

## A little trouble in big China leads to a swoon in June

Contact: Richard Ramsey  
Chief Economist, Northern Ireland  
02890 276354 or 07881 930955

[Richard.ramsey@ulsterbankcm.com](mailto:Richard.ramsey@ulsterbankcm.com)

[www.ulsterbank.com/economics](http://www.ulsterbank.com/economics)

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Following last month's equity market performance, many investors are likely to be heard muttering the old adage of *'Sell in May and stay away; don't come back till St. Leger's Day'*. Unlike last year, the month of May brought equity investors many happy returns with most of the major stock market exchanges posting net gains. China's CSI 300 Index and the German Dax were two of the star performers whilst Eurozone stocks as a whole (*the Euro Stoxx Index*) rose by 2.1% which was the same increase as Wall Street's S&P 500. The UK's Footsie 100 & the French CAC 40 increased by 2.4% in May.

However, as far as equities are concerned, May has been followed by a *'swoon in June'*. Falling BRICs have been the order of the day, with China posting the steepest fall of all. Both Brazil and China have entered official *'bear market'* territory which is defined as a fall of at least 20% from their recent peaks. Russia is not far off a technical bear market with the RTSSTD down 17% since the end of January. Meanwhile India's SENSEX index has experienced a relatively mild 8% fall from its 2013 peak. However, all four of the main equity exchanges in the BRIC economies are lower now than they started the year.

Europe's leading Blue-chip index for the Eurozone, the Euro Stoxx Index, has fallen by over 9% in June (*as of 24<sup>th</sup> June*). The Greek ASE Athens Stock Exchange posted a decline twice that of the Eurozone average at 18% with Italy's FTSE MIB index also outperforming the Eurozone average with a fall in June in excess of 12%. These declines now mean that these two exchanges are some 7% lower than they started the year. Cyprus (-16%), Austria (-8%), Spain (-6%) and the Netherlands (-2%) equity markets are all lower now than they started the year. Meanwhile Ireland (+13%), Germany (+2.6%) and Portugal (+2%) are three of the exchanges that remain in positive territory year-to-date despite the recent falls.

Outside of the Eurozone, the UK (*FTSE 100*) and the US (*S&P 500*) posted declines in June of 8.4% and 3.5% respectively. However, both of these equity markets remain in positive territory for the year to the tune of 3% (UK) and 10% (US). Meanwhile, Japan's Nikkei 225 index is 25% higher than it started the year and has increased over 50% since last October. The latter followed the realisation that Shinzo Abe was likely to become the new Japanese PM. However, the prize for the largest percentage gain in equity markets this year goes to Ghana's Stock Exchange (+58%).

So what has caused the swoon in June? Two key factors precipitated the change in investor sentiment, both of which were triggered by the central banks in the US and China.

On the June 19, the Federal Reserve signaled the conditions under which it would taper its \$85bn per month of asset purchases. It was suggested that this tapering could begin later this year and stop in mid-2014. In the same way that this stimulus raised all boats (*particularly in equity markets*), plans for its withdrawal have lowered all boats. Asian equity markets in particular benefited from the *'carry trade'* of borrowing cheaply from the US and *'searching for yield'* in Asia.

The second factor concerns a little trouble in big China. As we approach the sixth anniversary of the official start of the global credit crunch, fears of another credit crunch are causing a stir in financial markets. Back in 2007, the world's second largest economy, China, was largely unaffected by the global credit crunch. In the wake of the global financial crisis, China unleashed a massive monetary stimulus in 2008/09 in an attempt to

boost economic growth. Therefore China had a credit boom that mirrored the credit crunch in the rest of the world.

Fast forward six years and concerns are mounting that China now faces a credit crunch of its own. While the credit boom has bought impressive economic growth rates (*via infrastructure / property investment*), there are fears that the years of cheap money have created a credit bubble. Furthermore, the ability of credit growth to keep the economy growing at more than 8% per year has waned.

Indeed, June's manufacturing PMI pointed to a major slowdown in Chinese manufacturing activity. A feature of the global credit crunch was a spike in inter-bank lending rates (*or LIBOR's*). This reflected a rise in counter-party risk, or more simply put, an unwillingness for banks to lend to each other. Similarly, Chinese inter-bank lending rates (*or SHIBORs – Shanghai Interbank Offered Rate*) have been on the rise since the start of June and spiked last Thursday. The latter followed the decision by the Chinese central bank (*the People's Bank of China or PBOC*) to turn off the flow of cheap credit. This led to some of the highest lending rates on record with lending rates in some instances in excess of 25%.

However, it must be remembered that the performance of equity markets does not necessarily correlate directly to the performance of the economy, and that despite challenges in the Chinese economy, it remains a huge and growing market. So whilst equity investors may be muttering '*Sell in May and stay away; don't come back till St. Leger's Day*', for Northern Ireland companies, when it comes to China and other export markets, it very much remains a case of sell into them and definitely don't stay away.

*Richard Ramsey,  
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