

economist.com/leaders/2020/05/07/the-market-v-the-real-economy

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Wounds from the financial crisis of 2007-09 are being reopened. “This is the second time we’ve bailed their asses out,” grumbled Joe Biden, the Democratic presidential candidate, last month. The battle over who pays for the fiscal burdens of the pandemic is just beginning. On the present trajectory, a backlash against big business is likely.

Start with events in the markets. Much of the improved mood is because of the Fed, which has acted more dramatically than other central banks, buying up assets on an unimagined scale. It is committed to purchasing even more corporate debt, including high-yield “junk” bonds. The market for new issues of corporate bonds, which froze in February, has reopened in spectacular style. Companies have issued \$560bn of bonds in the past six weeks, double the normal level. Even beached cruise-line firms have been able to raise cash, albeit at a high price. A cascade of bankruptcies at big firms has been forestalled. The central bank has, in effect, backstopped the cashflow of America Inc. The stockmarket has taken the hint and climbed.

The Fed has little choice—a run on the corporate-bond market would worsen a deep recession. Investors have cheered it on by piling into shares. They have nowhere else good to put their cash. Government-bond yields are barely positive in America. They are negative in Japan and much of Europe. You are guaranteed to lose money by holding them to maturity, and if inflation rises the losses would be painful. So stocks are appealing. By late March prices had fallen by enough to tempt the braver sort. They steeled themselves with the observation that much of the stockmarket’s value is tied to profits that will be made long after the covid-19 slump has given way to recovery.

Tellingly, though, the recent rise in share prices has been uneven. Even before the pandemic the market was lopsided, and it has become more so. Bourses in Britain and continental Europe, chock-full of troubled industries like carmaking, banking and energy, have lagged behind, and there are renewed jitters over the single currency (see [article](#)). In America investors have put even more faith in a tiny group of tech darlings—Alphabet, Amazon, Apple, Facebook and Microsoft—which now make up a fifth of the S&P 500 index. There is little euphoria, just a despairing reach for the handful of businesses judged to be all-weather survivors.

At one level, this makes good sense. Asset managers have to put money to work as best they can. But there is something wrong with how fast stock prices have moved and where they have got back to. American shares are now higher than they were in August. This would seem to imply that commerce and the broader economy can get back to business as usual. There are countless threats to such a prospect, but three stand out.

The first is the risk of an aftershock. It is entirely possible that there will be a second wave of infections. And there are also the consequences of a steep recession to contend with—American GDP is expected to drop by about 10% in the second quarter compared with a year earlier. Many individual bosses hope that ruthless cost-cutting can help protect their margins and pay down the debts accumulated through the furlough. But in aggregate this corporate austerity will depress demand. The likely outcome is a 90% economy, running far below normal levels.

A second hazard to reckon with is fraud. Extended booms tend to encourage shifty behaviour, and the expansion before the covid crash was the longest on record. Years of cheap money and financial engineering mean that accounting shenanigans may now be laid bare. Already there have been two notable scandals in Asia in recent weeks, at

Luckin Coffee, a Chinese Starbucks wannabe, and Hin Leong, a Singaporean energy trader that has been hiding giant losses (see [article](#)). A big fraud or corporate collapse in America could rock the markets' confidence, much as the demise of Enron shredded investors' nerves in 2001 and Lehman Brothers led the stockmarket down in 2008.

The most overlooked risk is of a political backlash. The slump will hurt smaller firms and leave the bigger corporate survivors in a stronger position, increasing the concentration of some industries that was already a problem before the pandemic. A crisis demands sacrifice and will leave behind a big bill. The clamour for payback will only grow louder if big business has hogged more than its share of the subsidies on offer. It is easy to imagine windfall taxes on bailed-out industries, or a sharp reversal of the steady drop in the statutory federal corporate-tax rate, which fell to 21% in 2017 after President Donald Trump's tax reforms, from a long-term average of well over 30%. Some Democrats want to limit mergers and stop firms returning cash to their owners.

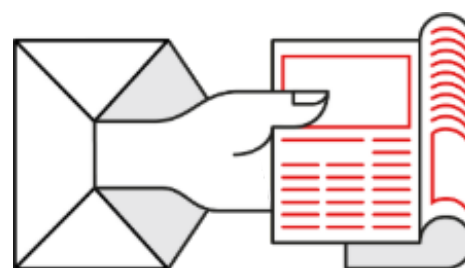
For now, equity investors judge that the Fed has their back. But the mood of the markets can shift suddenly, as an extraordinary couple of months has proved. A one-month bear market scarcely seems enough time to absorb all the possible bad news from the pandemic and the huge uncertainty it has created. This stockmarket drama has a few more acts yet. ■

This article appeared in the Leaders section of the print edition under the headline "A dangerous gap"

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A perky stockmarket v a glum economy

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7 mai 2020



FINANCIAL MARKETS look forward. Yesterday's news is stale. What matters is the future, in particular the returns that today's buyer of securities can expect. So there is some reason to think the S&P 500 share index might trace the near future of America's economy.

