Turmoil rips through global financial markets

Nick Beams
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Global financial markets experienced a day of violent gyrations on Wednesday amid growing signs that the financial house of cards created by the provision of ultra-cheap money by the world's major central banks may be collapsing.

European stocks experienced their biggest decline in three years as investors tried to cut their exposure to more risky assets. Concerns are mounting that the European economy is sliding into its third recession since the 2008 financial crisis and that global growth is slowing.

The FTSE Eurofirst index of the top 300 European shares ended the day more than 3 percent lower, its biggest one-day slide since late 2011. The key index is down 11 percent since the start of September.

A key European volatility index, sometimes referred to as the "fear gauge," reached its highest level since mid-2012 when concerns over the sovereign debt of a number of countries threatened to spark a crisis. All major European indexes are in negative territory for the year, with the key German Dax index down more than 10 percent.

As the European sell-off proceeded, it was joined by Wall Street in a day of wild trading in both the equity and bond markets, reflecting extreme nervousness, if not panic.

At one point in the day, the Dow Jones index was down by as much as 460 points, as money flooded into US Treasury bonds in search of a safe haven. Such was the movement of cash that at one stage the yield on treasuries fell by 35 basis points in a few minutes. The price of bonds, which move in an inverse relationship to the yield, was lifted by a surge in demand.

Commenting on this dramatic movement, *Financial Times* market columnist John Authers noted there was "no possible explanation" on the basis of economic data that normally shift the bond market. "Wednesday's sudden plunge in Treasury yields, even though most of it was reversed by the end of the New York trading day, suggests that the market pathologies we all grew to know during the crisis of 2008 are returning."

Following its plunge earlier in the day, the Dow rose to finish down by 1.06 percent for the day, with the S&P 500 index closing 0.81 percent down.

One of the main reasons for the slide was the fear that rapidly slowing global and European growth will impact heavily on the United States.

Following a contraction in German gross domestic product in the second quarter and a sharp fall in industrial output and export orders in August, the Economy Ministry has cut its economic growth forecast for 2014 to 1.2 percent from 1.8 percent, and its prediction for 2015 to 1.3 percent from 2 percent. Thomas Harjes, the senior European economist at Barclays in Frankfurt, told *Bloomberg*: "Financial investors are turning increasingly gloomy on the prospects for the German economy."

The weakening of the export-dependent German economy is indicative of worsening global trends, as the prices of industrial commodities tumble. Since June, the price of Brent crude oil is down by 28 percent, while the iron ore price has fallen 40 percent so far this year. The prices of corn, wheat and soybeans are also down by between 20 and 30 percent.

These developments are triggering fears that the much-touted US recovery, weak as it is, may be coming to an end. The sharp downturn on Wall Street began after the release of figures showing that retail sales had fallen by 0.3 percent in September following a rise in August.

Dankse Bank analyst Allan von Mehren told the *Financial Times* that while a decline was quite normal after a period of growth, "it creates the fear that the US is slowing more than expected and that the US is 'falling down' to the rest of the world, rather than the rest of the world catching up with the US."

Compounding the fears generated by falling world growth is the disarray in financial markets. In the US, there is growing uncertainty about where the US Federal Reserve is heading. It is nominally on track to begin lifting interest rates once its asset purchasing program ends this month.

However, the rise in the US dollar over recent months is impacting American export markets, giving rise to the belief that the Fed may postpone any return to higher interest rates.

There are deepening international divisions. The US financial sector wants the European Central Bank to extend its program of "quantitative easing" from the purchase of privately-held financial assets to government bonds. However, this is strenuously opposed by Germany, which believes such a move would weaken its financial position.

A divergence between the US and Germany on financial policy was one of the reasons for the US and global stock market crash in October 1987. The US Fed responded to that crisis by opening the spigots to supply unlimited cash to financial markets, initiating the policy that has seen the creation of one financial bubble after another over the past 27 years, all of which have burst with increasingly serious consequences.

The quantitative easing policy of the Fed, initiated in response to the 2008 financial crisis, has seen more than $3 trillion pumped into the coffers of the banks and finance houses. Nothing like it has taken place in the history of global capitalism, and no one can predict with any confidence what might be the consequences of even small rises in official interest rates. Some indication was provided in the gyrations in world markets last year as the Fed indicated it would begin to "taper" its asset purchasing program.

Mohamed El-Erian, the former second in charge at Pimco, the world's largest bond trading firm, and now an economic adviser to the German insurance company Allianz, has warned of "serious complications," including currency fluctuations, resulting from a divergence between the policies of the US Fed and the central banks of Europe and Japan. "Judging from history, sharp and rapid currency adjustments often end up breaking something," he told the *Financial Times* .

An even sharper warning of where financial markets could be heading was issued by the assistant governor of the Reserve Bank of Australia, Guy Debelle, in a speech delivered in Sydney on Tuesday.

Debelle, who is also head of the markets committee at the Bank for International Settlements, warned of a "violent" and escalating market sell-off because investors had relied too heavily on the continuation of easy money policies by central banks.

He warned that a number of investors had been "buying assets on the presumption of liquidity which is not there." There were a sizeable number of investors who assumed they could exit their positions ahead of any sell-off. But history showed "the exits tend to get jammed unexpectedly and rapidly."

Another reason any sell-off could be "violent" was the zero interest rate regime. "There are undoubtedly positions out there which are dependent on (close to) zero funding costs. When funding costs are no longer zero, those positions will blow up," he said.

Less than two days later, his warnings received at least partial confirmation in the rapid movements in financial markets.

The response of financial analysts and various "talking heads" on American business television channels is that so-called "structural reforms" in the US, European and global economy must be stepped up. In other words, as the conditions for the eruption of another financial crisis develop, with potentially even more devastating consequences than that of 2008, the mouthpieces of the global financial elites are demanding that what remains of social protections for the working class be completely eliminated.