

Markets plunge in worst fall since 2008 crisis

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Global stocks plunged yesterday in the worst sell-off since the global financial crisis of 2008, with indications that worse may still be yet to come as reflected in the fall in Asian markets when trading began today.

Yesterday, after falls across the Asia-Pacific, where the Tokyo and Sydney markets dropped by around 7 percent and similar sell-offs in Europe, Wall Street plunged on opening. The fall was so large that it triggered a circuit breaker that suspended trading for 15 minutes in order to try to halt panic selling.

The fall continued throughout the day with the Dow closing more than 2,000 points down, its largest one-day point fall in history. There was a drop of more than 7 percent in all market indexes, taking Wall Street close to entering a bear market—defined as a 20 percent fall—since its high in mid-February.

The downturn, initiated by the economic impact of the coronavirus, entered a new stage over the weekend with Saudi Arabia launching an oil price war. It boosted production and offered discount prices, following the breakdown of an agreement with Russia to limit supply and maintain prices.

The decision sent oil prices tumbling by between 25 and 30 percent when markets opened this week.

While the collapse in oil prices triggered the share sell-off, the underlying cause lies in the complete divorce of share market valuations—boosted by the continuing supply of cheap money from the US Federal Reserve and other central banks—from the underlying real economy.

Last week, the Fed responded to the sharp fall in the markets in the way it has done in the past, by announcing an emergency rate cut of 0.5 percent and indicating that more was to come. But the move failed to give any boost to share prices. As a former vice chairman of the Fed, Alan Blinder commented: “The markets were happy about that for about 15 minutes and then gave it a Bronx cheer.”

The collision between market euphoria, fuelled by the belief that central banks could forever counter any significant downturn, and the underlying recessionary

trends in the US and global economy, has resulted in fear and panic.

The head of US equities for Aviva Investors Susan Schmidt told the *Financial Times*: “This is total panic.”

Schroders’ head of global equities Alex Tedder told the newspaper: “The mantra right now is you can forget about return on investment, it’s return of investment—will I get my money back? That’s all investors care about.”

A portfolio manager at Janus Henderson Investors, Paul O’Connor said, in just over two weeks investor sentiment had swung from complacency to panic.

“What started as a virus-driven de-risking has now mutated into a broad-based, multi-asset capitulation,” he said.

The market sell-off is being exacerbated by the dysfunctional, one could say insane, response of US President Trump.

After dismissing the threats posed by the spread of the coronavirus, he claimed the drop in the oil price would be good for the US economy.

“Saudi Arabia and Russia are arguing over the price and flow of oil. That, and the Fake News, is the reason for the market drop!” he tweeted, adding “Good for the consumer, gasoline prices coming down!”

Meanwhile tens of millions of American workers have seen billions of dollars wiped off their 401(k) pension plans, together with losses incurred by millions of workers around the world dependent on similar schemes.

The deep-rooted crisis in the real economy is exemplified in a number of areas.

The oil price war itself is the outcome of significant falls in demand resulting from the downturn in the Chinese economy, apparent before the coronavirus outbreak, and the marked slowdown in the euro zone area. Germany, together with France and Italy, stand on the brink of recession or have already entered one.

Japan is also expected to record another quarter of negative growth having experienced a 6.1 percent contraction in the last quarter of 2019.

Global demand for oil has fallen by 2.5 million barrels a

day for the first quarter this year as a result of the contraction of the Chinese economy, the world's largest consumer.

The International Energy Agency has cut its global demand forecast for the rest of the year. It said there would be a fall in daily demand of 90,000 barrels, compared to the forecast of a daily increase of 825,000 barrels made only last month.

Another clear indicator of future trends is the precipitous fall in the yield on 10-year and 30-year US Treasury bonds as investors, searching for a safe haven, push up their price.

At one point yesterday, the yield on the 10-year bond fell to a low of 0.3 percent before rising to 0.5 percent. The yield on the 30-year bond fell below 1 percent for the first time ever, meaning that the yield is below 1 percent across the market.

The fall in the bond market makes it virtually certain that the Fed will again cut interest rates, probably by 0.5 percentage points when it next meets on March 17-18, or possibly even before. It is likely to cut again in April.

However, as the market response to last week's emergency cut shows, further interest rate reductions will have a very limited effect because they will do nothing to boost the real economy.

There is a growing realisation that what is unravelling is a series of mechanisms that have been employed not only since the global financial crisis of 2008, but stretching back to the late 1980s.

The crash of the stock market in October 1987 saw the implementation of a policy in which the Fed responded to every significant fall in shares by opening the financial spigots to enable further speculation.

This process was accelerated after 2008 through interest rate reductions and so-called quantitative easing. Trillions of dollars were supplied to the financial markets to enable the continued siphoning up of wealth to the upper echelons of society.

At the same time the working class was made to pay through austerity cuts to basic social services—health, education and other facilities—along with stagnant or falling real wages and the replacement of full-time jobs with part-time or contract work, much of it in the so-called gig economy.

The endless provision of cheap money has now created the conditions for another financial crisis, even more serious than that of a decade ago, which, as the historical record shows, will bring even deeper attacks on the working class.

One of the most significant developments in the financial system has been the accumulation of corporate debt, much of it of low quality. Corporations have taken advantage of ultra-cheap money to finance ever riskier operations as well as mergers and takeovers and share buy backs.

The result is that around 70 percent of corporate bonds, estimated to be as much as \$10 trillion in the US, are either below investment grade, so-called junk status, or have a BBB rating, one notch above junk, and are susceptible to a write down to junk status in the event of a recession or a financial crisis.

The use of high-risk junk bonds has been particularly prevalent in the US shale oil industry, which is dependent on the maintenance of higher oil prices and the generation of revenue to make interest payments.

The rise of this industry—financed by risky debt but hailed by Trump as providing economic independence of the US from the global oil market—is now becoming one of the transmission mechanisms for a financial meltdown.

As the *Financial Times* noted, access to bond markets for these companies, had already become strained, “raising the risk they will be unable to refinance their debt, pushing them into bankruptcy.”

The growing concern is that high-yield, high-risk corporate debt as a whole will be affected.

Those concerns are reflected in the lowering valuation of bonds issued by energy companies and the rising costs of insurance against the risk of default on junk bonds across the board.

Deutsche Bank analyst Craig Nichol said the outbreak of the conflict in the oil market could not have come at a worse time for the US high-yield market as whole.

“The big question... is contagion to the broader high-yield markets outside of energy. In our view it is inevitable.”

Whatever the gyrations of the markets over the next days and weeks, it is clear that an inflection point has been reached. The very processes and mechanisms used to sustain the global economy and financial system over the past period are now collapsing. Rather than a means to ensure stability, they have proved to be the source of a new and rapidly developing crisis.



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