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Insight Perspectives

Economic and political update

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The Insight Perspectives newsletter is produced by Insightview.eu Ltd (Private Limited Company), Denmark, and is published on a monthly basis.

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The Insight Perspectives newsletter provides a summary of what happened in the month under review, plus articles about "special issues" in the global economy.

The newsletter attaches importance to identifying and analyzing current and future trends in the global economy, financial market and politics.

All articles will be linked to external sources and Insightview.eu, which includes more charts, maps, data and elaborating comments.

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"This is actually a very good newsletter if you want to get quickly informed about major economic issues all over the world"

Flemming A. Jørgensen, Vice President, **Danfoss** Group Treasury & Insurance

"Insightperspectives is a valuable supplement to the daily stream of information, received from banks and the various other providers of news and market analysis. It puts the issues discussed into context and provides a view on the long term implications, which can easily get lost in the daily flow of information"

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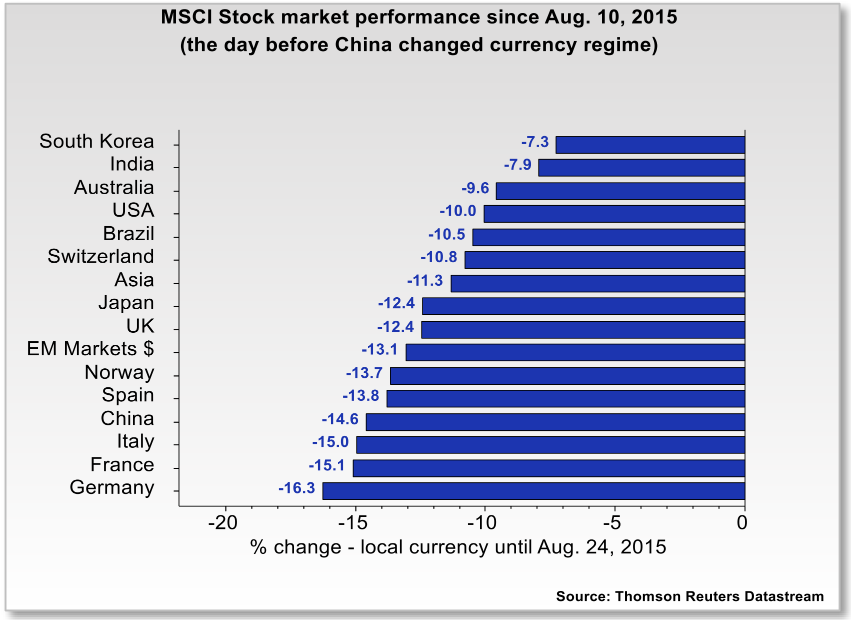
Peter Bundgaard, CEO, PM and founding partner of **BLS Capital Management**

The editor of Insightperspectives is simply the best macroeconomist I have ever experienced. For more than a decade I have been a reader of his thoughtful analysis that comes with an edge. This is the only macroeconomic analysis you will need to be able to follow global trends that can make a difference in your own day-to-day decision-making, whether in business or investments.

Global economic and political update

In August, the US Federal Reserve and the PBoC, China's central bank, said "boo" to the financial market. This was more than enough to trigger a sharp sell-off in the global stock market. The PBoC set the yuan's central parity rate to the US dollar nearly 3% higher, having seen the yuan appreciate dramatically in the last few years – read more in the China section on page 5 or the article, Questions and answers as Beijing joins the global currency war, on page 16. This comes at the same time as the US Federal Reserve is still "considering" to raise policy rates by no more than 25 basis points and hereafter go slowly.

None of these factors were supposed to have been a surprise to the financial market if it was not for the fact that central bankers around the world have turned global investors into financial "zombies". Indeed, monetary policymakers made the bed, so they must lie on it. Since the global crisis erupted in 2008, investment decisions in the financial market have been based less on free market fundamentals (rule-based). Instead, the flow of capital has increasingly become a function of central banks' willingness to print money.



This policy approach, financial repression, has not only moved many economies and financial markets far away from their real equilibrium; this has also forced investors far out on the ice floe (risk curve) where many risk-averse investors do not necessarily belong. Too many investors, including risk-averse investors, are now on the ice floe at the same time as monetary policymakers raise the temperature. Perversely, the global monetary approach pursued since 2008 has boosted the risk of long-term deflation although this was precisely a risk which triggered the previous global crisis.

This spells trouble, first of all for the financial market. On the other hand, the central banks' ability to reverse a policy of financial repression may ultimately have a significant impact on the broader economy, not least if the central banks fail to reverse monetary policy in an orderly way! The unanswered question now is whether the latest turmoil resets all economic projections?

The current situation has a worrying remininscence of 1998 shortly after the Asian Crisis started and a few years after China devalued (1994). At that time, the crisis spread beyond imagination and it was nearly impossible to identify the next trouble spot. The fall of Asian markets led to the fall of Long-Term Capital Management, which had an unpredictable snowball effect across the globe forcing investors to back out of risky investments. This could happen today after tighter regulation in the normal banking system has inflated the balance sheet of shadow banking in the developed countries in particular – read the FT-article, Debt mountains spark fears of another crisis (February 2015).

This newsletter has no doubt that the last seven years of monetary policy has front-loaded future growth by animating households and companies to spend "before it is too late". Ultimately, this cutting-corner-approach will hit global growth profoundly, which was also reflected in the 2015 Outlook released in the January edition of Insightperspectives. The question is of course only when the majority of economic players recognise that "the Emperor is wearing no clothes".

The current sell-off could be it. On the other hand, if one assumes that the current turmoil in the financial market is not spreading to the broader economy (the jury is still out), the US economy for instance remains exposed to more tailwind than headwind, at least this is the case right now – read the USA section on page 4. The same applies to the Euro-zone economy.

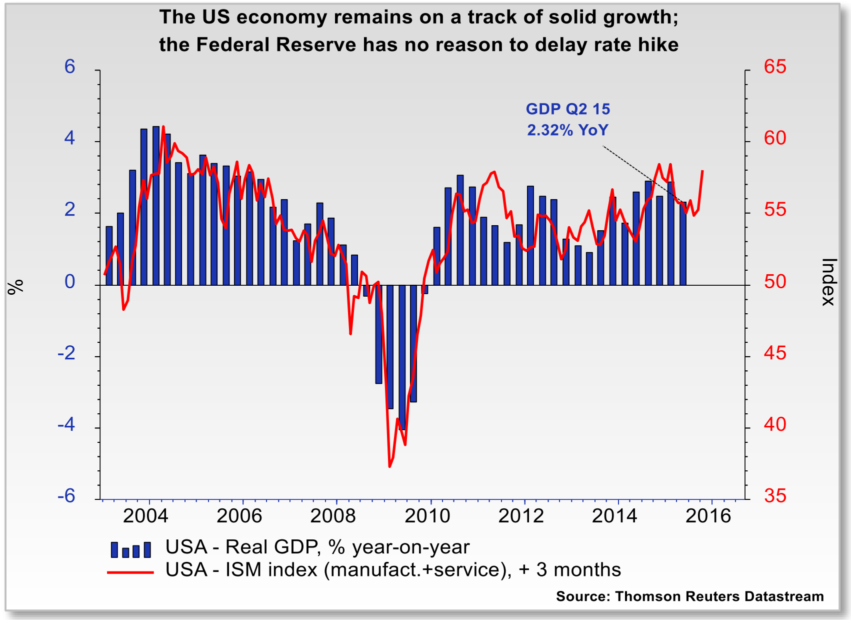
In the Euro-zone, the Greek crisis failed to derail business and consumer sentiment. On August 20, Greece paid a few billion euros to its creditors but only after the same creditors, Brussels and the IMF, accepted to disburse the first tranche, €26 billion, from the newest rescue package of €86 billion – read more in the Euro-zone section on page 7.

The problem, however, comes if the current turmoil is more than just a price correction in the financial market. In the developed countries, fiscal and monetary policymakers are running out of ammunition (this is precisely why the US Federal Reserve should have raised policy rates a long time ago). In that case, a "beggar-thy-neighbor-policy" remains the only policy option left, although this will be to the benefit of nobody!

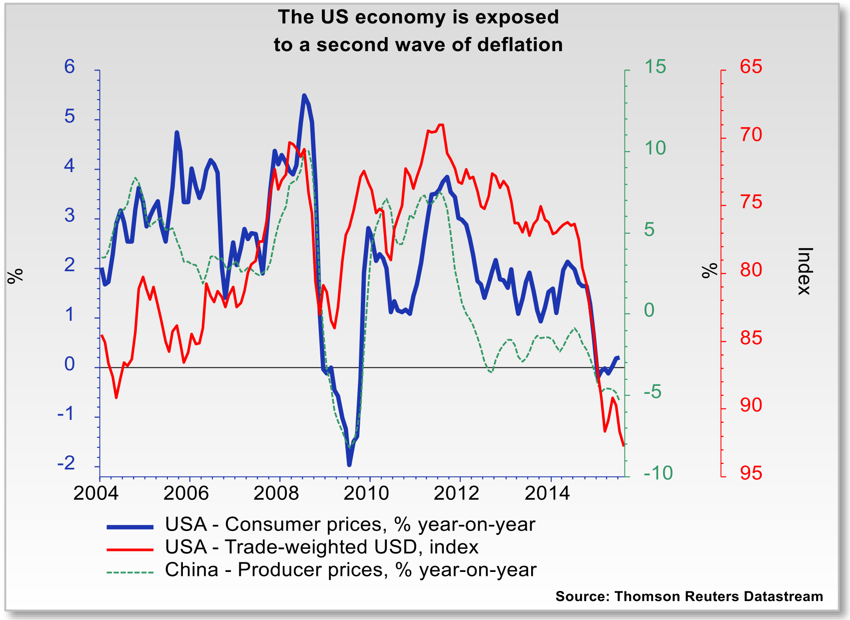
USA – Jitters in the stock market do not change strong short-term growth outlook – but this could change

In the United States, jitters are coming back into the stock market as the Federal Reserve is pondering yet again when to raise policy rates. On the other hand, there are no signs yet that the economy will falter, at least not as long as the central bank is only "pondering".

