Panic deepens on world financial markets

Andre Damon
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Global stocks plunged Thursday in the biggest one-day sell-off so far this year, after Federal Reserve Chairman Ben Bernanke said the US central bank might consider paring back its cash infusions into the financial markets within the next six months.

The panic in stock and bond markets sparked by the remarks of Bernanke, who on Wednesday suggested the Fed might start winding down its $85 billion per month in asset purchases, was compounded by the release of data on Thursday showing that Chinese manufacturing activity hit its lowest level in nine months.

These developments point to two fundamental facts about the current economic situation: the continuing slump in the real economy and the extreme dependence of global financial markets on virtually free credit from the Federal Reserve and other central banks.

In the United States, the Dow Jones Industrial Average fell 353 points, or 2.34 percent, in its biggest drop since November 2011. This followed a 206 point drop on Wednesday. The Standard & Poor's 500 index fell by 2.5 percent, and the Nasdaq Composite Index fell by 2.3 percent. All ten sectors of the S&P 500 fell by more than two percent.

The drop in US financial markets followed a panicky sell-off in Europe and Asia earlier in the day. The United Kingdom's FTSE 100 index lost 2.98 percent and the German Dax lost 3.28 percent. In Asia, Hong Kong's Hang Seng index dropped by 2.88 percent and Japan's Nikkei fell by 1.1 percent.

Asian markets declined further at their opening Friday morning, with the Nikkei down by 2 percent, the Hang Seng down by 1.75 percent, and the Australian All Ordinaries index down by 0.70 percent in early trading.

All major commodities were hit by Thursday's sell-off, with gold futures dropping below $1,300 per ounce, the lowest level in two-and-a-half years. Silver dropped by 9.7 percent during the day before recovering slightly, hitting its lowest level since 2010. Prior to Thursday's sell-off, gold prices were already down by 18 percent, in what may become the first yearly decline in the value of gold since 2000.

Every asset class, including bonds of every duration and quality, fell sharply. Yields on ten-year US Treasury notes went as high as 2.47 percent during the day, up from 1.61 percent in May, before retreating as the stock sell-off intensified.

Emerging market currencies continued to plunge against the dollar. The Indian rupee fell 2 percent to a new low, and the Turkish lira fell 1.8 percent. The US dollar rose more than one percent against the Korean, Russian, Polish and South American currencies.

A preliminary reading of HSBC's Purchasing Managers' Index (PMI) for China, a measure of manufacturing activity, fell to 48.3 this month, down from 49.2 in May. This was the lowest reading in nine months. The Chinese economy slowed to a growth rate of 7.7 percent in the first quarter and is expected to continue slowing in the second.

The Markit Flash euro zone PMI, also released Thursday, while slightly improved, nevertheless indicates that the European economy remains stagnant.

The economic slowdown and bond sell-off have sparked a credit crunch in China, where overnight inter-bank lending rates hit 13.1 percent, the highest on record and up from the previous day by 5.98 percentage points.

Data in the United States was little better. The day after Fed Chairman Bernanke reported an improved outlook for the US economy and the jobs market, the Labor Department said initial applications for unemployment benefits rose unexpectedly last week by 18,000, to 354,000.

The plunging bond market hit junk bonds especially hard, raising the prospect of troubled companies becoming insolvent. The iShares iBoxx High Yld Corp

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Bond, the largest junk bond fund, fell 1.5 percent.

"All these people who lined up to buy high-yield bonds, only looking to get that extra yield and not paying much attention to the credit quality of these companies, are now just trying to get out," Adrian Miller of GMP Securities told the *Financial Times* .

Bond prices have been plunging since May 22, when Bernanke indicated in congressional testimony that the Fed might slow asset purchases "in the next few meetings" if economic conditions continued to improve.

In revised economic projections released Wednesday, the Fed's policy-making Federal Open Market Committee (FOMC) lowered its 2013 unemployment rate forecast from 7.4 percent to 7.25 percent and concluded that economic growth would be 2.45 percent in 2013 and 3.25 percent in 2014, significantly higher than current market expectations.

While the Fed's official projections were upbeat, significant sections of the US ruling class are increasingly concerned about signs of a global slump, particularly in Asia and Europe, and the specter of deflation in the US economy. Wall Street, on the other hand, looks with dread on any significant improvement of economic growth and employment prospects, for fear the Fed will turn off the spigot of limitless and ultra-cheap cash, which is subsidizing super profits and rising executive pay packages.

Behind the Federal Reserve's hints that it may wind down its asset-purchasing program lie worries that the vast amounts of cash that have been pumped into the financial system have created a speculative bubble of vast proportions, threatening a financial collapse that could dwarf that of 2008.

The fall in global markets on Wednesday and Thursday is an expression of the fear and panic that predominate on financial markets amid mounting concerns that the asset bubble is beginning to burst.

The market panic of the past two days demonstrates that none of the underlying issues that led to the 2008 financial meltdown have been addressed, let alone resolved. Far from engineering any real economic recovery, governments and central banks have merely papered over the contradictions in the global economy while further enriching the financial elite, on the one hand, and brutally attacking the working class, on the other.

The response of the ruling class to the latest eruption of the financial crisis will be to intensify the assault on social programs and workers' jobs, wages and pensions.

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