Wall Street plunges amid fear and panic

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Wall Street saw another plunge in stocks yesterday, with the Dow Jones index falling by 1,032 points—the second time in four days it has dropped by more than 1,000 points. A large portion of the sell-off, which impacted on all other market indexes and went across the board, took place in the last hour, indicating that further selling may be yet to come.

The Dow finished down by 4.2 percent, the S&P 500 dropped 3.8 percent, taking the fall from its January high to 10 percent, and the tech-heavy Nasdaq lost 3.9 percent. The interest rate on the benchmark 10-year treasury note rose to touch 2.9 percent, but fell back to 2.82 percent as money moved out of stocks into government debt.

Markets across Asia plunged dramatically today and remain in the red. With several hours of trading remaining, the Nikkei index in Japan had fallen over 2.5 percent; the STX in Singapore was down 1.8 percent; the All Ords in Australia down 1 percent; and the Kospi in South Korea down 1.6 percent. The Hong Kong and Shanghai exchanges in China were the worst impacted, with the Hang Seng down 3.3 percent and the Shanghai composite down 4.1 percent by lunch.

Six days after the Wall Street sell-off began last Friday, some of the market mechanisms driving it have become clearer. The initial fall was triggered by the news that wage growth in the US last year was 2.9 percent, above market expectations. This intersected with a rise in bond market interest rates, with the yield on the 10-year treasury bond rising to its highest point in four years, following earlier forecasts that the decades-long bull-run in bonds, which has seen interest rates fall to historic lows, is coming to an end.

The violent reaction of the market to a marginal increase in wages resulted not from the increase itself but what it might portend: a resurgence in the class struggle in the US and internationally as workers push back against the continuous suppression of wages that has been a feature of the global economy for 30 years and particularly since the global financial crisis of 2008.

The suppression of wages has been a key factor in the surge in stock prices, fuelled by the quantitative easing policies pursued by the US Federal Reserve and other central banks to pump trillions of dollars into financial markets.

The return of volatility to the equities market last Friday had such a significant impact because of a complex set of new financial products created by the financial markets over the past period, centring on the volatility, or VIX, index.

Through a process of “financial engineering,” finance houses and major banks, including some of the biggest names such as Barclays, Credit Suisse, UBS and Citigroup, created a series of financial products, based on the VIX, that could be traded on the markets. This involved “shorting the VIX,” that is, placing bets that the volatility index, which set record lows throughout 2017, would continue to remain calm.

Before the eruption of this week’s sell-off, the S&P 500 index had gone more than 400 days without recording a drop of 5 percent or more, a situation not experienced since 1959.

Betting on low volatility was one of the major sources of gains from the stock market throughout 2017, when the VIX averaged 11—its lowest point since records began in 1990. In trade this week it has risen as high as 50.

The assumptions behind this strategy bear a striking resemblance to those that drove the trading in mortgage-backed securities in the lead up to the 2008 crisis, which was set off by the bursting of the sub-prime bubble. Those in the sub-prime market assumed that it would always provide a positive return because, while there may be ups and down in regional markets, the national market as a whole would not fall. That assumption was shattered by the nationwide fall in US house prices in 2007–2008, leading to the meltdown.

Likewise “shorting the VIX” was based on the assumption that the calm in the markets over the past year would continue indefinitely. That was upended last Friday, setting in motion the sell-off and forcing major traders to unwind their positions.

A major feature of the turmoil, pointing to the growth of fear and panic, has been the speed of events.

On Monday, the market finished down by 1,157 points, after crashing by 900 points in the space of just 11 minutes during the last hour of trading.

On Tuesday, the market opened at more than 500 points down, then finished up by 567 points. From bottom to top, it saw a swing of 1,200 points, with 29 changes of direction during the day.

On Wednesday, it hit an intra-day high of 381 points before closing 19 points down. This was followed by a continuous fall from the time markets opened yesterday.

Exacerbating the sell-off is the fact that much of the trading is based on borrowed funds, subject to margin calls—the borrower has to return cash to the lender if the asset on which the loan is based falls in value. Faced with demands for cash, borrowers have to liquidate investments, leading to a further market downturn and a negative feedback loop as lower asset values trigger further margin calls.

