Wall Street falls on global growth fears

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Wall Street fell sharply yesterday despite the fact that the US Federal Reserve left interest rates on hold after a 0.25 percentage rate rise in December.

There was a general perception that the Fed had moved away somewhat from earlier expectations it would initiate four interest rate increases this year. But in the wake of earnings downturns for major US firms and growing criticisms of the Fed's December decision, the general sentiment appears to be that the Fed did not do enough to indicate that monetary conditions would be eased, given the downturn in financial markets that has marked the beginning of this year.

According to Morgan Stanley, the tightening of liquidity so far this year, resulting from market turbulence, has already had an impact equivalent to four interest rate rises.

Before the Fed decision was announced, the market was slightly in positive territory but it plunged thereafter, closing 222 points down after dropping by 290 points at one point during the last two hours of trading. The broader-based S&P 500 index dropped by 1.09 percent and the Nasdaq composite index by 2.18 percent.

One of the triggers for the sell-off appears to have been the statement accompanying the Fed's decision, noting that "economic growth slowed late last year." The statement also said the Fed was "closely monitoring global economic and financial development and is assessing their implications for the labour market, and for the balance of risks to the outlook."

According to Jia Liu, a research fellow at the American Institute for Economic Research, the Fed statement showed that policymakers were "concerned about the implication of a weak global economy. Right now the markets are very sensitive to any kind of news."

The underlying recessionary trends in the global economy, which have been the driving force for the current fall in markets, were reflected in some major stocks.

The aircraft manufacturer Boeing and the hi-tech firm Apple together contributed 120 points to the drop in the Dow. Boeing closed down 8.93 percent for the day, its worst day since October 29, 2001.

The fall in Boeing's shares was precipitated by the announcement that it expected to deliver fewer passenger jets this year than in 2015. That forecast came a few days after the company said it would cut production of the 747 jumbo jet, once the mainstay of its fleet, to just six this year because of falling air cargo demand. This is an indication of the downward shift in trade—one of the most significant trends in the global economy.

The shares of Apple, the world's most valuable company by market capitalisation, fell by 6.55 percent, its worst day in two years. The company reported that sales in the March quarter of its key product, the iPhone, would record their first ever decline since the model was introduced in 2007.

In a call to investors on Tuesday, Apple chief executive Tim Cook said sales of iPhone units in the March quarter would contract to $50–$53 billion due to worsening international conditions, including volatility in China, as well as in currency and financial markets more broadly.

Cook said the company faced an "environment now that is dramatically different" from the second fiscal quarter with "extreme conditions, unlike anything we've seen before, just about everywhere we look."

Sales in the quarter ending in December were up by just 2 percent to $75.9 billion, a major slowdown compared to the 30 percent increase in the same period a year earlier.

Apple's chief financial offer Lua Maestri pointed to the fall in commodity prices, of which the decline in oil is only the most significant. “When you think about all the commodity-driven economies—Brazil and Russia and emerging markets, but also Canada and Australia in developed markets—clearly the economy is significantly weaker than a year ago,” he said.

So far this year, there has been a near one-to-one correlation between oil prices and the movement of the share market. The fall in the oil price, now down to around $30 per barrel, affects the markets in two key areas—finance and industry.

On the financial side, this is raising concerns in the high-yield or junk bond markets, where the viability of debts incurred when oil was around $100 per barrel are called into question now that the price has plunged by more than 70 percent. “Significantly stressed” US energy companies—that is, companies whose bonds exceed the comparable rates on treasury bonds by 7 to 10 percentage points—are estimated to account for about 20 percent of the high-yield bond market.

Banks could also be directly affected because of write-downs on the loans they have made to oil companies. Even large banks, such as Wells Fargo, Bank of America and JPMorgan Chase, have expressed concern over this possibility—an indication that smaller, regional banks may face bigger problems.

Apart from expressing the general tendency of lower growth, and even recession, falling oil prices also hit major industrial firms that supply the oil producers and exploration companies.

No upturn is expected. The World Bank this week predicted that the average price for crude would be $37 per barrel this year, compared to its forecast of $52 made just three months ago.

While the conventional wisdom still remains that falling oil prices should benefit the global economy “in the long run,” the downturn is causing immediate havoc, especially for so-called emerging markets that depend heavily on the export of oil and other industrial commodities.

In what is expected to be just the first in a series of similar moves, International Monetary Fund and the World Bank officials will travel to Baku, the capital of oil-exporting Azerbaijan, to discuss the organisation of a possible $4 billion loan package.

Azerbaijan, which depends on oil and gas for 95 percent of its export revenues, has seen a series of protests against the government of President Aliyev. There has been a 35 percent plunge in the value of the currency since the end of December, when the government abandoned a peg to the US dollar because of the rapid outflow of currency reserves needed to sustain it.

The downturn is extending across a range of commodity-dependent emerging markets, with potentially significant consequences for the global financial system.

In a note to investors Oxford Economics warned: “These are bad times for oil producers and their creditors. History provides reason for extreme pessimism on the likely fortunes of commodity producers.” It said emerging markets were prone to defaults and that “commodity slumps are possibly the biggest cause of defaults.”

Such events would have major international consequences.

One need only recall that the Russian default in 1998 led to the meltdown of Long Term Capital Management in the US, requiring intervention by the New York Federal Reserve. That was more than 17 years ago. Since then, global financial markets have become ever more integrated.