PICTET
1805

Sell-off in China is a correction, not a full-blown crash, says Christophe Donay, chief strategist at Pictet Wealth Management

Die Pictet-Gruppe | 24. August 2015

Kontakt
Oliver Möller
Leiter Unternehmenskommunikation
Pictet & Cie (Europe) S.A.
+49 69 79 500 930
omoeller@pictet.com

A renewed sell-off on Chinese stock markets has spread across Asia and is now hitting markets globally. We could be on the brink of a financial and economic crash in China that would derail the global economic recovery. However, we view developments on Chinese markets as a sharp correction rather than the start of a long-term bear market, and think that the Chinese authorities will succeed in stabilising the economy.

China's slowdown creates concerns

Underlying the current market turmoil are concerns about China's economic slowdown. The country has been a major driver of global growth since the beginning of the 1990s. However, after two-and-a-half decades of astonishing real GDP growth—between 9% and 12% annually—China has entered a period of adjustment. As its economy becomes more mature, growth should stabilise at around 5% within 4-5 years.

The considerable challenge for the Chinese authorities is to manage this transition without a recession or a financial shock. As the current turmoil shows, this is proving very difficult. In a pessimistic scenario, if problems on China's financial markets and real economy deepen, and the authorities fail to contain the situation, a full-blown financial and economic crash in China could ensue. This is currently the biggest risk for the global economy and financial markets.

However, we are more optimistic. The Chinese authorities retain considerable firepower to stabilise the economy. They could further loosen monetary policy, and also deploy fiscal stimulus.

China's real economic growth this year should therefore still meet our forecast of around 6.5%.

With the growing internationalisation and liberalisation of China's financial markets, the Chinese authorities do appear to have lost the ability to control the stock market. However, the current sell-off remains a sharp correction, not a full-blown crash: the Shanghai Composite surged by 125% from its low in October 2014 to its peak in mid-June, driven by liquidity, and the recent corrections have merely removed this excess.

The impact of China's difficulties is spreading
Emerging markets are already suffering from China's slowdown, as well as from lower commodity prices and the prospect of higher US interest rates. Brazil, the key economy in Latin America, faces recession. Emerging Asia, the most resilient part of the emerging world until recently, is now being dragged down as well.

For developed economies, the direct impact would be limited even if China's growth were to slump. For the US, China accounts for 10% of exports, comprising 1% of GDP, and for the euro area, China takes 7% of exports, equivalent to 1% of GDP. Emerging markets account for 10% of EBIT for US companies and 15% for European companies.

However, the indirect impact, through contagion to financial markets, would be significant. An economic crash in China would exacerbate global deflationary pressures and create a bear trend on global financial markets. Vulnerability is greater in Europe than the US. The US economic recovery is more resilient, and the US economy is also likely to benefit more from the support to consumption offered by lower oil prices.

EM assets likely to take a hammering
Emerging markets, especially commodity producers, look set to be the big losers from China's correction—EM assets and currencies are likely to see further falls. In the current context, investors will probably continue to favour DM equities. Finally, in a climate of elevated risk, diversification is key—core sovereign bonds (notably US Treasuries) will likely remain attractive to cushion portfolios.

-Ends-

Notes to the Editor

The Pictet Group

Founded in 1805 in Geneva, the Pictet Group is one of the premier independent asset and wealth management specialists in Europe, with EUR 403 billion in assets under management and custody at 30th June 2015. The Pictet Group is owned and managed by seven partners with principles of ownership and succession that have remained unchanged since foundation.

Based in Geneva, the Pictet Group employs more than 3,600 staff. The Group has offices in the following financial centres: Amsterdam, Barcelona, Basel, Brussels, Dubai, Florence, Frankfurt, Hong Kong, Lausanne, London, Luxembourg, Madrid, Milan, Munich, Montreal, Nassau, Paris, Rome, Singapore, Turin, Taipei, Tel Aviv, Osaka, Tokyo and Zurich.