



Extra Market Outlook

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Concerns about Chinese growth and the Fed's approaching interest rate hikes are creating worries and pushing share prices down

Last week saw stock markets prices tumble, and Monday started off the same way. For instance, the US and Swedish stock markets fell close to 6 per cent last week, and there was a similar trend around the world. That means August's stock market corrections are now in the range of 8-13 per cent in local currencies. As a result, most of the year's returns so far on many investments have now been wiped out.

Last week's decline was triggered in part by the Chinese government's decision to devalue the Chinese yuan (CNY) in several steps. Investors interpreted this as meaning that the Chinese government is worried about a sharp deceleration in economic growth and must therefore devalue the currency and implement supportive measures to try to bolster a fragile situation. Examining the most recent economic statistics from China, they were clearly below expectations. Meanwhile, we are drawing ever closer to the first key interest rate hike in the United States. The Federal Reserve (Fed) has its next regular policy meeting on September 17. Expectations have fluctuated as to whether the first rate increase will occur then or at the central bank's December meeting.

Signs of weakness from China alongside concerns about the effects of a Fed interest rate hike have caused investors to adjust their growth forecasts downward and modify their views on how much investment risk is appropriate.

In recent years, global economic growth has proceeded at a leisurely pace. Record-low interest rates and large stimulus packages have not led to the rate of growth that people had hoped for. However, the economic system has stabilised and adjusted the valuations (prices) of financial assets upward as well. In a situation like this, there is a risk that the global growth rate, which in turn is an important variable in explaining the business sector's ability to generate increased earnings, will not move in step with financial asset prices. When uncertainty factors surface, the result is profit-taking and lower risk appetite.

World stock market performance over the past year



Source: Bloomberg, performance calculated in USD from 2014-08-21 until 2015-08-21

The markets are probably now adjusting from a period of extremely low volatility (small price swings) to a more normal environment, and this also affects investors' views of what are appropriate prices for equities, corporate credits and other assets.

If we look at underlying economic trends around the world, the US has shown a stable and improved situation, including good consumption and a sharp rise in construction sector activity, but the country has also been hit by tougher competition in export markets as a result of the stronger dollar. The situation is different in Europe and Japan, where weak currencies and aggressive monetary policies are helping to boost growth, which is recovering from low levels.

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In a global perspective, the greatest source of uncertainty is the economic weakening in China and its impact on other emerging markets. This is especially true of countries that rely on revenues from commodity sales. On the other hand, countries that import commodities benefit from this trend. On a global basis, declining commodity prices contribute positively to growth in the long term. However, it is never good when price movements are very large over a short period of time.

The economies of regions and countries around the world continue to move in different directions, and the overall rate of growth is less than we had hoped. Still, growth

has not come to a halt. It is most likely that we are now experiencing a market correction and not the beginning of a sustained decline. Nor should we forget that the Chinese government and others will continue to take steps to stabilise the situation. In the coming period, the market will remain volatile as it continuously scrutinises new economic growth data that indicate how global growth is shaping up and as we also move ever closer to the date when we expect the Federal Reserve to raise its key interest rate. We should also remember that many financial assets have already lost value and, by definition, have become more attractively priced.

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