Sharp fall on Wall Street as coronavirus hits global markets

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The economic effects of the coronavirus surged through global financial markets this week, producing sharp falls in Asia, Europe and the US.

After a 450-point fall in the Dow on Monday, followed by a small upturn the following three days, the index fell by more than 600 points yesterday. It ended in negative territory for the month, the first time this has happened in five months.

The S&P 500 index was down by 1.77 percent, wiping out all of its gains for the year so far.

Similar falls have been recorded in Asia and Europe. Markets in Paris and Frankfurt closed 1 percent lower for the day, with the continent-wide benchmark Stoxx Europe index down 3 percent for the week.

Besides the effect of the coronavirus, the European sell-off was intensified by data showing that the euro zone's growth in the fourth quarter of 2019 was only 0.1 percent, below market expectations of 0.2 percent.

In Asia, the Taiwan market index, the TAIEX, fell by 5 percent earlier this week, its largest ever single-day drop. Shares of the Taiwan-based company Foxconn, the world's biggest assembler of iPhones and other high-tech products, dropped by 10 percent, its largest one-day fall in 20 years.

After yesterday's Wall Street plunge, the eyes of the financial world will be turning to China, where markets will reopen on Monday after the lunar New Year break. Already the value of the Chinese currency weakened this week to below the benchmark level of seven renminbi to the dollar.

The expectation is that the market will experience a major downturn, with the potential for becoming even more serious. A report in *Bloomberg* noted that the market declines are "likely to be exacerbated by the amount of leverage in the market… that could create a downward spiral where steep losses become steeper as traders face margin calls."

One of the key concerns surrounding the spread of the coronavirus is the effect it will have on the Chinese growth rate. More than a dozen provinces have announced an extension of the lunar New Year break by a week in response to the virus. It has been estimated that these provinces accounted for 69 percent of China's gross domestic product in 2019.

The government had been expected to announce a growth rate of "around" six percent when the National People's Congress meets in March. But the rate could fall significantly below that level, as China's largest industrial and manufacturing centres extend the lunar New Year break because of the virus.

Financial analysts are warning that the virus has created a more uncertain environment than the US-China trade war and its impact could be bigger than the SARS virus in 2002–2003.

In a note published on Thursday, *Bloomberg* economists reported that growth in the Chinese economy could fall to as low as 4.5 percent in the first quarter, a drop of 1.4 percentage points below the forecast made at the start of the year. They warned that it might drop to 5.6 percent for the year if the virus is not contained until the second quarter.

In a note to clients, economists at the Japanese financial firm Nomura said China's gross domestic product growth in the first quarter could fall to as low as 4 percent, a worse impact than from the SARS virus.

A report by the rating agency S&P Global pointed to the wider consequences. "In a scenario of widespread infection, the virus could materially weaken economic growth and fiscal positions of governments in Asia," it said.

The financial and insurance firm ING noted that the SARS virus in 2002-2003 had knocked as much a 1 percentage point off of China's growth, and it pointed to significant changes in the world economy since then that could make the effect of the virus bigger than that experienced 17 years ago.

The ING statement said: "In economic terms… the global economy has become more integrated and intertwined since 2003. Global air traffic, for example is currently more than twice as big as in 2003. Also, contrary to 2003, when Chinese tourism was mainly inbound-oriented, Chinese tourists have become a significant driver of global tourism. Consequently, the speed of the virus spreading could be faster than in 2003, while at the same time the negative impact on global growth could also be higher than in 2003."

While the sharp fall on Wall Street has been triggered by the coronavirus outbreak, there are other factors at work—most significantly, the fall in global growth and the signs that it is extending to the US.

In a comment to the *Wall Street Journal* earlier this week, one financial analyst characterized the rise on Wall Street as follows: "The market doesn't really believe in the global growth story anymore—it believes in the central bank prop-up."

