Sharp fall in global share markets

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Global share markets experienced significant falls yesterday amid concerns that the predictions of improved economic and financial conditions in 2014 may not be fulfilled. Equity markets have had their worst start to the year since 2010.

Wall Street had the biggest downturn with the Dow Jones index down 326 points, or 2.08 percent, while the S&P 500 index lost 2.28 percent.

In Europe the German Dax index was down 1.3 percent, the French CaC index fell 1.3 percent, while in Britain the FTSE 100 index was 0.7 percent lower. In Tokyo, the Nikkei index was down 8.5 percent for the month of January.

The immediate trigger for the US selloff appears to have been an unexpected fall in the Institute for Supply Management's (ISM) purchasing managers' index, which indicates future manufacturing activity, for January. It came in at 51.3, after forecasts of 56, and well down on the 56.5 recorded in December.

Another contributing factor may have been the sharp drop in car sales, down 12 percent at GM and 7 percent at Ford.

One market commentator described the ISM index result as "absolutely awful" and then expressed the hope that it was an "aberration."

While the decline in the ISM index was largely attributed to the very cold winter weather in the US, there are also global processes at work in the market selloff. This month has seen a drop in Chinese manufacturing activity and turbulence in the financial systems of so-called "emerging markets" as volatile capital seeks safer havens in the US and elsewhere. In addition, there are growing concerns about the long-term impact of a slowdown in the Chinese economy.

The outlook for the eurozone is also causing downward pressure with predictions that the inflation rate will come down even further in January—a sign of further economic contraction. Moreover, the European Central Bank may move to cut interest rates again.

Wall Street experienced its biggest monthly fall in January since May 2012, with the Dow down 5.3 percent and the S&P 500 3.6 percent.

The S&P index rose 30 percent last year—its biggest annual increase since 1997—and last month was the first time it had experienced a January loss since 2010. The CBOE Vix index, sometimes known as the "fear gauge" last week jumped by 15 percent to reach its highest level in three months.

Overall, global markets have had their poorest start to the year since 2010, with the FTSE world equity index falling by 4.1 percent.

An analyst at Capital Economics, Mark Williams, said it would be a couple of months before an accurate assessment could be obtained, free of new year "distortions" but nearly all the available evidence pointed "in one direction—towards a further slowdown at the start of 2014."

Most market commentators expressed the view that the downturn was a "correction" that markets had to have after the rapid rise in share prices last year. It has even been likened to winter pruning that makes way for growth in spring. But such reassurances ignore the completely speculative character of the share market boom.

The share price rise over 2013 was largely fueled by the US Federal Reserve Board's "quantitative easing." This program has pumped trillions of dollars of ultra-cheap money into financial markets and was accelerated in September 2012 with purchases of $85 billion worth of treasury bonds and mortgage-backed securities.

Over the past two months, the Fed has "tapered" its asset buying program by $20 billion, a significant factor in the turbulence in "emerging markets" that has seen a number of central banks lift their interest rates. This has led to the view that the present market downturn could be the start of something more than a "correction."

As a comment in the *Financial Times* (FT) put it: "[A]s storm clouds gather over areas of emerging markets and US companies post meagre revenue growth for the fourth quarter, investors are faced with the question: was January just a small speed bump in the five-year US equity bull run, or the prelude for greater challenges in the form of heightened volatility and bouts of pronounced risk aversion?"

The article cited figures which demonstrate the speculative nature of the boom. According to Alhambra Investment Partners, "money borrowed to buy stocks hit $445bn at [the] end of 2013, above the levels that characterised the market's peaks in 2000 and 2007."

"As soon as the calendar flipped from 2012, it was as if investors suddenly lost all caution and embraced as much leveraged risk as could possibly be attained," it noted.

The FT estimated that last year total margin debt usage increased by $142 billion, the biggest rise in any 12-month period in history.

Such leveraging yield enormous profits while the market keeps rising. But once a downturn sets in, enormous losses can result. As stock prices fall, demands are made for portions of the borrowed money to be repaid, setting in motion a snowballing process as speculators are forced to sell off shares to meet these demands, sending the market lower and prompting calls for further repayments.