis. Its returns this year have been boosted by its recent takeover of services firm EDS, involving 24,600 layoffs, as well as an announcement last May of an additional 6,400 job cuts.

At the same time, the financial system remains in crisis. No one knows whether the US banking system is solvent. The banks are holding on to massive volumes of toxic assets, declining to write them down or sell them off, while assigning them vastly inflated values to boost their balance sheets.

The crisis has worsened since the 2008 crash, with declining economic activity feeding back into the banking system in the form of mounting bad debts. A recent report by the Congressional Oversight Panel monitoring the Troubled Asset Relief Program (TARP) found that the value of one category of toxic assets on the books of the largest 19 US banks is up 14.3 percent since the beginning of the year.

In an extended comment on the US economy published August 10, David Rosenberg, chief economist and strategist with Canadian investment firm Gluskin Sheff, noted that the S&P 500 index's 49 percent gain in the five months since its March 9 low is "unprecedented back to the 1930s."

In the post-war period, Rosenberg continued, it has taken an average of 18 months for the stock market to rebound 49 percent after a recessionary low. Usually at the point of a 49 percent stock market rally, real GDP has expanded 4.5 percent, employment increased by 850,000, corporate profits recovered 12 percent, and bank lending increased by 5 percent.

Now, however, real GDP, employment, corporate profit, and bank lending are all still declining. "We have never before witnessed a stock market rally of this magnitude over such a short time frame and absent anything more than tentative signs of economic improvement," the economist noted. "The only rally of this magnitude was the wild bear market rally ride in 1930, which was followed by a resumption of the decline that finally bottomed 82 percent lower in 1932."

Rosenberg concluded: "This is the most speculative momentum-driven equity market since the early 1930s... What we have on our hands is a jobless, revenue-less, income-less, profitless and consumer-less recovery. It's a one of a kind."

Recent data on US economic activity has borne out this conclusion:

\* The Labor Department reported yesterday that producer prices declined by 0.9 percent last month, reportedly due to

lower food and energy prices. The decline in producer prices over the last twelve months is the sharpest since records were first kept 60 years ago. The latest monthly decline indicates persistent deflationary tendencies.

\* A Federal Reserve survey found that 30 percent of banks are further tightening conditions on consumer and small business loans, exacerbating the credit crisis. The banks are continuing to hoard the federal government's bailout money. The Fed and Treasury Department, refusing to take any measures to force the banks to free up credit, have announced an extension of the Term Asset-Backed Securities Lending Facility (TALF) until the end of the year. This program involves the Fed purchasing banks' securities that are backed by auto loans, credit card debt, business credit and commercial real estate.

\* Commerce Department figures released last week showed a 0.1 percent decline in retail sales from July to June, significantly worse than analysts' estimates of a 0.8 increase. Excluding auto sales, retail activity fell 0.6 percent. Research company Retail Metrics has predicted that retailers will soon register a ninth consecutive quarter of falling sales.

\* Data on housing starts released by the Commerce Department yesterday showed that new home construction fell by 1 percent in July, with building permits also down 1.8 percent and housing completions down 0.9 percent from a month before.

\* RealtyTrac has reported that foreclosures hit a new record last month, marking the third monthly record set in the last five months. Foreclosure filings, comprised of default notices, auctions and repossessions, reached 360,000, up 7 percent from the previous month and 32 percent from a year earlier.

\* According to the National Association of Realtors, more than one-third of all house sales in the second quarter were "distressed sales," that is, either foreclosures or short sales. Property prices continue to decline, with median home values reaching \$174,000 in the second quarter—down 15.6 percent from a year earlier.

Behind these figures is a growing tide of social misery. The strategy of President Barack Obama's administration—like that of governments in advanced capitalist countries throughout the world—is to make the working class bear the entire burden of the economic crisis. At the same time, nationalist and protectionist tendencies are mounting as each national ruling elite seeks to outmanoeuvre its rivals—raising the spectre of militarism and war.



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