This is also reflected in the best forward-leading indicators. In July, the national ISM service survey soared to the highest level since August 2005. The underlying details showed broad-based improvement. Furthermore, there are no signs of weakness in the housing market (normally an "early" economic indicator). In July, housing-starts rose to the highest level since 2007. The future outlook for the housing market remains buoyant, which was also reflected in the National Association of Homebuilders survey; the headline index increased to 61 in August from 60 in the previous month, which was the highest level since November 2006.



At present the US economy sees little short-term headwind with the exception of the negative implications of a falling oil price, which continues putting a lid on energy investments. Falling energy prices, however, combined with the fact that China now appears to have become yet again a deflationary factor should boost US households' real purchasing power in the coming months. The above mentioned is also reflected in an upwards revision of this newsletter's 2016 growth forecast for the US economy (assuming the latest decline in the stock market is only a "correction) – click here to see Insightview's "real-time" global growth forecast.



The current strength in the housing market and the service sector also explains why the US Federal Reserve still has plenty of good reasons to raise policy rates in September (monetary normalisation is long overdue) - read also the Financial Times article, Show steel and raise rates or the financial system will fracture.

Granted, this is no longer a clear call in the financial market as just the threat of tightening in the United States, together with the threat of more devaluation in China, has triggered a sell-off in the global stock market – read more here. Furthermore, the United States and other developed countries will be exposed to yet another global deflation wave in the coming months – read the Insightview article, US producer price report shows benign inflation; but second wave of deflation on the horizon.

This should not keep the US central bank from normalising monetary policy, according to this newsletter. The US Federal Reserve is not supposed to act as a "nanny" for the financial market and surely not as long this does more long-term damage than good to the economy – read the article, The oil price war is just one market disturbance partly caused by the central banks, Insightperspectives, January 2015.

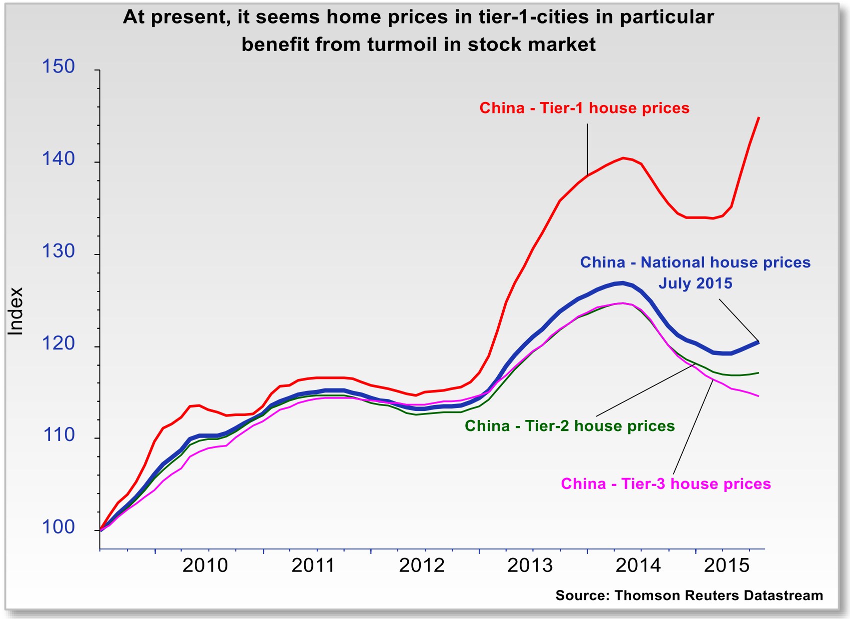
China – Beijing pulls the emergency brake

In August, Beijing allowed the yuan's central parity rate to depreciate against the US dollar in what was seen by the financial market as a highly surprising move. China, however, cannot be blamed for weakening the yuan. This is simply a necessity to mitigate the negative impact of significant global headwinds and an excessively overvalued yuan – see also the 2015 Outlook (January 2015).

Furthermore, manufacturing activity is slowing and the currency sees downward pressure from capital outflow, which has also been visible in China's foreign exchange reserves in the first part of 2015 – read the Bloomberg article, China Reserves Take a $40 Billion Hit on Yuan Intervention. Beijing cannot afford an overvalued currency at the same as the country is on a path of economic reforms and is exposed to excessive overcapacity in many sectors of the economy. Beijing was simply forced to or pull the emergency brake! This was not least the case after the ECB decided to "go Italian" at the beginning of the year.

In China, the change in the foreign exchange regime has made many market-oriented economists nervous about whether Beijing is now abandoning the road of reform - read the Caixing article, How to Solve Chinas Currency Parity Puzzle? There is no doubt that many policymakers on the mainland have little confidence in market forces, which is, however, no different from many developed countries. This also became highly visible during the latest turmoil in the Chinese stock market – read the article, Questions and answers as Beijing joins the global currency war, on page 16.

Nonetheless, Insightperspectives believes that Beijing will continue the reform process. But China’s decision to allow yuan depreciation should predominantly be seen as a sign that policymakers believe headwind is simply becoming too forceful! Granted, Beijing is eager to explain that the currency decision was "in the name of deregulation" or part of the reform process. But if Beijing really believes the financial market should have a bigger say on the exchange rate, policymakers would have been better off had they decided to widen the yuan’s trading band against the US dollar. They did not! In addition, China was forced to “devalue” in the month before president Xi Jinping meets president Obama in Washington, which is not necessarily the best timing, unless China deliberately wants diplomatic trouble.



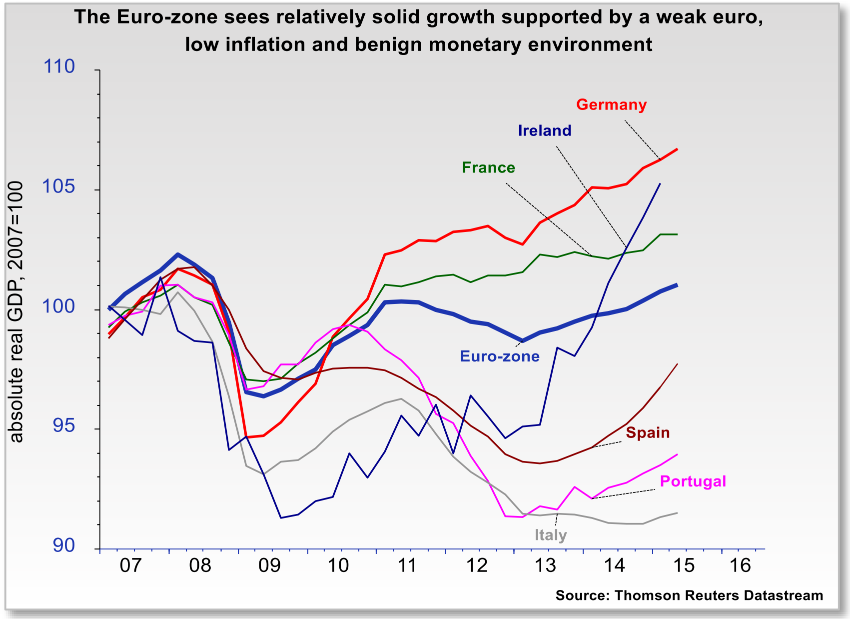
Insightperspectives believes Beijing aims for a depreciation "with Chinese characteristics". Ultimately, this will leave the yuan ten percent lower against the US dollar, down to the range of 6.6 to 7.0. On the other hand, this will only be a defensive move to mitigate the effect of a beggar-thy-policy in Japan and the Euro-zone. Beijing is well aware that China needs an overvalued currency to animate companies to move up the value ladder; but Beijing is not interested in an excessively overvalued currency!

Euro-zone – Growth supported by benign price environment and ultra-loose monetary policy

The Euro-zone economy is exposed to moderate but relatively solid growth, at least as long as the euro stays weak and inflation remains low (energy prices are falling sharply). This was also reflected in economic reports published in August. The Euro-zone economy grew 0.3% in the second quarter of 2015, which was up 1.2% compared to the same quarter in 2014 and after 1.0% in the first quarter. The Euro-zone's biggest economy, Germany, rose by 0.4% quarter-on-quarter, which was 1.6% year-on-year.

Even the two biggest Euro-zone "laggards", France and Italy, seem to be growing – see more in the chart section, Real GDP growth. On the other hand, growth in both countries is far too low to create jobs. This was also reflected in a report showing that Italy's youth unemployment rate hit an all-time high of 44.2% in June while the broader unemployment rate rose to 12.7% from 12.5% in May.

