



China Sneezes, Global Markets Get a Cold

Angel Ubide says markets are likely to remain in turmoil until economic fundamentals in China, the United States, and emerging markets become clearer.

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Steve Weisman: Global markets are in turmoil in the wake of China's devaluation of its currency earlier in August. This is Steve Weisman at the Peterson Institute for International Economics with Angel Ubide, to try and figure out what's going on in the markets. Angel, today is Monday, August 24th, and the Dow went down precipitously, then went back up, by the time you're seeing this maybe something else will happen. What do you think is going on, Angel?

Angel Ubide: I think markets are reacting to a big increase in uncertainty about the global economy that has been triggered mostly by the actions of the Chinese authorities in the last couple of months. First, it was that reaction to the Chinese stock market decline, then it was their sudden change in the framework for the currency and this has created a cloud of uncertainty about the skill and ability of the Chinese authorities to manage their economy. If China was supposed to be one of the pillars of the global economy and all of a sudden, it's in doubt, then I guess investors are reevaluating asset valuations and asset pricing and what we are having is a sudden reprise of these valuations.

Steve Weisman: But there are other emerging markets that are in big trouble, like Brazil.

Angel Ubide: So, this is coming on the heels of other, as you say of, mostly the BRICs, but also others who are showing to the world that they have weaker fundamentals than we thought. Brazil, I think, is the perfect example. It's a country that was growing very fast throughout the period of 10-20 years that, all of a sudden, is now in the throes of a deep recession, a recession that is going to probably be quite long, with a policy framework that is also quite uncertain and quite unorthodox, and that is creating many doubts for global investors.

Steve Weisman: What impact is this going to have on the Federal Reserve's decision later this year on whether to raise interest rates?

Angel Ubide: This is always tricky, right, because Central Banks are, in principle, supposed to look through shorter market volatilities and try to focus on medium-term fundamentals. Now, the decision, I think, in September was very finely balanced. There is, at least in my own personal opinion, there is very rarely inflationary pressure, very little argument to stop raising rates. I read the FOMC; there's also been sort of a split and with two groups that are quite balanced in their attitudes toward raising rates. I think at the margin this puts the way towards inaction and waiting until the smoke clears and see what outlook we have once this stock market destabilization finally happens.

Steve Weisman: Are people panicking? Is this another case, though, of markets overshooting because they are trying to get ahead of a trend?

Angel Ubide: I think it's overshooting but not because of panic. We need to understand how portfolios operate in these cases. You have a sudden change in uncertainty that increases volatility. When volatility increases, measures of risk, what we call in markets Value at Risk, increase suddenly so all of a sudden, your portfolio is riskier. Your risk manager comes to you and says you need to reduce your possessions. This is happening for everybody at the same time. Everybody's reducing possessions at the same time. It's not panicky but it looks panicky because what you have, you know we have this saying in markets that asset prices go up in the escalator and down on the elevator. And this is why. Because all of a sudden everybody is sort of forced to shrink their portfolios at the same time.

Steve Weisman: So where are they putting their money if they are shrinking their portfolios?

Angel Ubide: Probably in cash and wait for the storm to go away. And once the storm goes away, it stabilizes, we need to reevaluate what's the new outlook, what is the situation in China specifically.

Steve Weisman: Angel, thank you very much.

Angel Ubide: Thank you, Steve.