Figures issued by the Commerce Department on US GDP earlier this week indicate that the US is part of what the International Monetary Fund has characterized as a "synchronized" global slowdown. It reported that in 2019, US growth was 2.3 percent, the lowest since 2016, with the fourth quarter annual rate falling to 2.1 percent. This compares with a growth rate of 2.9 percent in 2018 and is well below the Trump administration's goal of 3 percent.

While the figures were broadly hailed in the US financial media as indicating "steady growth," in the words of the *Wall Street Journal*, there were clear indications of a slowdown. Consumption spending, which comprises around 70 percent of US GDP, contributed only 1.2 percentage points to growth in the fourth quarter, down from 2.1 percentage points in the third. Over the full year, consumption rose by 2.6 percent compared to 3 percent in 2018.

Even more significant was the continued decline in investment spending by corporations. This dropped by 1.5 percent in the last quarter of 2019. It grew by only 2.1 percent for the full year, down from a rise of 6.4 percent in 2018.

The figures show that the low growth rate in the US economy that has characterized the recovery since the financial crisis of 2008 continues, remaining at the lowest levels for a post-recession recovery in post-World War II history.

The average pace of growth over the past 11 years is just above 2 percent, compared to an expansion of 2.9 percent in the period 2001–2007 and a rate of 3.6 percent in the period 1991–2001.

These figures blow apart Trump's promise that his corporate and personal tax cuts would provide a boost to the US economy. The increased profits of major companies have largely been spent on share buybacks to boost the returns from the stock market rather than on new plant and equipment.

There are signs in financial markets that the risk of a significant downturn, if not recession, is rising. This week, the yield on the 10-year Treasury bond again fell below the rate on three-month debt, following several such episodes last year. The so-called "inversion" of the yield curve is regarded as an accurate predictor of a recession—without giving an indication of the timing—because it shows a growing lack of confidence in growth prospects.

The inversion followed the latest meeting of the US Federal Reserve's policy-setting Federal Open Market Committee (FOMC), held Tuesday and Wednesday, at which the central bank sought to issue further assurances to the markets that interest rates would remain low. It removed the word "near" from its stated inflation target of 2 percent.

"We wanted to underscore our commitment to 2 percent not being a ceiling… and we're not satisfied with inflation running below 2 percent," Fed Chairman Jerome Powell told a news conference after the FOMC meeting. In other words, with inflation well below 2 percent, there will be no upward movement in interest rates in the foreseeable future, and any future move will be down.

But there is one area of the Fed's policies that is causing concern in financial markets. This is the indication that it may start winding back its intervention in the overnight repo market, which began last September when interest rates, which normally hover around the Fed's base rate, currently 1.5–1.75 percent, jumped to as high as 10 percent.

Over the past three months, the Fed has pumped more than $300 billion into financial markets through the purchase of short-term assets, expanding its balance sheet to $4.1 trillion.

The US central bank has insisted that this injection of cash is not a return to "quantitative easing" (QE), and is merely a technical measure to stabilize the repo market. In his press conference address, Powell said that over the first half of 2020 the Fed would adjust the size of its repo operations "as we transition away from their active use in supplying reserves."

During the question-and-answer period, Powell was directly asked whether the Fed's repo operations had provided a boost to the markets. He avoided the question, saying markets were moved by "many" factors. But Steve Liesman of the business channel CNBC, who asked the question, later pointed out there was a direct correlation between the start of the Fed's intervention and the latest surge in the markets.

The issue was the subject of an article in the *Financial Times* titled "Analysts fear market hooked on Fed support," in which the newspaper warned that if the Fed does stop buying, it could trigger a reaction.

Priya Misra, head of global rates strategy at TD Securities, told the newspaper: "My biggest fear is that they stop in the middle of the year and the market sees this as QE ending. You could see a tightening of financial conditions… and if you get a 10 percent drop in equities, do they have to come in and start cutting rates?"

The prospect of a major fall and the potential for a financial crisis appear to have come a step closer with the turbulence that has ripped through financial markets this week.