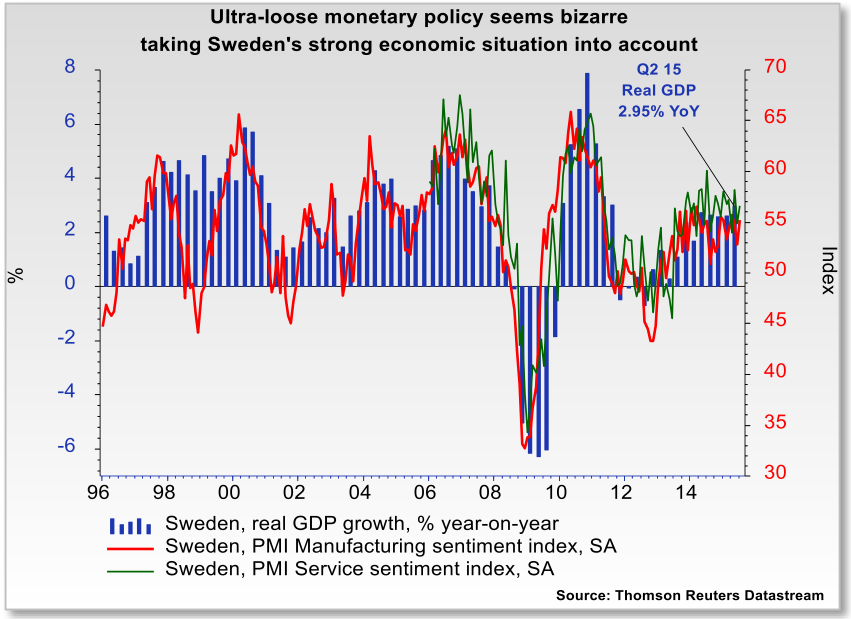
The outlook going into 2016 remains positive, according to the majority of leading indicators. In July, the Euro-zone Economic Sentiment Index (ESI) from the EU Commission rose to 104.4 in July from 103.3 in the [previous month](), which was the highest level since June 2011.



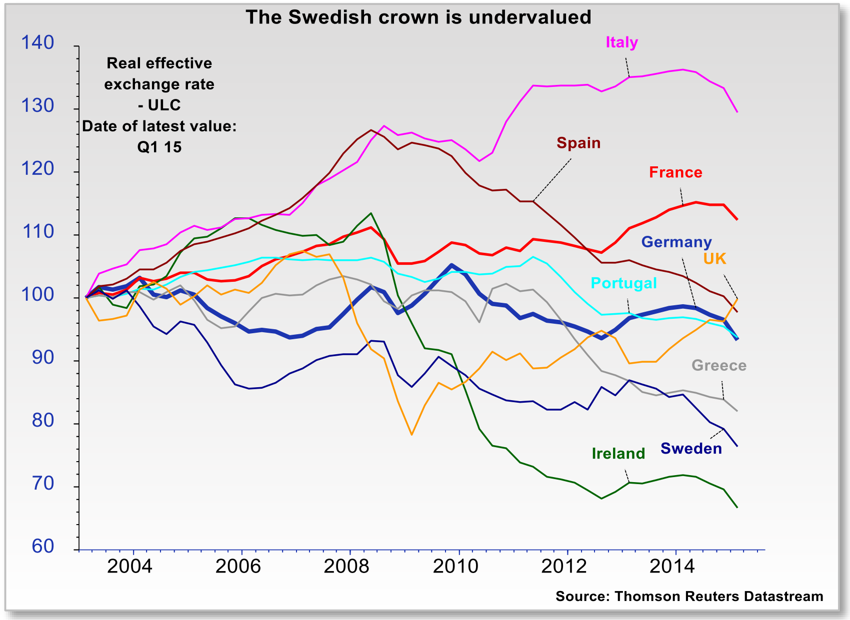
Furthermore, there are no signs yet that the European Central Bank intends to raise policy rates anytime soon and surely not if Insightperspectives proves right that a new deflation wave will hit the shores in the near future due to falling commodity prices and currency "devaluation" in China.

Sweden – Beggar-thy-neighbor-policy becomes even more bizarre

Sweden's monetary policy approach has probably never been more bizarre than it is today. This is the case after the Swedish economy expanded in the second quarter by 1%, which was 3.0% year-on-year and the highest annual growth rate since 2011.



The main growth contribution came from net-exports and private consumption. In the second quarter, the Swedish economy expanded at the fastest rate since 2011. All forward-looking indicators point toward stronger growth. In July, the headline indices in the leading manufacturing and service PMI surveys jumped sharply, which raises yet again the question what the central bank is up to?



The Swedish economy is doing far better than the majority of European countries. This, however, has not prevented the Riksbank from continuing on a path of ultra-loose monetary policy (money-printing and negative interest rates). This continues to keep the Swedish crown artificially undervalued, at least from a macroeconomic point of view.

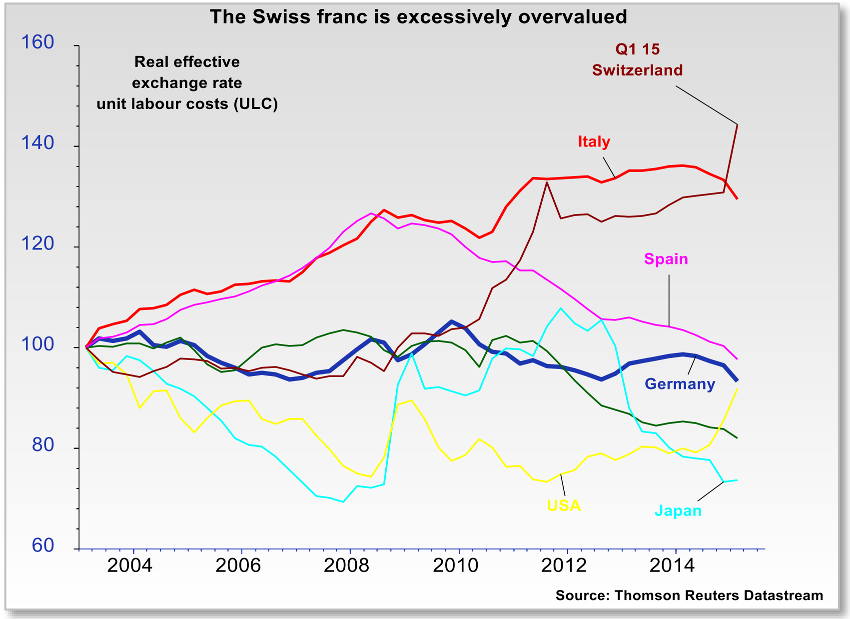
In fact, Sweden needs monetary tightening rather than monetary easing. At present, however, this seems unlikely, at least as long as the current monetary leadership is in charge. The Riksbank is one of a number of examples that the developed world lost its moral leadership long time ago when it comes to economic policy. Indeed, Beijing needs no excuse to join the global currency war.

Switzerland – Adjusting to other countries' inability to work with free market forces

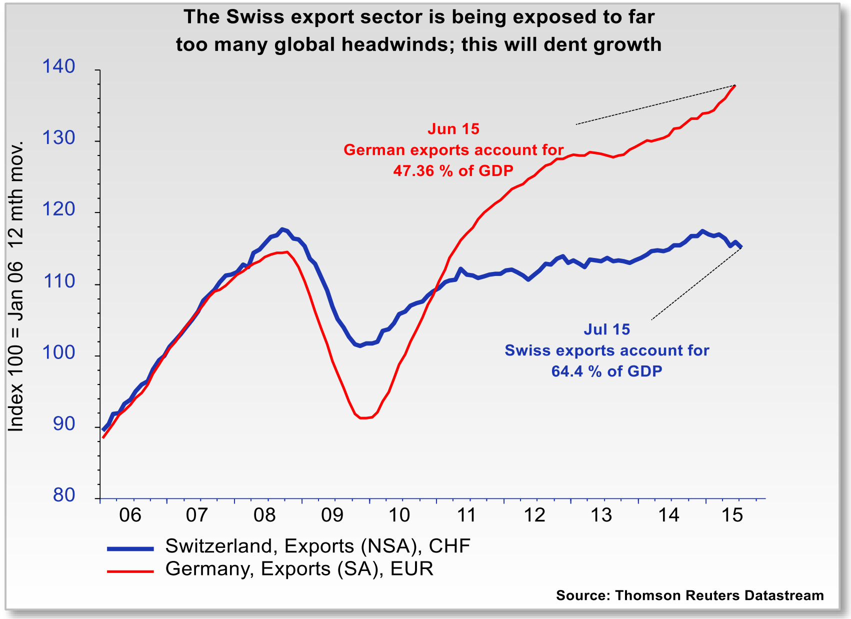
Since the European Central Bank decided to "go Italian", Switzerland has been working hard to adjust to other countries' inability to work in an environment of free market forces – read also the Sweden section. The Swiss franc remains excessively overvalued although the franc has lately declined to the weakest level since the Swiss National Bank abandoned the cap against the euro earlier this year.

