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Wall Street fears for next Great Depression

By Margareta Pagano, Business Editor
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Wall Street is bracing itself for another week of roller-coaster trading after more than $300bn (£150bn) was wiped off the US equity markets on Friday following the emergency funding package put together by the Federal Reserve and JPMorgan Chase to rescue Bear Stearns.

One UK economist warned that the world is now close to a 1930s-like Great Depression, while New York traders said they had never experienced such fear. The Fed's emergency funding procedure was first used in the Depression and has rarely been used since.

A Goldman Sachs trader in New York said: "Everyone is in a total state of shock, aghast at what is happening. No one wants to talk, let alone deal; we're just standing by waiting. Everyone is nervous about what is going to emerge when trading starts tomorrow."

In the UK, Michael Taylor, a senior market strategist at Lombard, the economics consultancy, said on Friday night: "We have all been talking about a 1970s-style crisis but as each day goes by this looks more like the 1930s. No one has any clue as to where this is going to end; it's a self-feeding disaster." Mr Taylor, who had been relatively optimistic, has turned bearish: "It really does look as though the UK is now heading for a recession. The credit-crunch means that even if the Bank of England cuts rates again, the banks are in such a bad way they are unlikely to pass cuts on."

Mr Taylor added that he expects a sharp downturn in the real UK economy as the public and companies stop borrowing. "We have never seen anything like this before. This is new territory for us. Liquidity is being pumped into the system but the banks are not taking any notice. This is all about confidence. The more the central banks do, the more the banks seem to ignore what's going on."

Mr Taylor added that the problems unravelling at Bear Stearns are just the beginning: "There will be more banks and hedge funds heading for collapse."

One of the problems facing the markets is that, despite the Fed's move last week to feed them another $200bn, the banks are still not lending to each other.

"This crisis is one of faith. We are going to see even more problems in the hedge funds as they face margin calls," said Mark O'Sullivan, director of dealing at Currencies Direct in London. "What we are waiting for now is for the Fed to cut interest rates again this week. But that's already been discounted by the market and is unlikely to help restore confidence."

Mr O'Sullivan added that the dollar's free-fall is set to continue and may need cuts in European interest rates to trim the euro's recent strength against the dollar. "But the ECB doesn't like cutting rates," he said.

On Europe, Mr Taylor said that while the German economy remains strong, others such as Italy's and Spain's are weakening. "You could see a scenario where the eurozone breaks up if economies continue to be so worried about inflation."

European financial markets were relatively unscathed by Wall Street's crisis but traders expect there to be a backlash when stock markets open tomorrow.

The Fed's plan will give 28 days of secured funding to Bear Stearns, which saw its value slashed over the week by more than a half to $3.7bn. JP Morgan will provide the funding, but the Fed will bear the risk if the loan is not repaid. Fed chairman, Ben Bernanke, who pumped $200bn of loans to cash-strapped institutions last week, said more would be available to help others in distress.

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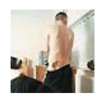
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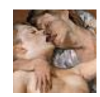
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