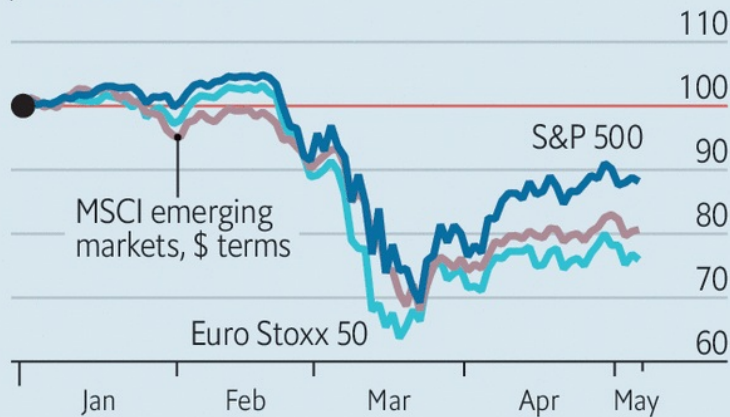
Share prices in America have followed a dramatic v-shape recently. A brutal sell off has given way to a lively recovery (chart 1). Yet a v-shaped path for the economy—a brief recession, followed by a swift recovery—seems unlikely. The scale of job losses suggests the economy is in a hole too deep to climb out of quickly. Claims for unemployment insurance have dwarfed peaks in previous recessions (chart 2).

So why has the stockmarket rallied so hard? In part this reflects the Federal Reserve's efforts to backstop the economy. It has bought bonds on an unprecedented scale, swelling its balance-sheet (chart 3). Bond yields have also become even paltrier (chart 4). Equities are appealing, if only by comparison.

The merrier mood in the markets

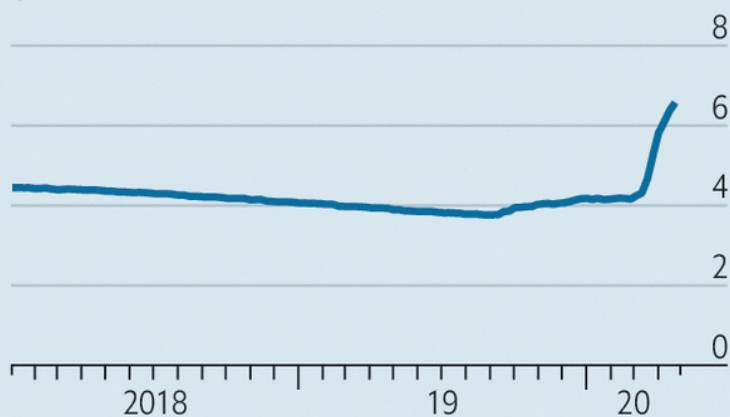
Share prices

Jan 1st 2020=100



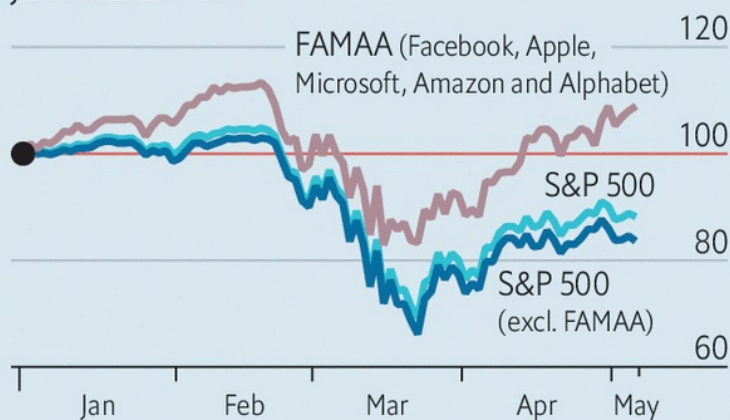
Federal Reserve balance-sheet

\$trn



Share prices

Jan 1st 2020=100



Sources: Datastream from Refinitiv; Bloomberg; Federal Reserve; *The Economist*

Americans claiming unemployment

Peak during recessions, millions



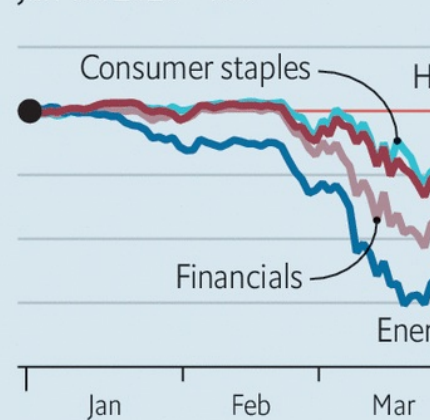
United States, government-

By maturity



S&P 500, selected sectors

Jan 1st 2020=100



The Economist

The pattern of share-price changes is revealing. America's have risen faster than Europe's. The industry make-up of each market explains much of this. Europe's bourses are weighed down by cyclical industries—banks, carmakers and energy companies. America's has a bigger tilt toward technology companies, the relative winners of the covid-19 crash. The five largest tech stocks continue to be market darlings (chart 5). Healthcare stocks and consumer staples have also proved resilient (chart 6). Investors are not looking much beyond stocks they judge to be recession-proof. The market's recent "v" is not for victory.