The current situation, however, is beginning to bite. This is the case even though Switzerland reported a huge trade surplus in July, according to a report published last week. The improvement was solely due to a steep 10.6% year-on-year decline in imports based on a three-month-moving-average calculation (exports fell 4.1% year-on-year).

Switzerland could soon see more headwind as China now appears to have joined the global currency war. Granted, Insightperspectives believes Beijing intends "only" to take the sting out of an aggressive beggar-thy-neighbor-policy in the developed countries; But this may "devalue" the yuan by as much as ten percent - read the article, Questions and answers as Beijing joins the global currency war, on page 16.



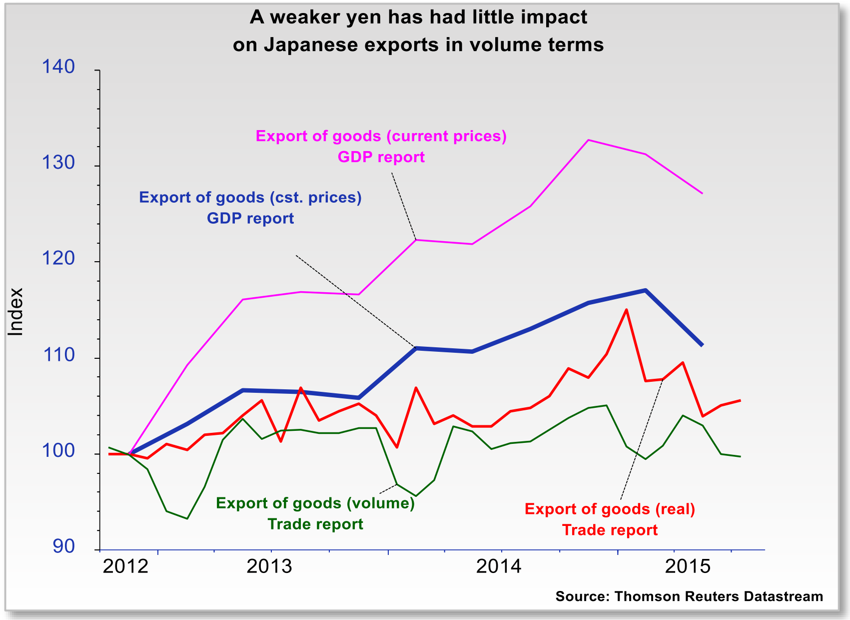
In Switzerland, the road towards stronger growth will be bumpy. Annual growth may hit zero in the second half of 2015. A strong Swiss franc has reinforced deflationary pressure. In July, annual consumer price inflation stood at minus 1.3%, which was the steepest price decline on record. This adds downward pressure on wages and appears slowly to hit consumer sentiment after a stronger franc initially was positive for households' real purchasing power. In the third quarter, Switzerland's leading consumer confidence index plunged to minus 17.1 from minus 7.0 in the previous quarter.



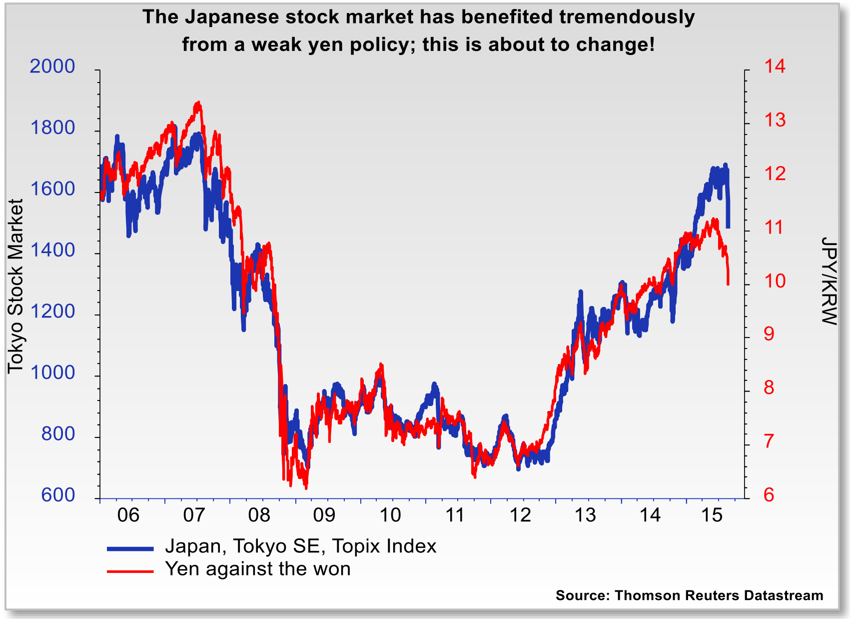
Insightperspectives still expects the Swiss franc to weaken against the euro, at least as long as the European Central Bank’s ultra-loose momentary policy prevents the two biggest Euro-zone ”laggards”, the French and Italian economy, from slowing again.

Japan – The currency boomerang comes back with a vengeance

In Japan, the economic recovery created by prime minister Abe's highly controversial policy approach, Abenomics, is fragile, which has also been underscored by this newsletter in the past. In August, a report showed that the economy contracted by 0.4% in the second quarter of 2015. The biggest negative contribution came from a significant drag from private consumption. The latter may have been due to the fact that the oil price rose in the first two quarters of 2015.



Since early July, however, the oil price has plunged, which was "supposed" to help consumer sentiment in the third quarter. Unfortunately, this is not yet visible. In July, the leading Japanese consumer confidence index fell to the lowest level since December 2014. The problem is still that Japanese wage-earners barely see any wage increases even though the unemployment rate continues to decline.



There are optimistic projections that corporate investment will make a bigger contribution to growth in the near future, at least according to the latest quarterly Tankan survey from the Bank of Japan. This, however, was not the case in the second quarter , according to the quarterly GDP report (higher investment was predominantly due to stronger public sector investments rather than corporate spending).

The Japanese economy is also "supposed" to see support from the fact that the yen is now at the weakest level in real terms since the early 1980s. But Japanese companies are so far predominantly using a weak yen to boost revenues in yen terms and to a much lesser extent exports in volume terms. In the second quarter, exports in real terms fell 0.7% compared to one year ago. This is bad news for prime minister Abe and leaves him with few growth drivers as Abenomics has eroded households' current and future real purchasing power.

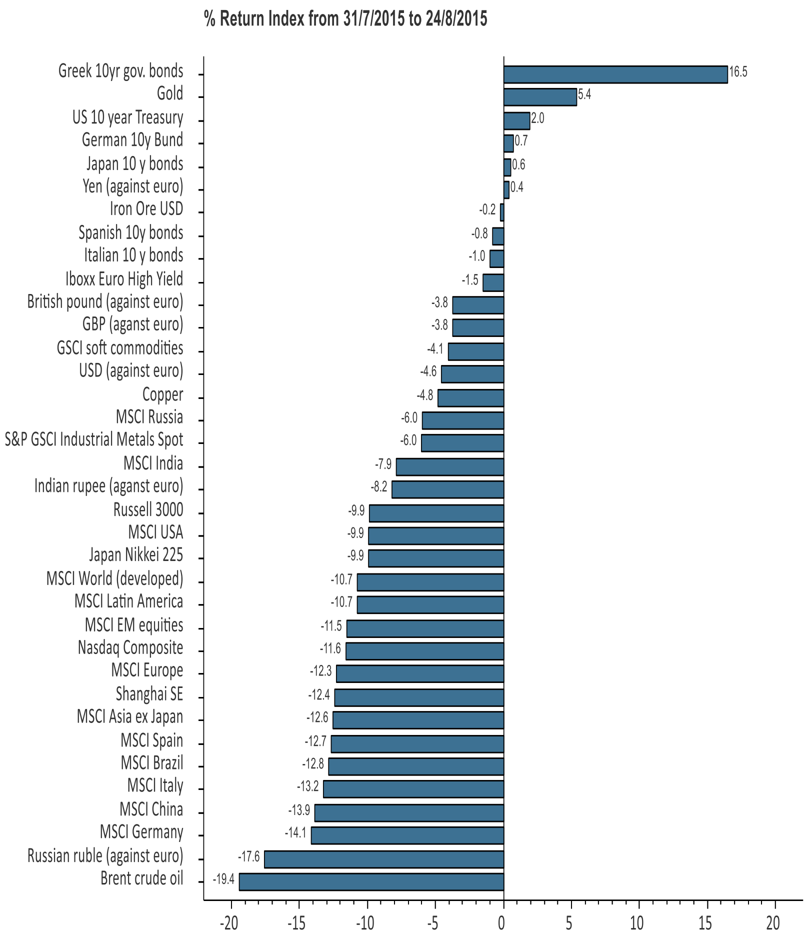
Japan's pain does not end here! Other Asian countries are now replicating Tokyo's beggar-thy-neighbour-policy. In August, China decided to change its currency regime and was followed swiftly by Vietnam – read the Bloomberg article, Vietnam Widens Dong Trading Band After China Devalues Yuan. This spells trouble for the Japanese stock market, not least if South Korea decides to join the global currency war more aggressively. So far, the performance of the Japanese stock market (in local currency) has predominantly been a function of yen weakness rather than prime minister Abe's slow reform process – unfortunately!

