Making Sense of Market Mayhem

Angel Ubide says uncertainty about China's growth outlook and the path of oil prices is keeping global markets on edge, even though the US economy is still fundamentally sound.

Pedro da Costa: I'm Pedro da Costa, Editorial Fellow here at the Peterson Institute for International Economics. I'm joined by Angel Ubide who's a Senior Fellow here and a former macro hedge fund manager. So, he's in a good position to talk to us about this market chaos that's been dominating the headlines recently. So, what's your take on the recent action? Is this a new analysis of the economic outlook or is it just kind of a panicky sell off that's taken a momentum of its own?

Angel Ubide: I think it's a bit Chapter 2 of what happened in August of last year. We had a moment of panic that, I think, was triggered mostly because all of a sudden we realized we didn't know if the Chinese authorities knew what they were doing. There was increased worry about their ability to handle this very complicated transition and it was manifested a little bit in their moves in the exchange rate.

What we are seeing now is a continuation of that. They continue to sort of fumble their communication and their management of the exchange rate. Combined with a continuous decline in oil prices which, I think, is the second uncertainty that markets have right now, they don't know where oil prices are going to go. And they don't know the impact of the decline in oil prices.

And if you want to add the third, the FED now is tightening policy and so, if an of the other two go wrong there is an increased feeling that policy makers don't have that much that they can use in order to cushion the blow. So, there is uncertainty out there, no question.

Pedro da Costa: So, it seems like a lack of trust in the Chinese context is really important factor. We had the official growth statistics and people of course always chuckle about that. They say, "Oh, you can't really trust the stats." But it's really not just that, it's really a question of--are they able to manage their policy in a stable manner.

And they have sent signals that are mixed. We don't know if they have a long term devaluation process. As we mentioned, they attempted to devalue and then they desperately tried to support the currency when it fell too fast.

Angel Ubide: Exactly. I think it's a combination of –you know, the opaqueness of data. We don't really know if that transition –I mean, I can tell a positive story about China. Manufacturing is declining, services is increasing. It's a question of transition. The overall growth is okay. The composition is changing. I just don't have very good means to double check my hypothesis.

And so, if I want to tell you the negative story I can also tell it very convincingly and you cannot tell me that I'm wrong. If you combine that with a management of this process of exchange rate adjustment where they say they are changing a little bit then they stabilize, then they want to join the SDR, then they let it depreciate again.

You know, transparency would go a long way into solving a lot of this fears. If the Chinese authorities could come out with a clear and coherent plan, explain it properly and provide the means for all of us to double check- That would make a lot of sense.

Pedro da Costa: Yeah, sure. Now, what about the impact on the west though because we talk a lot about the United States not having that many trade linkages or financial linkages even with China and yet our stock markets reacts as if we were tied at the hip.

Angel Ubide: Well, it's a question. You know, imagine I tell you that China is really not growing at 6.8%, but it's growing at 2%. Then all of a sudden we really need to revise down all our macro forecast. The probability of a global recession increases significantly with rates at zero and what seems to be a political inability to use fiscal policy, then all of a sudden we start thinking that there are the many things we can do if something goes wrong.

And that's what I'm saying, I don't think it's a downward revision on a baseline forecast of fundamentals. It's an increasing uncertainty about the downside risk. And in that case you need to mark down asset prices a little bit.

Pedro da Costa: Does this suggest that the FED's rate hike was ill-timed perhaps?

Angel Ubide: I don't think so. I think that US economy is doing fine. And I personally think that with the unemployment rate in the US coming down as fast as it has come, it's prudent that you slowly stop racing because you sort of accompany the decline in the unemployment rate.

If you happen to be wrong about the inflationary outlook and inflation picks up you were already moving. If you are wrong about where the [inaudible 00:04:15] is and the [inaudible 00:04:15] is a little bit lower you can just slow down.

But, I think, it's okay. I personally don't think the FED matters in this picture. Only to the extent that people may fear that if something goes wrong they don't really have much room to react.

Pedro da Costa: Thank you so much.

Angel Ubide: It's all right. My pleasure.