AP

The Big Story

Fear of slowing growth drags down global markets

By **PAUL WISEMAN** and **JOSHUA FREED**

— Jan. 24, 2014 6:33 PM EST

Home » **W.W. Grainger, Inc.** » Fear of slowing growth drags down global markets

Specialist Vincent Surace works on the floor of the New York Stock Exchange Friday, Jan. 24, 2014. (AP Photo/Jason DeCrow)

- **Prev**
- 1 of 4
- **Next**

Fear is back in the market.

Investors are worried about slower economic growth in China, a gloomier outlook for U.S. corporate profits and an end to easy-money policies in the United States and Europe. They're also fretting over country-specific troubles around the world — from economic mismanagement in Argentina to political instability in Turkey.

Those fears converged this week to start a two-day rout in global markets that was capped by a 318-point drop in the Dow Jones industrial average Friday. It was the blue-chip index's worst day since last June. The Dow plunged almost 500 points over the two days.

The Dow finished down 2 percent at 15,879 Friday. The Standard & Poor's 500 index fell 38 points, or 2.1 percent, to 1,790. The Nasdaq composite fell 90 points, or 2.2 percent, to 4,128.

As investors shunned risk, small-company stocks fell even more than the rest of the market, and bond prices rose.

Despite the sell-off, U.S. stocks remain near all-time highs after surging 30 percent last year. The S&P 500 is 3 percent below its record high of 1,848 on Jan. 15.

U.S. stocks have not endured a correction — a drop of 10 percent or more over time — since October 2011.

The turbulence coincides with a global economic shift: China and other emerging-market economies appear to be running into trouble just as the developed economies of the United States and Europe finally show signs of renewed strength nearly five years after the end of the Great Recession.

The trouble began Thursday after a January survey showed a drop in Chinese manufacturing activity. Days earlier, China reported that its economic growth last year matched 2012 for the slowest pace since 1999.

"It is interesting how even a mild tremor in China's growth causes such anxiety around the world," said Eswar Prasad, professor of trade policy at Cornell University.

In Asia, Japan's Nikkei 225 slipped 1.9 percent Friday to close at 15,391.56; Hong Kong's Hang Seng shed 1.2 percent to 22,450.06; and Seoul's Kospi dropped 0.4 percent to 1,940.56.

Slower growth in China is bad news for countries that supply oil, iron ore and other raw materials to the world's second-biggest economy. Some of those countries, such as Indonesia and South Africa, were already struggling with an outflow of capital as rising U.S. interest rates drew investors to the United States.

Here's a look at the forces buffeting global financial markets:

—

THE END OF EASY MONEY

Since the global financial crisis hit in 2008, the Federal Reserve has flooded markets with cash to push interest rates lower and encourage U.S. businesses and consumers to borrow and spend. But last month, as signs of growing economic strength emerged in the U.S., the Fed cut back — reducing its monthly bond purchases to $75 billion from $85 billion. It also said that it expected to reduce the bond-buying further "in measured steps" at upcoming meetings.

The Fed meets again Tuesday and Wednesday. Many economists expect the central bank to cut the purchases again — perhaps to $65 billion a month.

The scaling back of the Fed's easy-money policies has hit some emerging markets hard. When the Fed was pushing U.S. rates lower, emerging markets had seen an inflow of capital from investors seeking higher returns than they could get in the United States. Now investment is flowing back to America, hammering currencies in emerging markets.

The South African rand, Russian ruble, Turkish lira, and especially the Argentinian peso — which fell 13 percent Thursday — have been "trounced," said Jane Foley, a currency strategist at Rabobank. "Talk that the U.S. Federal Reserve will announce another reduction in its monthly bond purchases next week ... (is also) contributing to a loss of confidence in some emerging markets," she said.

—

POLITICAL TURMOIL

In some countries, concerns over the local political or financial situation have worsened the market volatility dramatically. That was most obvious in Argentina, where the peso this week suffered its sharpest fall since the country's 2002 economic collapse. The government, running short of reserves it could use to buy the currency and keep it from falling, has let the peso drop instead. The country's economic fundamentals are grim: Inflation is believed to be running at about 25 percent to 30 percent.