Front page – Table of Contents

Financial Market Update

In August, the global stock market was under severe pressure after the US Federal Reserve and the PBoC, China's central bank, said "boo" – see more in the Global Economy section on page 2. The Emerging Market stock market fell in particular; the MSCI Emerging market index fell 11.5% in August (August 24). The German stock market also fell relatively sharply (-14%) due to the capital goods sector's high dependency on China and the United States. The Chinese stock market also fell sharply again as the impact of Beijing's policy measures to support the market fizzled out relatively quickly. The MSCI China index fell 13.9% while the Shanghai A-shares index fell 12.4%.

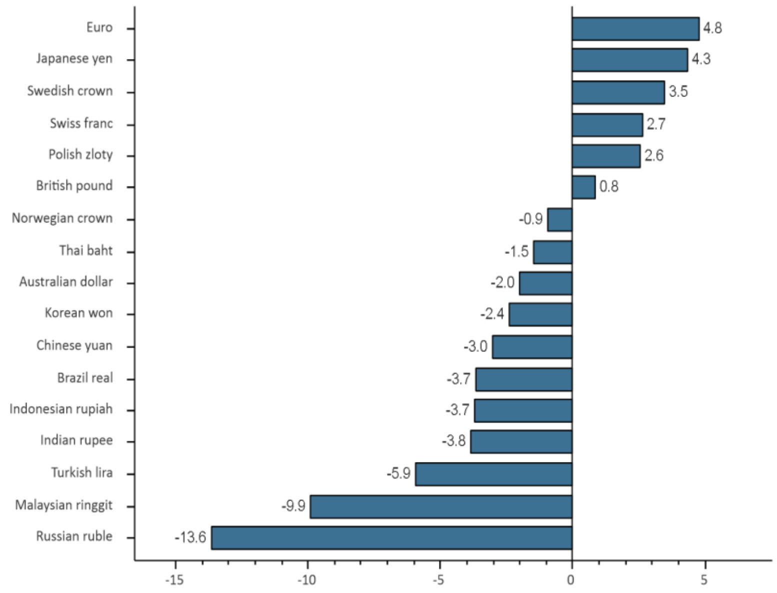
In the commodity market, the oil price fell by another 19% in August after a sharp decline in July. This was the case after reports showed neither visible signs of declining output in US shale nor in OPEC's output statistics. The latter was the case even though Saudi Arabia reduced its production in July; but other countries such as Iran and Iraq increased production – see OPEC's monthly report here. The S&P Goldman Sachs Industrial Metal Index fell 6%. Conversely, the gold price rose nearly 6% in August.



Source: Thomson Reuters Datastream

In the foreign exchange market, China's currency decision was immediately followed by Vietnam - read the Bloomberg article, Vietnam Widens Dong Trading Band After China Devalues Yuan. Furthermore, last week, Kazhakstan decided to devalue the tenge, read The Telegraph article, Kazakhstan currency plunges by record 23pc as government relinquishes control of exchange rate. The ruble fell 13.6% against the euro as the faling oil price increases pressure on the Russian economy.

% Return Index vs USD from 31/7/2015 to 24/08/2015



Source: Thomson Reuters Datastream

Conversely, the euro rose against the yen and the US dollar in spite of turmoil in the stock market. Normally, the current environment of risk-off is supposed to be far more supportive for the yen. This has, at least so far, not been the case. In August, the euro rose 4.8% against the US dollar while the Japanese yen rose 4.3% against the greenback. The main factor behind euro strength appears to be short-covering as the euro has increasingly been used as financing currency in carry trades since the ECB launched quantitative easing at the beginning of the year.

Front page – Table of Contents

China

Questions and answers as Beijing joins the global currency war

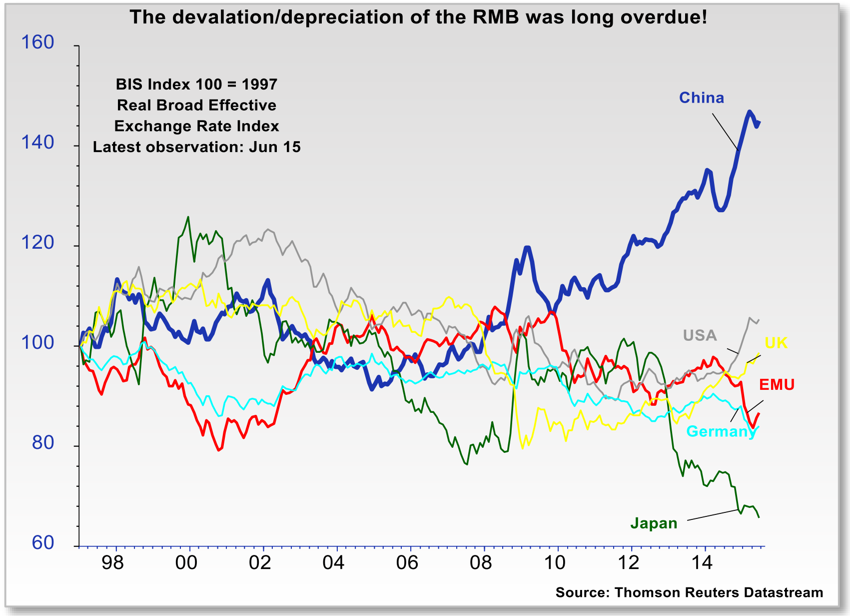
This article was pre-published on August 13, 2015

In August, the editor of Insightperspectives was interviewed by the Danish radio station Radio24Syv about the stock market turmoil in China – see the link here or click the image on the right. In this context, more questions were presented beforehand. There was, however, only time to answer a few questions. Here are all highly relevant questions and answers, which cover issues such as the Chinese stock market, RMB exchange rate and where China is headed.

What triggered the latest Chinese stock market collapse?

To answer this question, it is necessary to understand what triggered the rally in the first place. It all started by mid-2013 when a free-trade-zone (FTZ) was launched in Shanghai, which predominantly focused on launching financial service reforms. The pilot scheme in Shanghai was the beginning of more broad-based measures on the mainland. In November 2013, president Xi Jinping presented a comprehensive reform program which forced state-owned-enterprises (SOEs) to focus on the bottom-line rather than the top-line.

In April 2014, it was decided to launch Connect, which linked the stock exchange in Shanghai and Shenzhen with the stock exchange in Hong Kong. This is supposed to make it easier for foreign investors to access the Chinese stock market. In addition, more quotas were allocated to foreigners buying A-shares. Furthermore, Beijing-sponsored media fueled the rally by indicating that this was sponsored by China's Communist Party. The foundation for a stock market rally was created.



In June 2015, the value of the stock market hit 114% of GDP, which was the highest level since 2007 just before the stock market crashed. In May 2015, there was increasing anecdotal evidence of insider-selling. In addition, more companies intended to raise capital in the stock market. In June, a total amount of close to one trillion US dollar was offered (IPOs) at the same time as Beijing tightened margin trading rules. This of course triggered the sell-off.

How serious is the crisis?

When the stock market loses equivalent to approximately 30% of GDP within a few weeks, this of course poses a potential threat to the economy. On the other hand, the initial rally in the stock market, which started by mid-2014, failed to have a significant positive macroeconomic impact; the same may therefore apply when it comes to the latest stock market plunge. It is estimated that only 7% of Chinese households have exposure to the stock market. The jury is still out, however, and there have been signs that a falling stock market may have dented car sales.

Nevertheless, the biggest problem arising from the stock market turmoil is a credibility crisis when it comes to the relationship between the people and policymakers in Beijing – see more in the section on page 19, *President Xi Jinping lost face! What are the implications?*

What was Beijing's response to avoid more panic?

First of all, Beijing ordered China Securities Finance to start buying in the stock market. The institution was provided "ammunition" in the range of $400 to $500 billion (5% of GDP) of which $155 billion has already been spent, according to some estimates. In addition, Beijing has launched a number of fiscal stimulus packages.

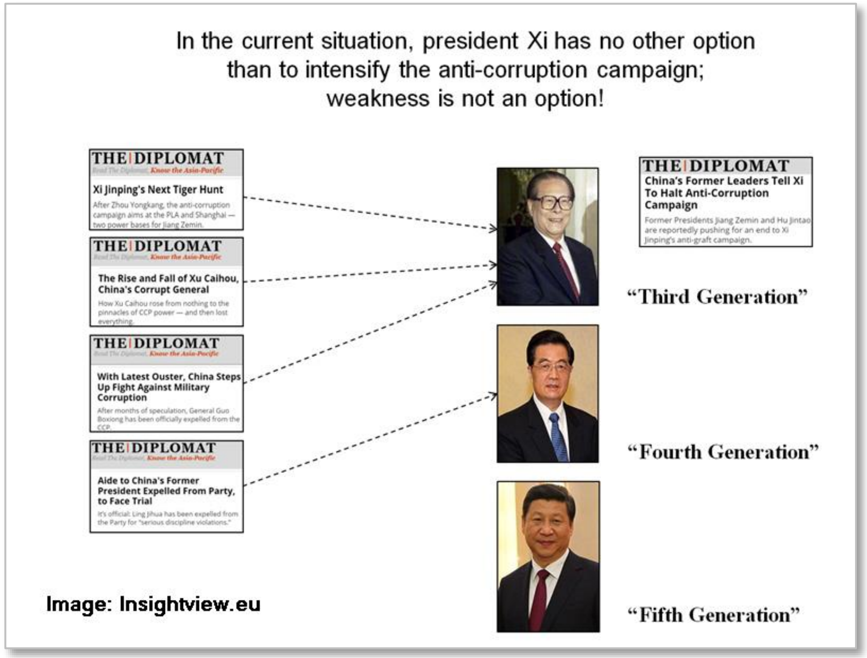
A trading stop has been imposed on more than half of the listed shares and short-selling is no longer allowed. Furthermore, major shareholders cannot sell in the coming six months; the same applies to board members. Policymakers have also halted new IPOs and the central bank has slashed policy rates; earlier this week, Beijing pulled the emergency brakes by devaluing the currency.

