Global markets continue to fall

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Global stock markets have experienced their worst opening week in a new year in two decades as concerns over the Chinese economy, the value of the renminbi and the policies of Chinese financial authorities sent out a series of shock waves. More than $2.3 trillion was wiped off the value of global stocks for the week.

Markets in the US had their worst opening week ever. Shares closed down about 1 percent on Friday, after falls in Japan and Europe, with the German Dax index posting its biggest loss since 2011.

The Dow lost 6.19 percent in value for the week, and the S&P 500 was down by almost 6 percent, with falls across all ten sectors of the index. The high-tech-based Nasdaq composite index fell by more than 7 percent.

The continued decline came despite a stronger-than-expected jobs report in the US, which indicated that an additional 292,000 jobs were created last month. There was also an upturn in the Chinese market, after trading was suspended for two days last week when falls in share prices exceeded 7 percent, triggering circuit-breaker mechanisms.

Following criticisms that these mechanisms were contributing to, rather than alleviating, market instability, financial authorities lifted them on Friday, leading to the uptick in share prices. In another move aimed at stabilising the value of the Chinese currency, the renminbi, the foreign exchange regulator issued guidelines to banks limiting the purchase of US dollars by corporations and individuals.

The renminbi was down 0.8 percent for the week, its biggest decline since the People's Bank of China made a surprise move last August to reduce its value. In a sign of the extent of capital outflow, China's foreign currency reserves fell by $108 billion in December.

Summing up the events of the week, the *Financial Times* commented that if any lesson was to be learned from the past six months it was that any bump in the Chinese economy could not be ignored by the rest of the world. "The question is whether the rest of the world feels a gentle ripple or a tidal wave."

The article noted that the fall in China's growth rate from more than 10 percent in 2010 to the estimate of just 6.3 percent for this year could be expected, on the basis of China's weight in global gross domestic product, to reduce world growth by about 0.75 percentage points.

According to International Monetary Fund chief economist Maurice Obstfeld, however, the effects are much greater than is indicated by a direct consideration the 18 percent of the global economy that China comprises. "The global spillovers from China's reduced rate of growth … have been much larger than we would have anticipated," he said.

This is because China is at the head of a series of integrated supply chains that involve the countries of South East Asia, Japan and Korea.

An indication of the impact of falling growth is seen in the decline in Chinese imports. They fell by 15 percent in the first 11 months of last year, with purchases from all its major trading partners, except Vietnam and Canada, in decline.

Furthermore, there are increasing concerns that the real level of Chinese growth is considerably less than official figures, with some estimates putting it closer to 4 percent.

An article in the *Wall Street Journal* on Friday pointed to the gloom that has descended in one of China's most important industrial areas.

"Executives at businesses in the manufacturing heartland of south-eastern and eastern China, which churn out everything from electronic gadgets from textiles to furniture, talk of slack orders and late payments," it reported. "China's traditional heavy industrial engines of steel, cement and glass remain saddled with excess capacity built up in the boom years." According to one executive cited in the article "no numbers point to a rosy picture."

While there is no question that slowing Chinese growth rates, fears of a fall in the renminbi, doubts over reliability of government statistics and the destabilising effects of the seemingly ad hoc decisions of Chinese authorities are having their impact, more is involved than simply the state of the Chinese economy.

Financial Times columnist John Authers noted that "Chinese markets are shaking the world," but, as in the past, "this says more about the frayed nerves in the rest of the world than it does about China."

Authers pointed to the "greatest fear prevailing in the west: deflation" which impacts on the ability of companies to maintain, let alone increase, their profits. With central banks desperately trying to escape this situation "anything that threatens to intensify the problem is very serious."

According to Authers, the "stark reaction to this week's Chinese events reveals a deep lack of confidence in the health of the western corporate sector."

He drew a parallel with events in February 2007, when a 9 percent fall in the Shanghai index triggered a major fall on Wall Street which, amid growing concerns about the state of the subprime mortgage market, signified the end of the "Great Moderation" when market volatility had remained relatively low.

Multi-billionaire investor George Soros also drew comparisons between the present situation and the events that led to the global financial crisis. In a speech delivered in Sri Lanka this week, he said there was a "serious challenge which reminds me of the crisis we had in 2008."

It is not clear where the present course of events will lead. However, the rise in corporate debt in the US, where the trillions of dollar pumped into the financial system by the Federal Reserve have been used to finance a speculative bubble in stocks, as well as in emerging markets, where corporate debt has increased rapidly over the past four years, have created the conditions for another major financial crisis.