Nick Beams
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Wall Street records biggest monthly decline since start of pandemic

September was the worst month for Wall Street since the meltdown of March 2020 at the start of the pandemic amid growing problems for both the US and global economy.

A sign for a Wall Street building, Wednesday, May 19, 2021, in New York [Credit: AP Photo/Mark Lennihan]

The three major indexes ended the month on Thursday with significant falls. The Dow dropped 547 points, or 1.6 percent, the S&P 500 was down 1.2 percent and the NASDAQ was off 0.4 percent. The monthly declines for the three indexes were 4.3 percent, 4.8 percent and 5.3 percent respectively.

The fall has been driven by several factors, working in combination. These include: inflation; the prospect of interest rate rises; the conflict over the US debt ceiling and slowing production in China resulting from a power crisis.

On the inflation front, despite the mantra from the Federal Reserve chief Jerome Powell, along with other central bankers, that the surge is due to temporary factors which will abate once economies begin to recover from pandemic effects, there are growing fears it is becoming permanent.

One indication of this came this week when the price of oil went over $80 a barrel amid a surge in natural gas prices.

Speaking to a House financial services committee on Wednesday Powell maintained his position that the price hike was temporary. He expected it to reverse but gave no indication when that might happen and nor could he.

The surge in prices, he said, was a "function of supply-side bottlenecks over which we have no control. We have an expectation that high inflation will abate, because we think the factors that are causing it are temporary and tied to the pandemic and the reopening of the economy."

In response to questions, Powell said the Fed would find itself in a "very difficult situation" if inflation continued above the Fed's 2 percent target while the economy was "far away" from full employment. If inflation came down of its own accord, then the Fed would not have to face the "difficult trade-off" of having to lift interest rates while there was still slack in the labour market.

But so far there are few signs that inflation will subside. Earlier this month, the Organisation for Economic Cooperation and Development (OECD) issued a revised projection saying it expected inflation to be higher in 2021 and 2022 than it had previously forecast.

OECD chief economist Laurence Boone said inflation would present policymakers with a "difficult balancing act."

A *Financial Times* (FT) report on the latest OECD projections provided an insight into the political economy of the insistence by Powell and others that the inflation spike is temporary.

According to the FT: "Boone said consistent communication on the temporary nature of much of the inflation would help prevent businesses and household from thinking it was fair to raise prices and demand higher wages, something that would make higher inflation last longer and become more damaging."

There is no greater fear in leading economic policy circles than the present round of prices will spark a push for higher wages in the working class—the indications of which are growing—to make up for the cuts in living standards that have already taken place.

Another factor in the growing market nervousness is the fear that central banks are going to lift interest rates sooner than anticipated. Wall Street took heart from the latest Fed meeting of September 21–22 and rose even though Powell indicated that the central bank would most likely announce a winding back of its $120 billion monthly asset purchases at its November meeting.

This was because he insisted any decision to lift the bank's base interest rate from virtually zero would not take place until the tapering process had concluded. But the subsequent announcement by the Bank of England that it was considering tightening its monetary policy by the end of the year sparked a wave of selling.

Low interest rates and the trillions of dollars of asset purchases by the Fed and other central banks since 2008—a process which accelerated as a result of the pandemic—have fuelled the rise in the stock market, but there are warnings of a sharp turn of events.

Mike Lewis, the head of US equity cash trading at Barclays, told the FT this week: "The game is going to work until it doesn't and when it doesn't… I foresee something very violent. I could see a real equity market drawdown. You've had 14 years of global co-ordinated central bank accommodative behaviour."

Bond prices have started to fall leading to an increase in interest rates—the two have an inverse relationship. This week the yield on the 10-year Treasury bond—a benchmark for

US and global financial markets—rose to 1.55 percent from 1.31 percent a week earlier—a seemingly small increase but a steep rise in the bond trading world.

Adding to the market uncertainty is the conflict over the move to lift the US debt ceiling. While a resolution passed by Congress on Thursday has averted an immediate US government shutdown and provided money for most departments until December 3, the issue of raising the debt ceiling remains unresolved.

This is despite continued warnings by treasury secretary Janet Yellen that failure to do so will have “catastrophic” consequences if the US government defaults on its debt. The Republicans have refused to vote for the increase on the grounds that this would be endorsement of the Democrats spending program. In fact, lifting the ceiling does not authorise new spending, it merely makes possible spending passed by Congress.

Speaking to a business conference following her testimony to the Senate banking committee, Yellen said a dysfunctional Congress could be a bigger threat to the US economy than the pandemic.

The president of the New York Fed, John Williams has warned that if no agreement is reached investors would become “extremely nervous” leading to an “extreme kind of reaction in markets.”

The financial market nervousness is being compounded by the growing financial and economic problems in China. While there is general sentiment that the problems surrounding the debt-laden property developer Evergrande can be contained—by no means a foregone conclusion—other issues are emerging.

This week China’s official manufacturing purchasing managers’ index, a gauge of factory activity, dropped to 49.6 in September. This was the first time it has fallen below the 50-point mark, which marks the boundary between contraction and expansion, since the start of the pandemic in February 2020.

The decline was the product of severe power shortages and a slowdown in the property sector.

Power shortages have affected at least 10 Chinese provinces. Power companies have been unable to meet rising demand from industries because of the rising price of coal and other energy sources as well as the increased costs imposed to meet the government's emission targets.

Earlier this week Bloomberg reported that the top state-owned energy companies—in coal, electricity and oil—had been ordered to secure supplies for winter "at all costs" with the directive coming from Vice Premier Han Zhen, who is in charge of the country energy sector and industrial production.

The chief China economist at the Japanese financial firm Nomura, Ting Lu, told the FT that the power issues in China may have been underestimated because of the focus on Evergrande.

"The power-supply shock in the world's second-biggest economy and biggest manufacturer will ripple through and impact global markets," he said.

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