So far, China's direct measures to support the stock market only correspond to 1.5% of GDP. In comparison, the Troubled Asset Relief Program (TARP), a program of the United States government to purchase assets and equity from financial institutions to strengthen the financial sector in 2008, was $475 billion, which was the equivalent of 3% of GDP. However, if all measures are launched (including fiscal and monetary support), this will correspond to 10% of GDP.

What can Beijing do that is not possible in the United States and Europe?

There is probably not that big difference between what policymakers in Beijing are able to do and what policymakers in the West have done since the global crisis erupted in 2008. Many of the monetary policy measures launched in the United States and Europe were decided by officials who are not elected by the voters (quantitative easing).

Furthermore, democratically elected politicians have had little influence on monetary policy. In both China and the developed countries, the need to intervene heavily in the financial market is seen by many as a significant failure of market liberalism although these measures have absolutely nothing to do with market liberalism (read the Insightview article from April 2009, The defeat of market liberalism - a severe threat to long-term growth).



Even though the political leaders of China's Communist Party are not elected, they need the support of the people, not least when at the same time they are exposed to the potential threat of fractions within China's Communist Party, who have seen their power decline during the anti-corruption campaign – read the SCMP-article, Stop meddling in politics: Chinese President Xi Jinping's coded message to Jiang Zemin. Read more in the next section.

President Xi Jinping lost face! What are the implications?

The main consequence of the stock market crisis is the fact that president Xi Jinping lost face in front of the Chinese people. In the past, decision-making in Beijing has always been a collective decision within the standing committee of the politburo. Furthermore, the previous generation of policymakers have always played a significant role.

This has changed somewhat under the current leadership, as President Xi Jinping has used the anti-corruption campaign to get rid of not only corruption, but also many top-level persons within the CCP linked to the older generation of political leaders. In fact, the anti-corruption campaign has come very close to former president Jiang Zemin ("third generation"); in 2014, Mr. Jiang apparently warned the incumbent president Xi ("fifth generation") not to get too close!

On the other hand, the fight against "real" corruption has been appreciated by the middle class and below.

Since Mr. Xi took power, this has indeed provided some public support for the Communist Party, which the party had needed for a long time, since, during the last decade, many Chinese have become highly sceptical of the CCP's role. The stock market turmoil has, however, eroded much of Mr. Xi's hard-earned goodwill. The rally was after all supported by state-owned media and comments from high-level officials in Beijing.

The stock market turmoil has therefore made Mr. Xi vulnerable. The anti-corruption campaign has certainly given the president many enemies within the Communist Party and the military in particular. The only answer for Mr. Xi is to show strength rather than weakness. This is precisely what the president is doing. The anti-corruption campaign shows no signs of dwindling (the opposite appears to be the case). More importantly, the economic reform process will intensify. This weekend, Beijing published a plan for how to reform the state-owned enterprises – read the South China Morning Post article, How China's Singapore-like plan will 'boost growth' by shaking up state-run behemoths.

Should one invest in China?

If Chinese A-shares are permitted entry into MSCI indices, this will force many institutional investors into the mainland stock market. This may become the case next year, although full participation will take years. Ultimately, China's share of the MSCI Emerging market index will increase to nearly 43.6%, according to some calculations.

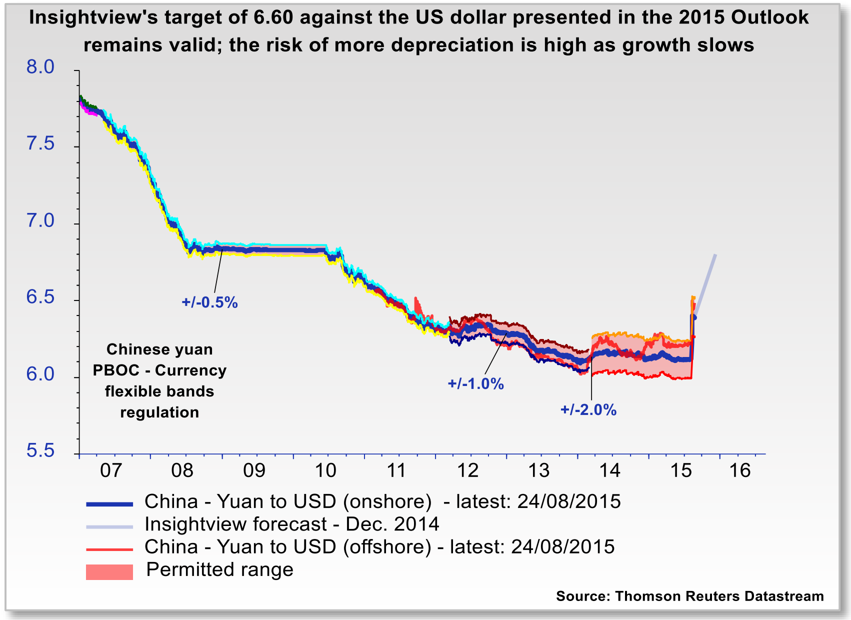
There are other good reasons for European investors to focus more on China's stock market. Mainland companies are moving up the value ladder, although the current pace is, admittedly, still slow. But it is a fact that an increasing share of Chinese households prefer domestic rather than foreign brands. Furthermore, the quality gap between foreign and domestic products has closed in recent years. Interestingly, even foreign high-end products appear to feel some pressure from domestic brands, at least according to Mr. Lars Rebien, CEO of Novo (listen to Novo's interesting comments about China in a CNBC interview).

Granted, there are also good reasons for European institutional investors to stay away from the Chinese stock market, such as a lack of transparency (China is exposed to a significant shortage of accountants). But the question is whether foreign investors can afford to stay away?

What comes next in China?

China's political leaders are fully aware of the long-term need of economic reforms. This is required to maintain high growth. This will also be reflected in the 13th Five Year Plan (2016-2020). On the other hand, China faces short-term headwind, partly attributable to an unprecedented monetary and fiscal policy launched in November 2008 (mother-of-all-stimulus). This has created excess capacity in many sectors of the economy (and excess leverage). The biggest problem, however, is that this has been exaggerated by the majority of developed countries pursuing a beggar-thy-neighbour-policy (currency war), which has made the Chinese yuan significantly overvalued.

Therefore, it was also not a surprise that the Chinese central bank devalued the yuan on August 11; this was the biggest devaluation since 1994 - see more in the 2015 Outlook presented in December 2014. This latest move is not enough to make a significant difference for the deeply troubled "lower 50%" of China's manufacturers. In fact, Insightperspectives forecasts Beijing to devalue (depreciate) the yuan against the US dollar by a total of 10% to the range of 6.6 to 7.0.



Insightperspectives sees Beijing's decision as a necessity! There is absolutely no doubt that Beijing prefers to maintain a relatively strong yuan. This will help animate mainland companies to move up the value ladder and boost the internationalisation of the yuan. However, the decision to launch quantitative easing (money printing) in Japan and the Euro-zone in particular has left China with no other option than to devalue/depreciate. No other country in the same situation has solved similar excess capacity problems without devaluing their currency.

What is the future for SOEs?

When it comes to state-owned-enterprises (SOEs), Beijing is well aware what is needed. Last week, Beijing published a blue-print outlining measures to boost the performance of SOEs. Foreign investors should, however, not be fooled. Beijing has no intentions to privatise SOEs which have a favourable long-term outlook.

Instead, Beijing wants foreign investors and companies to help make SOEs more efficient and profitable. In general, Beijing aims to strengthen the competitive position of Chinese companies in the domestic market, not only SOEs, but also private Chinese companies. Furthermore, Beijing intends to increase the link between SOEs and the private sector (many private companies on the mainland are owned by former SOE managers).

On the other hand, this also means that foreign companies in China will continue to see increasing headwind in the Chinese market, unless they are on the very high part of the value ladder. In the last few years, foreign companies in China have been under increasing pressure from Beijing (read the Insight-perspectives article from 2013, When the mandarins turn against foreign companies). Read more in the section on page 20, *Should one invest in China?*

How is Beijing's transformation of the economy progressing?

China is making progress when it comes to moving up the value ladder, but the process is still too slow. The decision to devalue/depreciate the yuan was not, however, a move in the right direction (although unavoidable). China has closed the technology gap in many sectors of the economy, but China still needs to improve when it comes to home-made innovation.

On the other hand, China has been much more efficient in transforming western technology into business ideas with "Chinese characteristics" (Alibaba, Tencent etc.). Furthermore, Chinese businesses are moving faster when it comes to branding – read the China Daily article, China Customer Satisfaction Index rising in China.

A final note - QE boomerang is coming back with a vengeance!

