Wave of selling hits US markets

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US stocks markets tumbled Wednesday as oil prices continued to fall and voices in the finance industry, together with economic commentators, warned of the potential for a major crisis.

The sell-off was across the board, the Dow falling by 365 points, 2.21 percent, the S&P 500 by 2.50 percent and the Nasdaq down by 3.4 percent. The day opened with an uptick but large-volume selling soon set in, the prevailing sentiment being that it was necessary to get out without waiting to see what would happen during the rest of the day.

Commentators said the sell-off was not just about oil, which has been touching levels as low as $30 per barrel, but the fall in prices for all industrial raw materials induced by the slowdown in China.

The sharp downturn has come in the wake of a series of assessments by banking officials that the conditions for a new financial crisis are fast developing.

On Tuesday economists at the Royal Bank of Scotland issued an assessment that said investors faced a "cataclysmic year" in which stocks could fall by 20 percent and oil could go as low as $16 per barrel.

In a note to clients, the RBS said: "Sell everything except high quality bonds. This is about return of capital, not return on capital. In a crowded hall, exit doors are small." It warned that the present situation recalled 2008 when the collapse of Lehman Brothers set off a global crisis. This time the trigger could be China.

The bank's credit chief Andrew Roberts said China had set off a "major correction and it is going to snowball" with equities and credit becoming "very dangerous." He warned that the London market was particularly vulnerable to a negative shock because of the large number of commodity companies in the UK. The prices of all industrial raw materials, not just oil, are moving sharply down, reaching lows not seen since the immediate aftermath of the financial crisis.

"All those people who are long [buyers of] oil and mining companies thinking that the dividends are safe are going to discover than they're not at all safe," Roberts said.

RBS's prediction of a sharply lower oil price was matched by Morgan Stanley which said it could go to $20 per barrel. Standard Charter forecast an even bigger fall, to $10. "Given that no fundamental relationship is driving the oil market toward any equilibrium, prices are being moved almost entirely by financial flows caused by fluctuations in other asset prices, including the US dollar and equity markets. We think prices could fall as low as $10 per barrel."

The Standard Chartered analysis points to the development of a vicious circle: a falling oil price sends down equity markets and then financial flow-on effects from the decline in stock prices lead to a further drop in the price of oil.

Following the RBS call to "sell everything," the *Guardian* sought responses from a series of economists. While none went as far as the RBS, there was a distinct lack of confidence in their replies.

Erik Britton, director of Fathom Consulting, did not dispute that China would have a "hard landing." He said it was headed for just 2 percent growth in gross domestic product, markedly less than the official government prediction of 6.5 percent for this year.

Jonathan Porter, the director of the National Institute for Economic and Social Research, said he was "worried" by current events "but not yet panicked."

"But if the current concerns turn into a systematic meltdown on financial markets, then all bets are off," he added.

Chris Williamson, the chief economist at the financial data provider Markit, said the worry was that the RBS warning could become a self-fulfilling prophecy and if a financial market rout led to a new recession, "policymakers are seriously lacking in tools to fight the new downturn."

The RBS assessment was echoed by comments on Wednesday from Albert Edwards, strategist at the Societe Generale bank, who has long held the belief that equity markets are considerably over-valued. He said the West was about to be hit by a wave of deflation from emerging market economies and central banks were not aware of what was about to hit them.

He told an investment conference in London that developments in the global economy would "push the US back into recession. The financial crisis will reawaken. It will be every bit as bad as in 2008–09 and it will turn very ugly indeed."

The US economy was in much worse shape than the Fed realised, with the US corporate sector being "crushed" by the appreciation in the value of the dollar. "We have seen massive credit expansion in the US. This is not for real economic activity; it is borrowing to finance share buybacks," he said.

In an assessment of the significance of the fall in the markets, which in the US have experienced their worst new year opening in history, an article in the *Financial Times* on Monday pointed to longer-term trends. In the wake of the financial crisis, "aggressive easing" by the Fed and other central banks, coupled with a "mammoth spending binge" by China, had suppressed market volatility for an extended period and created a tide that lifted global assets prices.

"Now that liquidity is draining away and the bill for China's spending—in the shape of overcapacity in some industries and high levels of indebtedness—is coming due," the article noted.

"The worrying signal from the current turmoil is that the investor herd truly has become fearful and thinks the financial system is broken. Namely, that quantitative easing has merely papered over the cracks of global economic imbalances, borrowed hefty investment gains from the future and left taxpayers and company bondholders with a massive rise in outstanding debt."

International Monetary Fund managing director Christine Lagarde also pointed to longer-term trends in a speech delivered in Paris on Tuesday. She said emerging market economies were facing a "new reality" in which their growth rates would be significantly slowed.

"Growth rates are down, and cyclical and structural forces have undermined the traditional growth paradigm," she said.

That paradigm was based on boosting exports and attracting capital inflows. On current forecasts, she said emerging economies would move towards advanced economy incomes at less than two-thirds the pace predicted by the IMF a decade ago. "This is cause for concern," she said.

The World Bank last week warned that these economies faced difficulties in 2016 after growing last year at their slowest pace since the financial crisis of 2008.

Lagarde said the shift by the Fed towards ending its easy monetary policies, together with the continuation of these policies by other central banks, had the potential to trigger exchange rate ructions.

"This volatility could be induced not only by the divergence in monetary policies in major advanced economies, but also by uncertainty about their overall prospects and policy action."

In an indication of the deepening recessionary trends in the global economy, she noted that oil and metal prices were down by two-thirds from their peak and were likely "to stay low for a sustained period," placing several developing economies "under severe stress."

That stress is already in evidence with major economic contractions in Brazil and Russia, but it is not confined there. The economic outlook for two developed commodity-exporting countries, Australia and Canada, is also worsening.

Former US treasury secretary Lawrence Summers added his voice to those warning about the state of the global economy in a comment published in the *Financial Times* on Monday. He said that while markets do sometimes send out false alarms, economic and financial authorities should take notice because "the conventional wisdom never recognises gathering storms."

"Because of China's scale, its potential volatility and the limited room for conventional monetary manoeuvres, the global risk to domestic economic performance in the US, Europe and many emerging markets is as great as at any time I can remember," he wrote.

It is impossible to predict exactly how the present turmoil will play out. But two certainties have been established.

Firstly, that the 2008 financial crisis was only the beginning of a breakdown of the global capitalist economy, for which the ruling elites have no economic solution. In fact, their actions have only created further wealth for the ultra-rich, increasing social inequality, while setting up the conditions for another financial meltdown.

And finally, that the renewed turbulence is going to produce even deeper attacks on the working class which, on top on those already being implemented, will bring an upsurge in social and political struggles.