The New York Times
nytimes.com

January 22, 2008

World Markets Plunge on Fears of U.S. Slowdown

By MARK LANDLER and HEATHER TIMMONS

FRANKFURT — Fears that the United States may be in a recession reverberated around the world on Monday, sending stock markets from Mumbai to Frankfurt into a tailspin and puncturing the hopes of many investors that Europe and Asia would be able to sidestep an American downturn.

Until now, overseas markets had largely avoided the sell-off that has caused steep declines recently in the United States, whose markets were closed in observance of Martin Luther King's Birthday. But investors reacted with what many analysts described as panic to the multiplying signs of weakness in the American economy.

And in a sign that the United States could join the sell-off on Tuesday, trading in stock index futures pointed to a substantial decline when markets reopen on Wall Street.

The angst about the United States belies the popular theory that Europe and Asia are not as dependent on the American economy as they once were, in part because they trade more with each other. The theory, known as decoupling, has been used to explain why economies like China and Germany have kept growing robustly, even as the United States has slowed.

"The market is not at all convinced about decoupling, and I think the market is probably right," said Thomas Mayer, the chief European economist at Deutsche Bank in London. "When you look at it more closely, we're suffering from the same issues."

As exchanges opened on Tuesday in Asia, the decline only seemed to accelerate. Markets in Tokyo, Hong Kong, Sydney and Seoul, South Korea, all fell farther in the opening hours of trading than they had all day on Monday. The Hong Kong market plunged another 7.22 percent by late morning after tumbling 5.49 percent on Monday. In Tokyo, the Nikkei hit a low not seen since September 2005.

Monday's sell-off was evenly distributed from east to west. The DAX index of the Frankfurt Stock Exchange plummeted 7.2 percent, its steepest one-day decline since Sept. 11, 2001. The 7.4 percent drop in the Sensex index in Mumbai was the second-worst single-day tumble in its history.

Stocks followed suit when markets opened in the Western Hemisphere. Canadian stocks were down nearly 5 percent, and a key market index in Brazil was off 6.6 percent.

Shares of banks led the decline on Monday in many countries, underscoring that the subprime mortgage crisis continues to hobble the global financial system. On Monday, a German state bank, WestLB, said it would report a loss of $1.44 billion in 2007 because of its exposure to deteriorating mortgage assets.

"There is indeed some panic," Mr. Mayer said. "What we're seeing, in Europe and Asia, is that the markets are pricing in a recession."

Investors were scarcely comforted by President Bush's announcement on Friday of an economic stimulus package of as much as $145 billion. Mr. Bush's "shot in the arm," economists said, did not persuade the rest of the world that the United States will escape a recession, or that it will either.

In reference to the global stock sell-off, Jeanie Mamo, a spokeswoman for the White House, said: "We don't comment on daily market moves. We're confident that the global economy will continue to grow and that the U.S. economy will return to stronger growth with the economic policies the president called for."

The turmoil will put even more pressure on the European Central Bank, which has charted a different course from the Federal Reserve by warning that it might raise interest rates to curb inflation, rather than cut them, as the Fed has, to ward off a recession. Mr. Mayer and others predict the bank will be forced into an about-face in coming months.

While Asia has been less buffeted by the credit crisis than Europe, the Bank of China now appears vulnerable, with analysts predicting it will have to write-down the value of its American mortgage holdings.

Investors in Asia have been in a state of denial about a possible recession in the United States, said Adrian Mowat, JPMorgan's chief strategist in Asia. But now, he said, many believe "there's no debate about it." The only question, he added, is "how long and deep" a recession might be.

In Japan, which may be facing a new recession of its own, most indexes were off Monday by more than 3 percent .

In Europe, the housing market is cooling after a long boom, especially in Britain, Spain and Ireland. That will depress the growth rate in those countries, which are among the region's economic pace-setters.

European banks continue to make unwelcome disclosures about write-downs of mortgage assets, even if the losses are not as dire as those reported by Citigroup or Merrill Lynch. Bank loans across Europe are being constrained, according to a recent survey by the European Central Bank.

German banks, in particular, are haunted by the American subprime crisis. The troubles of WestLB came a week after a German property lender, Hypo Real Estate, lost a third of its market value after it disclosed higher-than-expected losses from the credit crisis. WestLB, after warning that its 2007 losses would be more than twice its earlier estimate, said its biggest shareholders, the state of North Rhine-Westphalia and regional savings bank, had agreed to inject up to 2 billion euros ($2.9 billion) of capital into the bank to stabilize it.

Also on Monday, Commerzbank warned it would make additional write-downs in the fourth quarter of 2007. This caught analysts off guard.

"The amounts are not so significant," said Simon Adamson, an analyst at CreditSights, an independent research firm in London. "It was more the way the market was caught by surprise."

Shares of Commerzbank fell 10 percent Monday, Deutsche Bank declined 6.7 percent, Société Générale of France dropped 8 percent, BNP Paribas decreased 9.6 percent and the ING Group of the Netherlands fell 10.5 percent.

But the damage extended to the shares of energy companies like BP and Royal Dutch Shell, which dropped on worries that a global economic slowdown would crimp the demand for oil and gas.

“The problem is more deeply rooted in anxiety about the global economy than it is in Germany,” said Boris Boehm, an asset manager at Nordinvest in Hamburg. “People are really afraid. But it’s a good thing because fear, along with action, gets the market to its proper level quickly.”

Those jitters extended to fast-growing markets, like China and India, that are thought to be relatively insulated from the United States. The Shanghai composite index, which had risen nearly 88 percent in the year through Friday, closed down 5.1 percent on Monday, while Hong Kong’s Hang Seng fell 5.5 percent, also the most since Sept. 11, 2001. It had been up 24 percent in the year through Friday.

While emerging markets may have been poised for a drop after their run-up, the rout on Monday may also signal a basic shift in sentiment, analysts said. Mr. Mowat of JPMorgan said that it did not matter whether markets were separated by geography or asset class because, he said, “we trade together in corrections.”

No matter how many bridges, roads, and power plants China builds, or how many new cars India sells, a downturn in the United States will ripple across the economies of Asia, experts said.

“If the United States consumer quits buying things, it is going to hurt in Asia,” said Deborah Schuller, an Asia regional credit officer for Moody’s Investors Service. She said most rated corporations there would be able to withstand a nine-month recession in America, but if it were to stretch to 12 months or more, there could be serious problems.

Worries about China are adding to Asia’s uneasiness. Its private property market is in the midst of a shakeout, and scores of small developers have gone out of business.

In both Asia and Europe, there may be further shocks as banks tally the fallout from their investments in the American mortgage market.

“There’s an old saying in the market that banks lead us into recession and banks lead us out,” Mr. Boehm of Nordinvest said.

Mark Landler reported from Frankfurt and Heather Timmons from New Delhi. Keith Bradsher contributed reporting from Hong Kong and Gardiner Harris from Washington.