It is Insightperspectives' conviction that China's unavoidable decision to devalue the yuan (or allow market forces to depreciate the currency) will maintain high deflationary pressure around the world. China is joining a global currency war which was originally declared by the US Federal Reserve in 2009 and followed by Japan in December 2012 and the Euro-zone in February 2015.

On the other hand, Beijing will only use the decision to adjust for excessive overvaluation. This is not a proactive decision to create growth, but is predominantly a move to mitigate excessive short-term headwind exaggerated by a beggar-thy-neighbour-policy in the developed countries.

The above mentioned shows once again that only few countries around the world have used the global crisis to solve underlying economic imbalances (Spain, Portugal and Ireland). This is also why it remains far too early to make any verdict on whether the strategy of Ben Bernanke (and his successor Janet Yellen), Mario Draghi (ECB president) or Haruhiko Kuroda (Bank of Japan governor) has been successful.

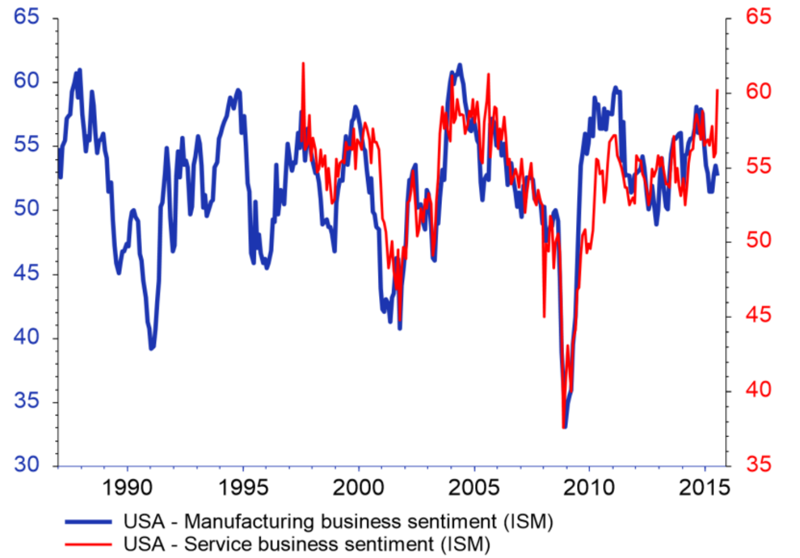
Unfortunately, there are increasing signs that the "financial engineers" have set off an avalanche of devaluations. The next country to act is probably South Korea - read the article, Weak South Korean Q2 GDP report; BoK may be forced to launch unconventional stimulus measures. Indeed, the QE boomerang is coming back with a vengeance!

Front page – Table of Contents

Charts

All charts are updated on August 24, 2015

Business Sentiment



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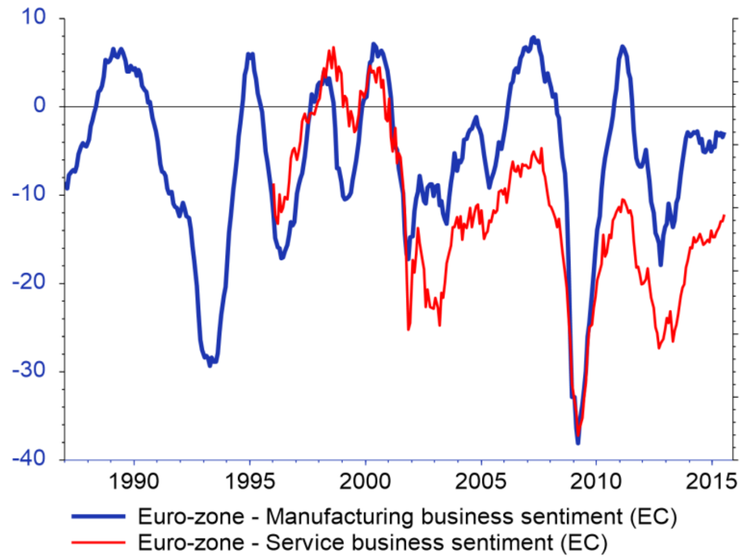

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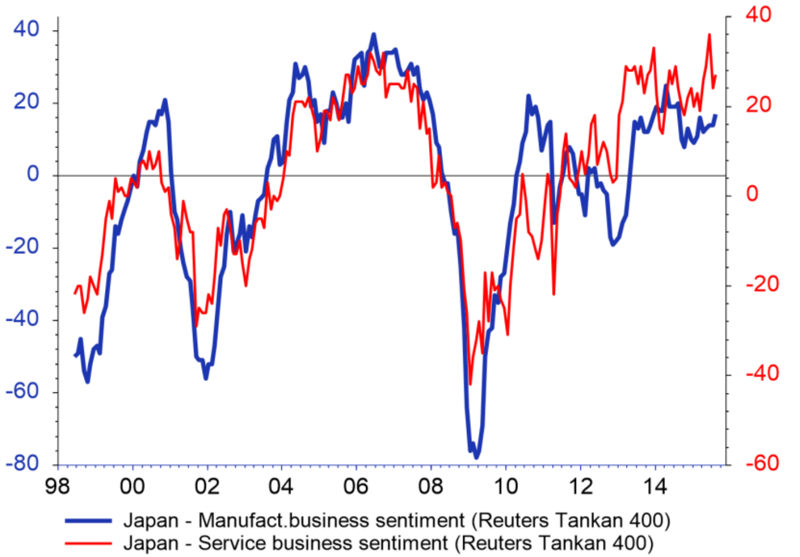

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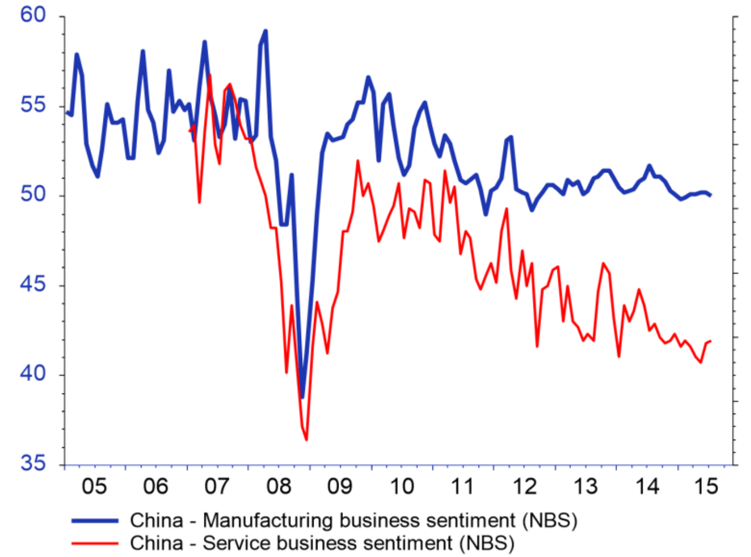

