From the London End

Stock Exchange Jitters

THE dramatic collapse on Wall Street, followed rapidly by repercussions on Stock Exchanges in London and the Continent, has given most people an unpleasant shock and despite the apparent quick recovery, the markets are now more unsettled than they were before. Although the recovery was equally dramatic and the American administration is pretending that everything in the garden is lovely once more, these soothing bromides do not really mask the underlying uncertainty in America or Western Europe.

How deeply the shock in Wall Street has affected the sensitive London market can be seen from the fact that even the two encouraging announcements on Thursday of last week, had very little tonic effect on the market. The first of these related to a substantial release of special deposits to be made by the Bank of England to the Clearing Banks — an announcement which followed, ironically enough, closely on the Chancellor's threat that the credit squeeze might, in fact, be tightened and the second to the decision to repay a further £ 25 million to the International Monetary Fund. The first measure certainly shows that the Bank of England has now a better grasp of economic realities, and appreciates that the rise in consumer spending has not been as substantial as was expected.

Chain Reaction

The behaviour of the Stock Exchanges throughout the world has justified the old saying that "when Wall Street sneezes London catches a cold". Critics of capitalism can point to the almost copybook reaction in all the main capitalist countries. The fall was particularly beavy in Switzerland, but large declines were reported from Frankfurt, Amsterdam, Milan and Paris. Everywhere, one of the causes of pressure was selling by America's nvestors, who in the past year or we have bought good many securiies in a variety of foreign markets.

The official explanation that the novement on the Stock Exchanges vas just a large technical readjustment, masks the fact that the business community generally is losing faith in the strength of the present recovery and in the intention of the American administration. U S profits were on a plateau from 1956 to the middle of 1961. There are still nearly four million unemployed, and the general belief in America is that the economic upswing will level off or turn into a recession some time in 1963. This fear about the trend of business is the real root of the bear market, and in these circumstances Wall Street prices appear to have been too high.

Gracks in the Boom

The main lesson is that prosperity can no longer be taken for granted. Small shareholders have been encouraged to buy equities to share in the fruits of economic growth; they are now by no means sure how much long-term growth the American economy can count upon, or how much this will be reflected in profits and in dividends. It now begins to look as if the "cult of the equity" is on the way out. The post-World War II inflationary boom—which was a long *one* and led to the widespread assumption that it might be indefinitely prolonged ~- is coming to an end.

Many investors have found the argument of hedging against inflation convincing enough to make them buy shares. This they haw been doing consistently since 1949. Only since the middle of May has the decline become general and gathered momentum. Investors have begun to realise that share prints have been pushed up beyond their real merit; the over-valuation had to be corrected, and once a bear market starts, no-one can say how far it may go. For almost two decades investors have got used to taking inflation, with rising profits and with rising share prices for granted. Expectations, and hence share prices, have been based on their continuation. Share values have been raised to levels that could only be justified if profits and dividends were to go on rising at the rate of the past (en years, The present setback can be read as the first substantial doubt in investors' minds whether this state will continue indefinitely.

Squeeze on Profits

The first real sign of weakness in Wall Street began after Kennedy's apparent victory over the steel men. Firm action against the steel magnates came as a further pointed reminder to investors that the days were now over when industry could simply raise prices to offset increases in wages and thus protect profit margins. Share prices, based on the continuation *of* expanding profits, were thus bound to suffer. The lesson was driven home in the U S and Europe that high economics activity, coupled with heavy pressure on profit margins on an international scale, could lead to a period of "profitless prosperity" which would make current yields and share prices ridiculously out of proportion. Indications *of* the pressure on profits were seen in Selwyn Lloyd's deliberate pay pause and credit squeeze and in Dr Erhard taking up the cudgels (less successfully than Kennedy) against the Volkswagen Company. In these circumstances. European investors have also had to adjust their ideas of future profits, and thus of present share prices.

The dilemma that facts Western Capitalism is this — measures to secure internal growth can lead to difficulties in the balance of payments, and a loss of confidence in the currency, a particularly important point for countries like the U K and the U S A with sterling and dollars accepted as international currency. Fear of the repercussions on the balance of payments has led to the slow rate of growth in the I K. America now faces the same problem. Austere economic policies in the United States might tend to help the dollar at least in the short term, but would certainly depress Wall Street. Big Government spending and deficit budgets would cheer up Wall Street at the expense of the dollar and the gold reserves. The long post-war period when the

main problems have been caused by boom and overstrain could well be coming to an end, and in the 1960s the trouble may not be inflationary pressure, but a deficiency of demand.