Margin trading is only the tip of the international debt iceberg. The Bank for International Settlements estimates that the ratio of global debt to gross domestic product (GDP) is 40 percent higher today than a decade ago. Standard and Poor's has reported that global non-financial corporate debt has risen by 15 percentage points to 96 percent of GDP in the past six years, with 37 percent of companies deemed to be "highly leveraged," compared to 32 percent in 2007. With interest rates on the rise, the ability of companies and even governments to service this debt is called into question.

While trading in complex derivatives based on the VIX has been the immediate trigger for the market plunge, broader developments indicate this is a financial inflection point.

One of the continuous themes of the commentary on the market gyrations, including in a tweet by US President Donald Trump, is that the market is acting at variance with the direction of the real economy, which is showing signs of growth.

Such commentary ignores what has been the central feature of the rise and rise of the financial markets since 2008. The surge in US stock prices, rising by more than 350 percent from their low in March 2009, has taken place amid low growth—the weakest recovery from a recession in the post-war period. The "real economy" is characterised by historically low levels of investment and low productivity as profits have been diverted into ever-more risky forms of financial speculation.

The key factor in sustaining the markets has been the inflow of cheap money from the Federal Reserve, which has expanded its balance sheet from around $800 billion before 2008 to more than $4 trillion today. Speculators have operated on the assumption that the Fed is ready to step in and ensure the market will not fall precipitously, a key factor in the decline in market volatility.

That assumption is now being called into question. Confronted with an uptick in US economic growth, the Fed has started to lift interest rates, indicating that three rises may be enacted this year. Other central banks are moving in the same direction. The Bank of England indicated yesterday that interest rate rises in the UK may come sooner and be larger than expected. The European Central Bank is also under pressure to start winding back its program of quantitative easing which has sent interest rates to record lows, in some cases into negative territory.

The Fed and other central banks are concerned that if they intervene with more cheap money this may lead to a rise in inflation. That is how they characterise their greatest fear of all: an intensification of the class struggle as workers seek to regain the losses in their wages and living standards.

The market crisis is also being fuelled by the key policies of the Trump administration, supported by the Democrats, of massive tax cuts for the corporate and financial elites and a boost to military spending for war. These measures are set to push the US budget deficit toward $1 trillion from its current level of close to $700 billion.

The result will be more government bonds on the market, leading to a fall in their price, and lifting interest rates, as the two move in an inverse relationship. Even before the announcement of the latest measures to vastly increase military spending, New York Federal Reserve president Bill Dudley said in a speech last month that the current fiscal path was unsustainable and the adverse effects of the tax cuts on the budget bottom line would outweigh any positive effects on capital spending and output.

The likelihood of these measures causing interest rate rises is being exacerbated by geo-political tensions. Under conditions in which the Fed is withdrawing from bond purchases, the US is mounting a trade war against the second largest purchaser in the recent period, China. Last month, in anonymous comments, high-placed Chinese financial officials told Bloomberg they were considering pulling back on bond purchases, partly in response to the more aggressive moves by the US on trade. If this takes place, for either financial or political reasons, it can only further roil US financial markets.

Whatever the immediate outcome of the present turmoil, some clear economic and political facts of life have been established. None of the contradictions of the capitalist system, which exploded to the surface in 2008, has even been tackled, let alone overcome.

The past period has been marked by the drive to war, with the growing danger of a nuclear conflagration either on the Korean peninsula or elsewhere. At the same time the banks, finance houses and capitalist oligarchs, along with the world's central banks, have responded to the disaster into which they plunged the world a decade ago by creating new speculative "weapons of mass financial destruction," setting up the conditions for the eruption of a crisis even more serious than that of 2008.

The world working class must take stock of the situation. The response of the ruling classes to the current meltdown will be to impose ever-deeper attacks on its social rights than those initiated a decade ago.

The capitalist system has no political and economic legitimacy, and threatens to plunge the mass of humanity into a disaster. It must be overturned in the struggle for an international socialist program by the world working class.