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Financial markets 2016: Further sharp swings on the cards

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On the stock exchanges the start to 2016 could hardly have been worse. The markets were rattled by the ongoing slide in oil prices to an 11-year low, growing tensions between Saudi Arabia and Iran and, above all, worries about the Chinese economy, underpinned by a sudden slide in the yen. All of this triggered sheer terror on the financial markets.

However, there is no cause for panic. The turmoil on stock exchanges is overdone and does not presage a slowdown in global growth. One thing is clear, the days of supercharged Chinese growth of 8% and more are over. The realignment of the Chinese growth model and the reduction of existing imbalances are no simple task. But the end of the credit-fueled investment boom will not cause the economy to crash. The Chinese government and the central bank still have sufficient leeway to prevent a nasty landing.

And concern that, with the devaluation of the yuan, China is wading into the global currency war in order to boost its own exports also seems overdone. At around 6.56 against the dollar the yuan is currently at its lowest level for around five years, but prior to this China had for many years lived with a strong appreciation against the dollar and other currencies. In this context, the two sharp drops since August of last year can still be viewed as moderate. Peking is likely to desist from a drastic devaluation as this would jeopardize its new domestic growth strategy.

It is certainly true that the slowdown in China has intensified the downward pressure on the oil price. But the main reason is an ongoing glut and OPEC’s decision not to cut output. And the recent deterioration in relations between Saudi Arabia and Iran does not suggest that a drop in supply is imminent. For the industrial countries as well as China and most Asian emerging markets the low oil price is a boon in the form of substantial purchasing power gains, buoying consumption and the economy.

The first trading week in 2006 is likely to have provided a foretaste of what investors can expect to see in the coming 51 weeks. Drastic overshoots, calling for strong nerves. In the low interest environment, with valuations extremely high in many places, new information or rumors can quickly unleash sharp corrections. Potential triggers for turmoil are not hard to find: from geopolitical tensions in the Middle East to the UK referendum on whether to remain in the EU and the growing divergence among the major central banks. But the overall trend on the stock exchanges should be upwards, if current economic forecasts are anything to go by. And of late these have proved pretty accurate.