Surplus Capacity in Europe

Taken in conjunction with the emergence of an obstinate unemployment problem in the United States, and the growth of surplus capacity in industry after industry in Western Europe, the weakness of security prices suggests that a fundamental change is taking place in the economy of the West. Therefore, the traditional financial virtues will need reappraisal. This brings into prominence the recent debate that has been going on between expansionist economists and financial puritans in both the U S and Britain. The ability to cope with the new world of Insufficient rather than excessive spending will be a decisive test for the viability of Western capitalism. Can capitalism avoid the tragic part of unemployed men and machines side by side with unsatisfied human wants as conditions of chronic surplus emerge?

The main difficulty for America in following the group of economic advisers, headed by Walter Heller, who want to pump more purchasing power into the economy to make sure that increasing output can be sold, is that this might lead to a risk that a change in the dollar price of gold might one day become necessary, and this is one of the traditional shibboleths which the Americans find hard to abandon.

Inadequate Monetary System

That the Bretton Woods monetary system is hopelessly inadequate is becoming increasingly obvious. Problems of liquidity and the uneven distribution of the world's purchasing power must now really be faced. The present system is naturally unstable, based as it is on too little gold, secondary reserves which command no real confidence, a volatile fund of "funk money" moving freely from one financial centre to another, combined with nervous international stock markets. This could lead to a very dangerous situation.

There is little doubt that in the immediate future, the feeling of uncertainty will remain and both businessmen and consumers will be reluctant to extend their commitments. One of the main risks is that periodic financial crises) will undermine business confidence. Swiss businessmen, who have seen their stock market fall by 20 per cent in six weeks, and some leading stocks fall by 25 per cent in one day. arc not likely to be in an expansionist mood. The general feeling is bound to put a damper on business investment plans and on consumer spending intentions, certainly in the U S and to some extent in Britain and other European countries too There is no doubt that business confidence in the USA has been shaken — the further fall in Wall Street on Monday of this week is but another indication of this fact—and any slowing down of the U S business recovery is bound to have a considerable effect on the level of commodity prices arid on world trade.

Demand Stimulation : How?

This naturally raises the question of whether the stock market slumj) will generate a more general economic recession as it did 32 years ago. But 1962 is not 1929 and capitalist Governments to-day, although unable to prevent the unstable swing from boom to recession, have a whole panoply of instruments to combat a real slump consisting, in the main of the Keynesian countercyclical measures to stimulate demand and consumer spending, including large public works and deficit budgets. How quickly Governments will set about using them depends on the tenacity of the exponents of financial orthodoxy. An equally critical question is whether demand stimulation will take the form of an intensification of the arms drive, or whether it will lead to channelling of larger aid funds to the developing countries of the world, hungry for the products that can be made by the idle factories and labour and spare capacity of the West.

Behind Wall Street Crash

Ajit Hutheesing

JUST three months ago an Amcrican colleague in Wall Street observed that the recurrence of a 1929-type stock market collapse was impossible. He argued that condition? prevalent in the capital market in 1929 which brought about the crash arc no longer possible. The present cash requirement ('margin') is 70 per cent on new purchases of stock against the upto 20 per cent requirement in 1929. Also, the creation of the Securities and Exchange. Commission (SEC) in 1933 to protest the investor's rights and maintain an orderly market has done much to prevent a repetition of the widespread misconduct and misrepresentation, of the twenties. Other important dincrences too could be cited to substantiate the argument. Nonetheless on 'Black Monday'. May 28, 1962, there was panic on Wall Street and the market collapsed in a manner bearing some resemblance to the 1929 debacle. The question must be asked. "What went wrong on Wall Street?"

Recession Psychology

It is important to examine the context in which the problem finds its roots There can be no doubt that any elaborate comparisons with 1929 would involve false reasoning. Apart from the controls established in the stock exchanges since then, the United States economy is tightly regulated today. In recent years, the pundits of Wall Street have reacted to a "bear" market by giving events a curious optimistic twist. ,"It will separate the men from the boys" or "I have been waiting for an opportunity to buy depressed situations" were the sort of remarks heard with monotonous regularity* A detached observer once jokingly retorted, "But what happens when the cash is separated from the men?" The question, which was then treated with disdain, has now received serious consideration.

An agonizing reappraisal of the forces at work in Wall Street has been long overdue. How is it that