

# Despite massive Fed intervention, market plunge continues

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The sell-off on Wall Street intensified on Monday, with market indexes falling by the largest amount since the “Black Monday” collapse of October 1987, despite the Federal Reserve slashing its interest rate to near zero and resuming financial asset purchases.

The market plunge went across the board as the coronavirus spread across the US and internationally and new restrictions on economic and social activity were put in place.

The Dow dropped almost 3,000 points—its largest point fall in history—losing almost 13 percent. The S&P 500 index fell 12 percent, taking it to 30 percent below where it was a month ago. The Nasdaq was down 12 percent, the largest one-day fall in the history of the index.

The Wall Street plunge followed major selloffs in the Asia-Pacific region and Europe. The Australian market was one of hardest hit, down almost 10 percent for the day. The UK’s FTSE index dropped a further 4.7 percent, bringing its total losses for the year to 30 percent.

The theme of all the comments by financial analysts was that action by central banks could do nothing to halt the downward spiral.

“The Fed has thrown everything at this. If are now facing the end of central bank action, it means we are on our own,” said Seema Shah, chief strategist as Principal Global Investors. “There is a fear settling in the market; investors are terrified that this was all that was left.”

In comments reported by the *Financial Times*, Joachim Fells, global economic adviser to the major bond trader Pimco, said markets were concerned about “what currently looks like an inevitable recession... turning into a depression and the financial markets [going] from a drawdown to a meltdown.”

What a “recession turning into a depression” looks like can be seen from the latest economic data from China.

In the first two months of the year, as the country went into lockdown due to the coronavirus outbreak, industrial output fell by the largest amount on record, declining by 13.5 percent, much worse than had been expected by

analysts.

Retail sales plunged 20.5 percent and fixed asset investment fell 24.5 percent, following a 5.4 percent increase when it was last reported.

Growth in services fell 13 percent. Combining these figures, Capital Economics has estimated that Chinese gross domestic product fell 13 percent in the first two months of the year.

The massive hit to the Chinese economy is a preview of what the rest of the world can expect in coming weeks and months.

Jim McCafferty, the joint head of Asia-Pacific equity research at the Japanese finance house Nomura, told the *Wall Street Journal* the Chinese data were “sending a frightening signal to other economies. We will see a similar impact on global GDP numbers.”

A foretaste of what is to come in the US and elsewhere was provided by a survey conducted of New York state business activity at the beginning of this month.

It found that an index of general business conditions dropped by 34 points to -21.5—the biggest fall in its history and its lowest level since 2009.

One of the key motivations for the Fed’s emergency intervention was the clear indication of a freeze in credit markets as the yield on Treasuries rose, rather than falling, as a result of the market plunge, and trading in mortgage-backed securities came to a standstill.

In an effort to alleviate this situation, the Fed poured \$1.5 trillion into the overnight repo market. But this measure failed and it decided to resume purchases of financial assets such as Treasuries and mortgage-backed securities.

The first purchase of \$40 billion took place yesterday. But the New York branch of the Fed still found it necessary to make a \$500 billion intervention into the repo market yesterday, after rates jumped to as high as 2 percent. It said the additional support was needed to ensure the “smooth functioning” of the short-term dollar funding market.

One of the reasons for the precipitous market decline is the issuing of margin calls to debtors by their creditors, in which

they demand more cash to back up their loans. This leads to a situation where stocks are sold off in a falling market in an endeavour to obtain cash, exacerbating the plunge.

The extent of this process is indicated by the fall in the price of gold and platinum, both of which are usually regarded as a safe haven during market turbulence.

Gold has now wiped out all its price gains for the year and the price of platinum has dropped by more than a quarter.

According to one trader, cited by the *Financial Times*, “it’s case of selling everything” as hedge funds and other speculators seek to cover losses and margin calls.

The credit crunch extends far more broadly because of the accumulation of debt over the past decade, much of which has not been used to finance productive investment but deployed in share buy-backs, takeovers and merger deals.

First in line are companies that have used lower than investment grade, or so-called junk bonds, to finance their activities. This has been a major source of financing in the US shale oil industry where investments were undertaken on the basis that the oil price would stay above \$50 a barrel.

Many of these companies are facing bankruptcy because of the plunge in oil prices to around \$30 a barrel.

The slide was initiated by the oil price war launched by Saudi Arabia 10 days ago and has been exacerbated by the stock market plunge and the recognition that the global economy is certain to experience a recession, if not something worse.

But as the crisis deepens other areas of the economy, above all the airline industry, are being severely affected. Yesterday, the S&P ratings agency lowered the debt rating of the world’s largest aircraft manufacturer, Boeing, to BBB, just one notch above junk status.

The downgrade was motivated by the fear that Boeing would rapidly burn through the cash available on its credit line of more than \$13 billion.

Airline companies are slashing their flight schedules, both for international and domestic travel, with US companies reporting that cancellations of bookings exceed new orders.

In a symptom of the global crisis in the industry, the Australian carrier Qantas has announced it is cutting its international operations by 90 percent and domestic flights by 60 percent.

In a report on the industry, the Centre for Aviation, a well-known consultancy group, has warned that by the end of May most airlines will be bankrupt as a result of travel restrictions introduced by governments around the world.

“Many airlines have probably already been driven into technical bankruptcy, or are at least substantially in breach of debt covenants,” it said. The centre called for emergency government action “if a catastrophe is to be avoided.”

Even before the latest round of travel restrictions, IATA,

the airline trade organisation, estimated the industry would lose as much as \$113 billion as a result of the crisis.

The broader significance of the financial and economic crisis was pointed to in a research note issued last Friday by Australian investment bank Macquarie last Friday.

“Unless this ‘death spiral’ is arrested,” it said, “all assets—except extreme safety—will collapse, capital will freeze and liquidity disappear. At that point our entire asset-based financialized world will reset.

“Funds will collapse, pensions won’t get paid and we will need to recognise that decades of growth were not sustainable, ultimately converging money supply and GDP, and in the process wiping out years of rising standards of living.”

Issued before the latest meltdown, the Macquarie research called for central banks to embark on fully-fledged quantitative easing. Since then, the US Fed has adopted that policy and still the collapse continues.

The reference to the convergence between money supply and GDP points to the underlying reason for the economic crisis, which is the divergence between the elevation of financial markets, pumped up by debt over the past three decades, and the real economy.

The resulting financial house of cards is the source of the deepening economic, financial and health crisis. It can only be resolved by ending the domination of finance capital responsible for the disaster, and the massive reallocation of resources and wealth out of the financial system to meet social and human needs, not profit.

In short, it requires the complete economic reconstruction of society on a world scale on socialist foundations.



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