

Market turbulence continues in day of swings

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Global markets recovered somewhat yesterday from Monday's massive sell-off in a trading day that culminated in large swings on Wall Street.

It began with a rise in Asia, prompting a comment from one Tokyo-based trader that there was a "thin semblance of sanity ... but we are talking very thin indeed." European stocks opened 4 percent higher but then closed down by 1.1 percent.

In the US, the day began with a rise in stocks, followed by a sharp fall that saw major indexes come within a hair's breadth of entering bear market territory—defined as a fall of 20 percent from their peak—before a surge at the end of the day.

The Dow finished up 1,167 points, a rise of 4.9 percent, with the S&P 500 rising by the same percentage.

The main factor behind the Wall Street rise appears to have been the announcement by US President Trump that the administration will launch a "major" economic relief package, prompting the belief there are profits to be made out of such measures, at least in the short term.

However, the key determinant of the state of the economy and its impact on financial markets is the rate of spread of the coronavirus worldwide. That is continuing to rise with the economic fallout widening—the lockdown of Italy being the sharpest expression.

The always fanciful notion that the effect on the global economy would be V-shaped—a sharp downturn in the first quarter followed by an upturn—has now been scrapped as economic forecasters downgrade their predictions.

As the *Wall Street Journal* noted yesterday, regions affected by the coronavirus are being hit from two sides. There is a supply shock as factories stop and a demand shock as consumers and businesses hold back spending.

"The combined effects risk pushing the global

economy into a self-reinforcing, downward spiral—a possibility fuelling market turmoil and prompting many executives around the world to prepare for darker scenarios than before," it said.

On Monday, the ratings agency Moody's cut its forecast for growth in the US for the year from 1.7 percent to 1.5 percent and for the G20 economies from 2.4 percent to 2.1 percent. But even these lowered forecasts may be optimistic.

Moody's vice president Madhavi Bokil warned that "a sustained pullback in consumption coupled with extended closures of businesses would hurt earnings, drive layoffs and weigh on sentiment" and that "such conditions could ultimately feed self-sustaining recessionary dynamics."

That process has already begun in the global airline industry as travel is cut back because of the virus.

Carriers are slashing flight schedules and grounding large planes. United Airlines has said it expects revenues to fall by as much as 70 percent in April and May. Korean Air has warned that it may not survive unless the coronavirus is quickly brought under control, and has cut 80 percent of its international capacity.

Alan Joyce, the chief executive of the Australian-based airline Qantas, said the company was grounding its large-capacity aircraft, cutting almost a quarter of its international flights, and foreshadowed job cuts. He declared that 2,000 staff were now "surplus to requirements."

Predicting that some airlines would go to the wall, Joyce said: "I think this will be a survival of the fittest."

The oil price war, which broke out over the weekend with the collapse of an agreement between Russia and Saudi Arabia to limit production in order to sustain prices, is hitting oil-producing states. This is giving rise to turbulence in financial markets because of its effects on highly-indebted shale oil producers in the US.

With oil now at around \$35 per barrel, having plunged by up to 25 percent virtually overnight, many oil-producing countries will not be able to sustain their already strained budgets and will face currency and balance of payments problems.

Nigeria announced on Monday that it would slash its budget for 2020 which had been based on an average of \$57 per barrel for the price of oil.

Angola, already dependent on support from the International Monetary Fund to try to boost its non-oil revenue, will need even more support.

Algeria, which has initiated major cuts in public spending, had based its budget plans on an oil price of \$60 a barrel. According to the North Africa director of the International Crisis Group, Riccardo Fabiani, “the impact of the latest fall in oil prices will be massive.”

Other countries to be adversely affected include Iran, Iraq, the Gulf states, and Venezuela and Ecuador.

The oil price war is also reaching into the US financial system via the market in corporate bonds issued by oil companies. They have exploited the provision of ultra-cheap money by the Federal Reserve since the global financial crisis to fund ever more risky financial operations.

Yesterday the *Financial Times* reported: “Nearly \$110 billion of bonds sold by energy companies in the US have fallen into distressed territory, after a plunge in oil prices left investors doubting that the money will be paid back.”

Of the \$936 billion worth of bonds issued by US oil and gas companies, around 12 percent are trading with a yield more than 10 percentage points above that on US Treasuries, a measure regarded as the definition of stress.

For so-called junk bonds, those rated below investment grade, which account for \$175 billion of the total, the proportion under stress has risen to almost two-thirds. According to Michael Anderson, a strategist at Citi, “there is definitely a significant amount of default risk.”

There have been major falls in the valuation of oil and gas corporate bonds this week. The *Financial Times* reported that a \$477 million bond issued by the Denver-based company SM Energy lost more than half its value in Monday’s market plunge, falling from 90 cents on the dollar last week to just 42 cents. Other companies’ bonds have dropped by as much as 40

cents on the dollar.

Smaller companies, which have sought to cash in on shale oil production, issuing large amounts of debt to do so, are not the only ones to be hit.

Yesterday Occidental Petroleum, one of the largest US oil and gas companies with major global operations, announced it was cutting its dividend by 90 percent, the first time it has made such a move since 1991.

Occidental was among the hardest hit in Monday’s bloodbath, as its share price plummeted by 50 percent.

The company’s financial operations are symptomatic of the parasitism throughout the entire US financial system. Last August it ramped up its debt in a \$55 billion takeover battle with Chevron to acquire Anadarko Petroleum. The deal was based on the gamble that oil prices would continue to rise.

Since the deal was concluded, with assurances to investors that dividend payouts would remain sacrosanct, Occidental’s market capitalisation has fallen from \$42 billion to around \$12 billion.

The issue hanging over the US financial system is how many other companies are in the same position because their market capitalisation, boosted by the inflow of cheap money from the Fed over the past decade and more, bears no relation to the state of the real economy.

There is also a growing fear that the rising risk of defaults in the oil-based corporate bond market could be the start of a process that extends more broadly, under conditions where a large majority of US corporate debt has junk status or is rated at BBB, just one notch above it.



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