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World stock markets fall as U.S. ills spread

By David J. Lynch, USA TODAY

No place to run. No place to hide.

As the sun moved west Monday, it shone on one market bloodbath after another. First Tokyo, then Hong Kong and Bombay. Later, Moscow, Frankfurt, Paris and London joined the casualty list. Market indexes in every important capital ran red.

"It's a scary time in markets worldwide. This is turning into a crisis of confidence around the world," said Eswar Prasad, former chief of the International Monetary Fund's financial studies division.

If the rest of the world once hoped it might decouple from the sputtering U.S. economic engine, those hopes have been shredded. Monday's comprehensive market rout was both a verdict of "not good enough" on the United States \$700 billion financial rescue plan and a stark expression of the investor fear that is spreading without regard to borders.

"This is global, and this is the downside of globalization," said Stephen Wood, senior portfolio strategist with Russell Investments.

Investors were battered from one side of the globe to the other. In Jakarta, Indonesia, stocks dropped more than 10%. Trading in Russia was halted in an unsuccessful attempt to stop the slide; stocks plunged almost 19%. Frankfurt's Dax index sank 7%. Paris lost 9%.

Monday's nerve-rattling downturn reflected worries — only 72 hours after it had been signed into law — that the U.S. bailout will prove insufficient. Much of the investor anxiety was only made worse by Europe's halting efforts to safeguard its suddenly suspect banks.

As recently as last week, European officials confidently regarded the financial crisis as a mostly made-in-America problem. No longer. Sweden, Iceland and Denmark on Monday became the latest nations compelled to guarantee their citizens' bank deposits, joining Germany, which acted Sunday, along with Ireland, Greece and Austria.

The action was welcome, but the flurry of individual moves fell short of pan-European action akin to the U.S. Treasury's comprehensive approach. French President Nicolas Sarkozy, who hosted the leaders of Britain, Germany and Italy in a summit of Europe's four leading economies this weekend, had sought a coordinated response to the vulnerable banks. But vehement opposition from Germany and the U.K., loath to commit their taxpayers' money to bail out banks in fellow EU nations, sank the effort.

That disappointment left skeptics fearing that Europe will remain behind the curve in its response to the fast-moving crisis. It's long been apparent that Europe's banks held much of the toxic mortgage-backed securities that U.S. institutions peddled in recent years. In April, the IMF reported that banks on the other side of the Atlantic held 41% of an estimated \$740 billion in net subprime mortgage exposure.

Several European banks — Drexia, Germany's Hypo Real Estate and the U.K.'s Bradford & Bingley — already have needed government rescues ranging from capital injections to outright nationalizations. "The main problem for Europe is that a coordinated response has proved impossible to reach, and the case-by-case approach that has so far been applied has clearly failed to restore confidence," Dragana Ignjatovic, an analyst at Global Insight, wrote in a note to clients.

The European currency is reflecting that lack of confidence. Monday, the euro fell below \$1.35 for the first time in more than a year. This spring, the currency traded as high as \$1.60.

It's not over, over there

Two weeks ago, German Finance Minister Peer Steinbrück predicted that the current crisis would mark the end of the U.S. "superpower status in the world financial system." But now, it's Europe's political limitations that are on display. Unlike the

U.S., the European Union has no single financial supervisory authority that can act with the power of the U.S. Treasury and no truly federal budget that could act as the deep pockets needed for a genuine bank bailout.

The European Central Bank, too, has shown itself far more concerned about the danger of resurgent inflation than about the danger of the economy sliding into an abyss. In the past year, while the Fed cut interest rates and invented ever more novel ways to pump staggering sums of money through the USA's financial plumbing, the European Central Bank stood pat. In July, even as the world trod steadily toward the edge, the ECB raised interest rates to the current 4.25%. Last week, it kept them at that level, though giving a rhetorical nod to the possibility of a coming cut.

The spread of economic weakness to encompass the three major advanced economies, the U.S., Europe and Japan, is raising fears that even so-far-resilient developing nations will eventually succumb.

"The markets are telling you we're going to have a severe recession. ... I think there's a chance the wheels could come off entirely," said Tim Lee, an economist at Pi Economics in Stamford, Conn.

The next hope for a coordinated response by policymakers comes later this week with the annual meeting of the International Monetary Fund and World Bank. Finance ministers and central bankers from 185 nations will gather in Washington, D.C., for four days of meetings starting Friday. Discussions are expected to focus on a potential multilateral remedy for the ailing global economy.

"This crisis is the result of regulatory failure to guard against excessive risk-taking in the financial system, especially in the U.S. We must ensure it does not happen again," says IMF Managing Director Dominique Strauss-Kahn.

Bill Gross, managing director of investment management firm Pimco, told clients Monday that the success of the Federal Reserve's crisis-fighting efforts depended, in part, on global coordination. "American-style capitalism is not just the bastion of America anymore," Gross wrote.

There are widespread calls for a coordinated rate cut by the Federal Reserve and foreign central banks. But such monetary policy teamwork may not be easily achieved. Some central banks, such as in Brazil, are at the end of a round of interest rate increases, Gross noted. Yet, some say the economic situation is becoming more dire by the day.

"Right now, markets do seem to be in something of a free fall, and the view could look much worse five days from now," said Prasad, an economics professor at Cornell University. "The time for action is definitely now."

It's not just in Europe that emotions are on edge. In India, when a few of ICICI Bank's ATMs ran out of money last month, it caused a minipanic. The bank, India's second-largest, held about \$81 million of Lehman Bros. securities, a tiny sum compared with the bank's \$10 billion capital base. Still, amid rampant speculation, India's central bank was forced to issue an unusual public statement, attesting to the bank's soundness.

From bad to worse?

Although the U.S. stock market rebounded from its midday lows Monday, there was no mistaking a growing worry that events now are in the saddle, and may be bound for an unattractive destination. "The situation has deteriorated so much that the choice now ... is between global recession and global depression," wrote Stephen Jen, Morgan Stanley's London-based currency specialist.

Jeffrey Frieden, author of the history *Global Capitalism*, says the current crisis is the inevitable result of economic imbalances that have persisted for years. For a decade or more, Americans have consumed more than they produced. To finance the resulting trade deficit, they borrowed hundreds of billions of dollars annually from foreign central banks. Dozens of economists said such large-scale borrowing was unsustainable and would end badly for the U.S. and its creditors alike. Now, they look like prophets.

That flood of capital — several trillion dollars over the decade — helped fuel the massive expansion of credit and resulting consumption boom that is now unwinding, Frieden said. There's only one path out of the kind of bust that follows such an unsustainable boom. The U.S. will need to reverse its bad habits, including saving more than it consumes. Such an abrupt turnaround, perhaps already reflected in the most recent consumer spending numbers that showed no growth over the same period one year ago, may be underway.

"That's very uncomfortable," he said. "That's austerity."

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