Fed cuts interest rate, but market plunge resumes

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Wall Street plunged again Tuesday, following a record single-day point rise of 1,294 in the Dow on Monday, despite an emergency rate cut by the US Federal Reserve of 0.5 percentage points.

The market opened sharply down and then rose, with the Dow climbing by 300 points after the Fed decision, only to resume the plunge over the rest of the day. At one point it was down by 997 points, finishing the day 786 points lower, a fall of 2.9 percent.

The S&P 500 closed down 2.8 percent after the index had recorded its largest one-day rise for two years on Monday, and the Nasdaq fell by nearly three percent.

The Fed rate cut, unanimously agreed to at a teleconference on Monday evening, was the first carried out between scheduled meetings since the financial crisis of 2008.

Announcing the decision, Fed Chairman Jerome Powell said the coronavirus and the measures taken to contain it "will weigh on economic activity here and abroad for some time." In an effort to reassure markets, he acknowledged that, while the central bank's decision would not reduce the rate of infection or fix a broken supply chain, "we do believe that our action will provide a meaningful boost to the economy."

But there are indications it may be having the opposite effect, with a common reaction to the decision being the question "what does the Fed know that we don't." Moreover, the decision has a major impact on banks, whose profit margins are reduced by a lower benchmark interest rate. Bank stocks, together with high tech, led the market down.

Longer term concerns about the state of the US and global economy were reflected in the fall in the yield on 10-year US Treasury bonds. At one point it fell to below one percent, finishing the day at just above that level, a record low.

The 10-year yield has been falling sharply since the beginning of the year, before the effects of the coronavirus began to hit, as investors sought a safe haven, driven by fears that the global economy might be moving into recession.

With the impact of the virus rapidly spreading, Goldman Sachs downgraded its forecast for US growth to an annualised rate of 0.9 percent in the first quarter and zero in the second.

The Fed's statement pointed to further interest rate reductions, saying it would continue to monitor developments and their implications, and would "use its tools and act as appropriate to support the economy."

The reaction in the market indicates it wants still more action—a position expressed in a tweet by US President Trump. "The Federal Reserve is cutting, must further ease," he tweeted. "More easing and cutting!"

The Fed's emergency move came in the wake of decisions by both the Malaysian central bank and the Reserve Bank of Australia (RBA) to cut rates. The RBA said the coronavirus outbreak was having a "significant effect" on the Australian economy, the world's twelfth largest.

The finance ministers of the G7 group of major economies issued a statement that they stood ready to use all appropriate tools to "achieve strong, sustainable growth and safeguard against downside risks," but did not specify any coordinated action.

They also promised fiscal support to health systems. This supposed commitment could be characterised as rubbing salt into the wound. Health systems in all major countries have been severely hit by years of cuts, as part of deep-going austerity programs and the effects of privatisation, which have left them ill-equipped to deal with the health crisis.

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Just as the effects the coronavirus on infected individuals appear to be exacerbated by preexisting health problems, the same could be said about its social and economic impact.

This week, the 36-member Organisation for Economic Cooperation and Development (OECD), covering the world's major economies, issued an emergency report on the state of the global economy. In the best case scenario, it said that on the assumption that the epidemic peaks in China in the first quarter of this year and outbreaks in other countries are mild and contained, global growth could fall to 2.4 percent, lower by 0.5 percentage points than its forecast last November. Economies with close connections to China, such as Japan, South Korea and Australia, would be particularly hard hit.

But in the event of a longer lasting outbreak, global growth could drop to just 1.5 percent.

Even this figure could be an underestimation, as the OCED pointed to the significant slowdown in the world economy before the virus struck. It noted that "industrial production continued to stagnate in late 2019, and the growth of consumer spending lost momentum." The pace of decline in global car sales had started to moderate through 2019, but "demand has subsequently tumbled again."

Global trade "remains very weak," with merchandise trade volumes contracting in the last quarter of 2019 and for the year as a whole—the first such decline since the plunge in world trade in 2009.

Investment, a key factor in the capitalist economy, tells the same story. According to the OECD, investment growth in the G20 economies (excluding China) fell from an annual growth rate of five percent at the start of 2018 to just one percent last year.

The report pointed to the effects of the US trade war against China, saying the higher tariffs imposed by Washington were "an important factor behind the weakness of global demand, trade and investment."

Growth in the euro area was expected to remain sub-par, at an average of around one percent over the next two years, with the effects of the virus further weakening the outcome in the first half of this year.

The OECD added its voice to those warning of the rise of global debt and the mounting financial risks posed by the increased issuance of lower than investment-grade (junk) bonds and BBB-rated bonds, just one notch above junk status. Last year, over half of all new bonds were rated BBB, and a quarter were below investment-grade level.

These developments "raise the risk of significant corporate stress" in the event of a sharp economic downturn, the OECD wrote. Under such conditions, BBB-rated bonds could be reduced to noninvestment grade, "with the associated enforced sales amplifying the financial market effects of the initial downturn triggered by the coronavirus spread."

The effects of the coronavirus outbreak are only beginning to make themselves felt, but fundamental political conclusions can already be drawn.

The ruling elites have delivered a class response: trillions of dollars are being made available to the markets in order to sustain the wealth-gouging of the financial oligarchy, while virtually nothing is being provided to meet the health needs of the mass of the population. In the US, for example, Trump has asked for only $2.5 billion, half of which would be taken from other health programs.

But the fall in the market following the Fed's latest rate cut indicates that financial markets are on a collision course with developments in the underlying economy, and that the policy of trying to boost the economy through ever greater supplies of cheap money, pursued over the course of the last four decades, is breaking down.

The response of the ruling class will not be to reverse course, but to double down on its attacks on the working class.

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