The peso fell 16 percent in two days, easily the worst performer among emerging markets.

Turkey's national currency, the lira, hit multiple record lows in recent weeks as investors worried about the fallout of a corruption scandal that threatens to destabilize the government. Having a stable government for the past 10 years has been one of the key ingredients in the country's economic revival.

The lira hit an all-time low of 2.33 against the dollar on Friday — from around 2 per dollar in December — despite a $3 billion -intervention by the central bank in foreign exchange markets.

Beyond political problems, the countries that have seen their currencies fall most are those that rely heavily on exports of raw materials used in manufacturing. The Russian ruble was trading at 34.58 per dollar, from below 34 on Thursday. The South African rand weakened to 11.13 per dollar, from 10.98 the day before.

—

CHINA AND GLOBAL GROWTH

Since the recession, the global economy has relied heavily on China and other emerging markets as the developed economies of the United States, Europe and Japan struggled.

But China's economy is decelerating. It grew 7.7 percent in October-December 2013 from a year earlier, down from the previous quarter's 7.8 percent growth. Factory output, exports and investment all weakened. On Thursday, the preliminary version of HSBC's purchasing managers' index of Chinese manufacturing fell to 49.6, the lowest reading since July's 47.7. Anything below 50 signals a contraction.

China's growth is still far stronger than the United States, Japan or Europe, but is down from the double-digit rates of the previous decade.

Many economists are troubled less by the slower growth numbers than by China's over-reliance on trade and investment instead of spending by its consumers.

"China, and the world at large, would benefit from its shift to a lower but more sustainable pattern of growth that is not so heavily dependent on investment-led growth fueled by bank credit," Cornell's Prasad said.

China's growth is slowing just as the world's rich economies begin to gain momentum.

The 17 countries that use the euro currency appear to be recovering from a debt crisis that tipped them into a double-dip recession in late 2011.

In the United States, households have reduced crippling debt levels and are in better shape to start spending again. The International Monetary Fund expects the U.S. economy to grow 2.8 percent this year, up from 1.9 percent in 2013, and for the eurozone economy to grow 1 percent in 2014 after contracting 0.4 percent in 2013 and 0.7 percent in 2012.

___

CORPORATE PROFITS

In the U.S., the outlook for corporate profits has already been weakening, and the turmoil in emerging-market currencies could make matters worse.

About two-thirds of the 123 S&P 500 companies that have reported fourth-quarter earnings so far have beaten analysts' estimates, according to S&P Capital IQ, in line with the historical average. But the forecasts for income growth have been falling and could decline further.

As recently as this summer, analysts predicted earnings growth of more than 11 percent for the fourth quarter, but now they expect just half that — 5.9 percent.

Some companies are becoming more pessimistic, too. For the January-March quarter, seven out of every 10 that have talked about their prospects have cut projections, more than average, according to FactSet. The stocks have tanked as a result. Since United Continental lowered revenue estimates on Thursday, for instance, its stock has fallen 6 percent.

U.S.-based multinational companies posted some of the biggest declines on Friday as investors worried about overseas sales. Oracle and 3M have warned that their results could take a hit because of the strengthening dollar. Shares of the companies fell 3 percent.

Companies that rely on overseas sales will bring home fewer dollars if the dollar continues to appreciate against foreign currencies, especially in emerging markets that have been hammered this week. In Argentina, for example, the same amount of pesos buys fewer dollars today than it did last week.

On Tuesday, Europe-based consumer goods giant Unilever said fourth-quarter sales slowed because of weakness in emerging markets. The decline was mostly because of unfavorable currency moves.

"So when emerging markets sniffle," said Lawrence Creatura, a portfolio manager with Federated Investors, "large-cap companies can catch a cold."

____

Associated Press writers Bernard Condon in New York, Toby Sterling in Amsterdam and Suzan Fraser in Ankara, Turkey, contributed to this story.