US markets in biggest fall for six months

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World stock markets will be a focus of attention this week following significant falls on Wall Street last week. The question increasingly being asked in financial circles is whether this was just a blip or if the financial bubble may once again be about to burst.

Last week's falls, which saw the Dow Jones index plunge by 317 points on Thursday followed by a further 69-point decline on Friday, underscored the role played by financial parasitism and speculation in the world's largest economy.

The immediate impetus for the fall appears to have been fears in financial circles that the US Federal Reserve would begin to tighten interests rates somewhat sooner than had been previously expected, as well as a report showing rising labour costs.

For the past six years, financial markets have been sustained by the Fed's virtual zero interest rate policy and its program of "quantitative easing," which together have pumped up to $4 trillion into financial markets, sending stock market indexes to record highs even as the underlying economy continues to record low growth.

With the Fed now winding back its purchases of financial assets—US Treasury bonds and mortgage-backed securities—amid expectations that the program will come to an end in October, the attention of the banks and finance houses is being directed to the question of when interest rates might start to rise.

Such is the dependence of financial markets on the continued provision of ultra-cheap money to fund highly profitable trades that even the slightest indication of an earlier-than-anticipated move towards higher rates can provoke a major reaction.

The rationale for the Fed's handouts to the banks and financial corporations is that its "accommodative" interest rate policy is necessary to help boost a recovery in the US economy. Consequently, any signs that the Fed believes the economy may be improving is taken as a signal that interest rates may start to be lifted, promoting concerns that the flow of funds may be cut back.

There were such signs in the statement issued by the Fed's open market committee on Wednesday. In a slight change of language, the Fed statement noted that inflation had "moved somewhat closer to the Committee's longer run objective" rather than that "inflation has been running below the Committee's objective."

Coupled with the report that the US economy had grown at an annual rate of 4 percent in the second quarter, following a 2.1 percent contraction for the first three months of the year, this was taken as an indication that interest rates could start to shift upwards.

Another straw in the wind was the dissent vote by Charles Prosser, the president of the Philadelphia Fed, who disagreed with the stated intention to keep interest rates low for a considerable period of time following the ending of the asset-buying program. This was taken as an indication that pressure was increasing for a rate rise.

Reports that labour costs had increased were taken as another indication of pressure for interest rate increases. The US economy is particularly sensitive to such movements because the chief source of profits for non-financial corporations is no longer the expansion of investment and markets, but relentless job-cutting and the lowering of real wages.

However, the markets received "reassurance" on Friday when the jobs report on the US economy indicated that there has been no significant increase in wages. The markets also took heart from the fact that the reported increase of 209,000 jobs was below economists' expectations.

The Dow continued its decline, dropping by a further 69 points, but the fall was less than would have taken place had the job numbers and wage growth figures indicated an improvement in the economy. While job numbers increased, the unemployment rate rose from 6.1 to 6.2 percent as workers who had dropped out of the labour market began actively to seek work. Last June, the participation rate—measuring the proportion of the population seeking employment—fell to its lowest level since 1978.

A rise in the interest rate on ten-year treasury bonds, which went from 2.50 to 2.56 percent, was another sigh of relief from financial markets that the pressure for rate rises may not have been as great as initially feared. As Bloomberg noted: "[T]he increase in unemployment and subdued wage gains damped bets the Fed will move fast to reduce monetary stimulus."

It is a measure of the perverse character of economic relationships following the financial breakdown of 2008 that supposed "good news" on the economy produces an adverse reaction in financial markets.

Around the world, the sell-off in US markets was followed by falls in European and Asian markets. The Australian market saw $2.1 billion wiped off share values in what was described as a "wake-up call," ending the "eerie calm" that has "hovered over financial markets for the past six months" despite rising geopolitical tensions.

In the longer term, further gyrations in financial markets could result from a divergence in policy between the Fed and the European Central Bank. While the Fed is moving towards an increase in rates, the ECB is under pressure to inject more money into the financial system in order to try to combat the threat of deflation. Latest figures show that the inflation rate for the euro zone area is now just 0.4 percent, amid continuing stagnation in the region's economy.