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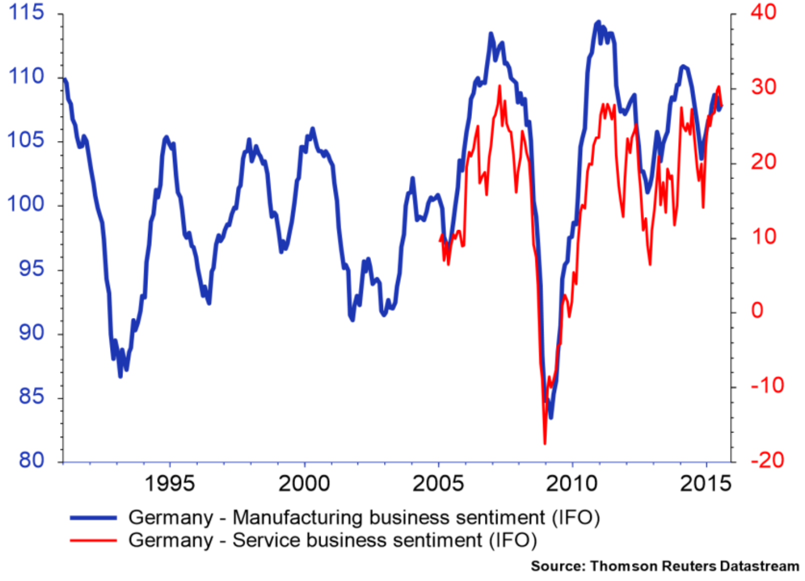
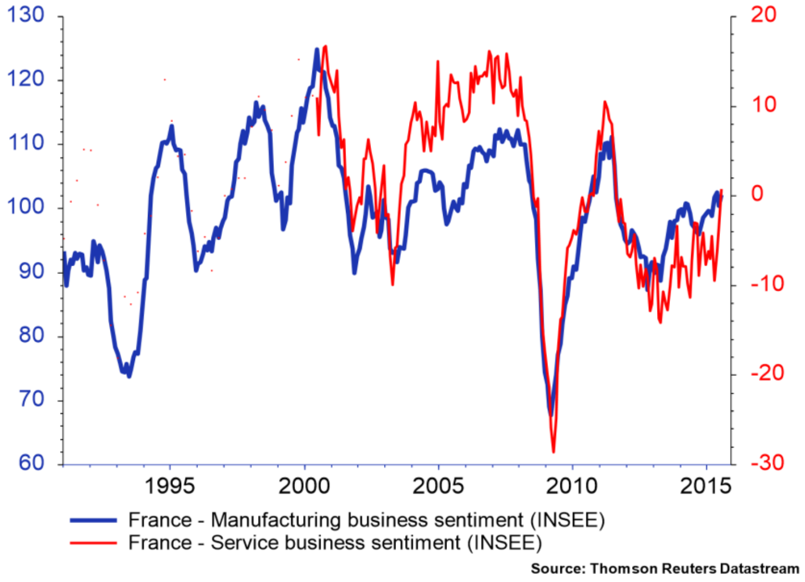
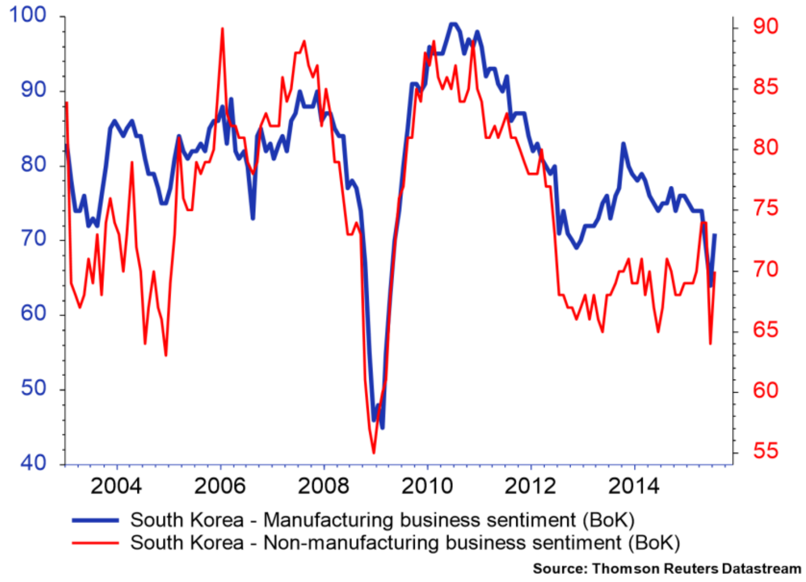
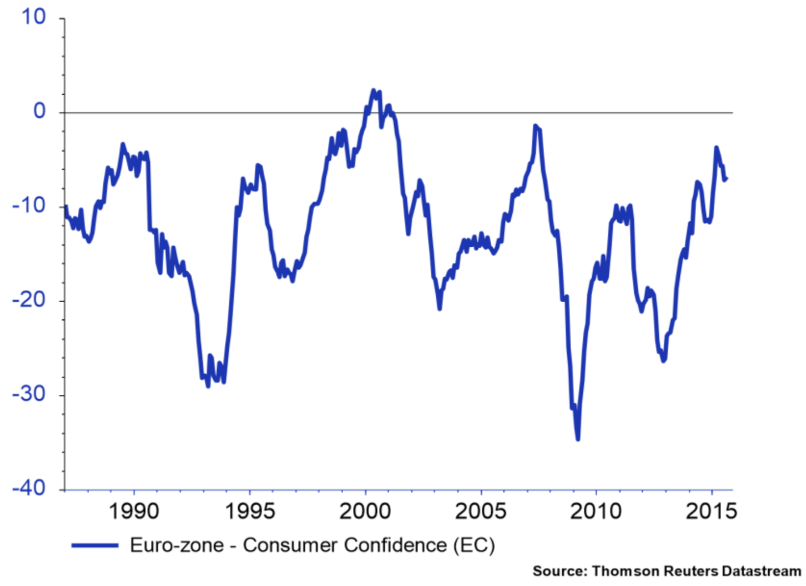
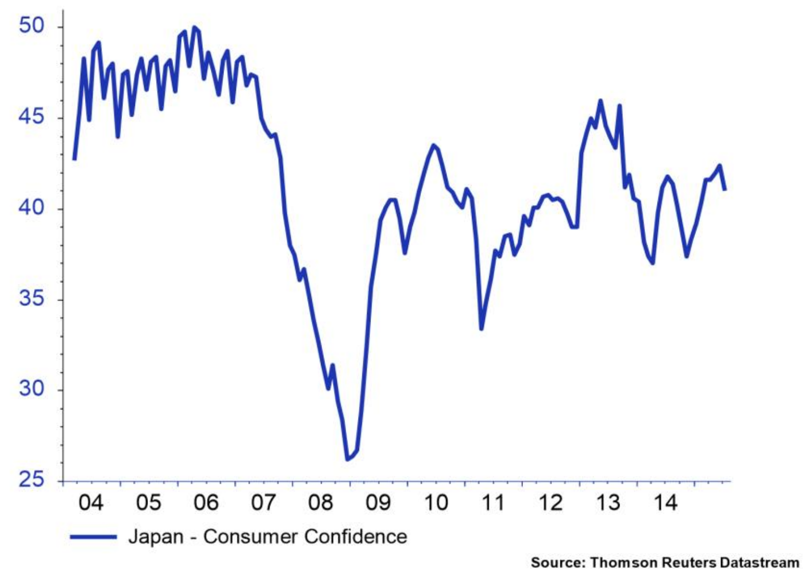


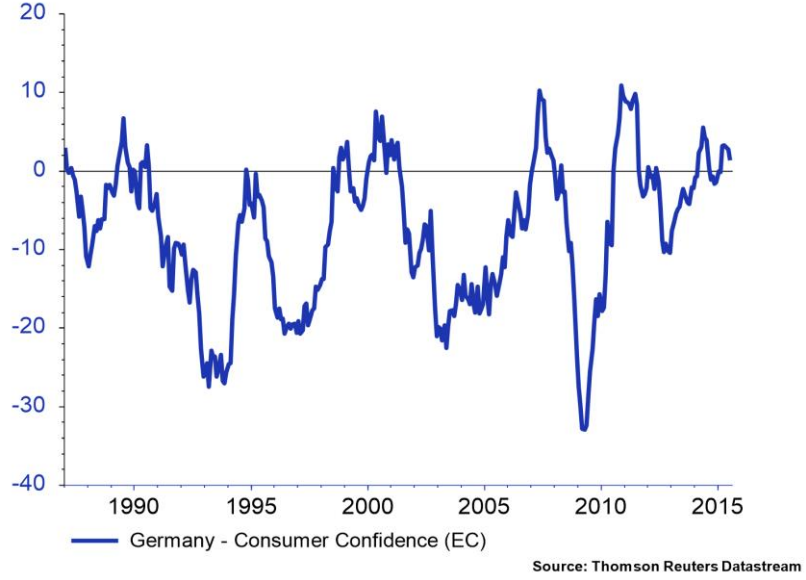




Consumer Confidence







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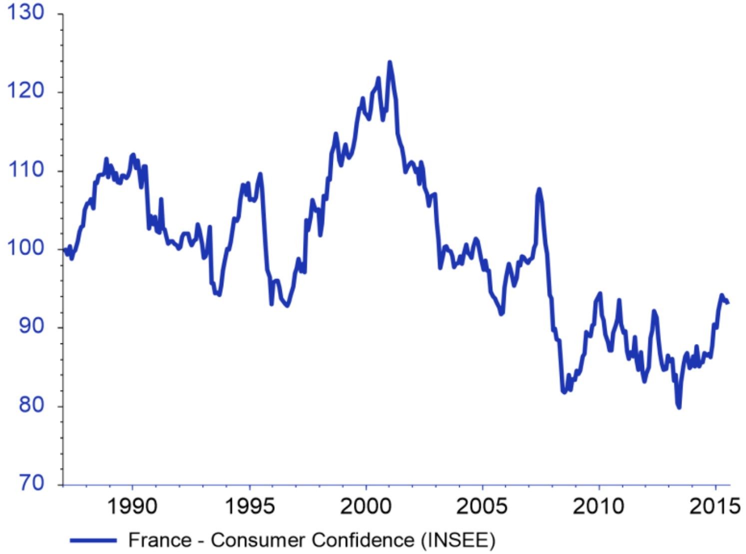

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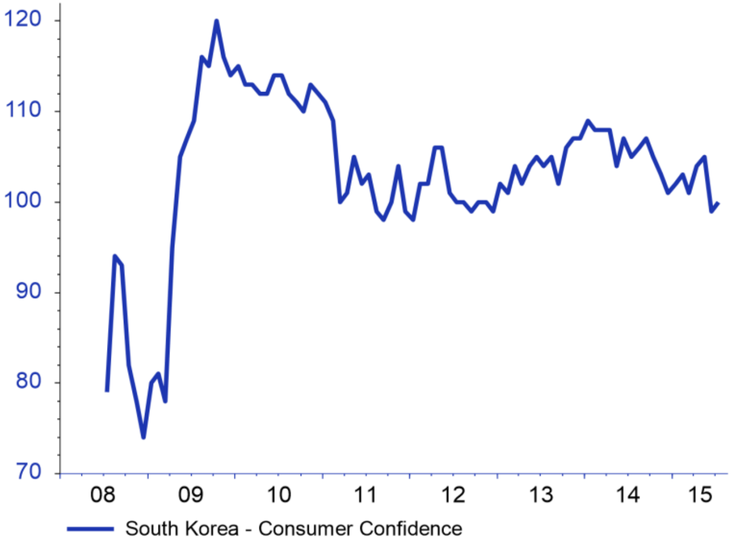

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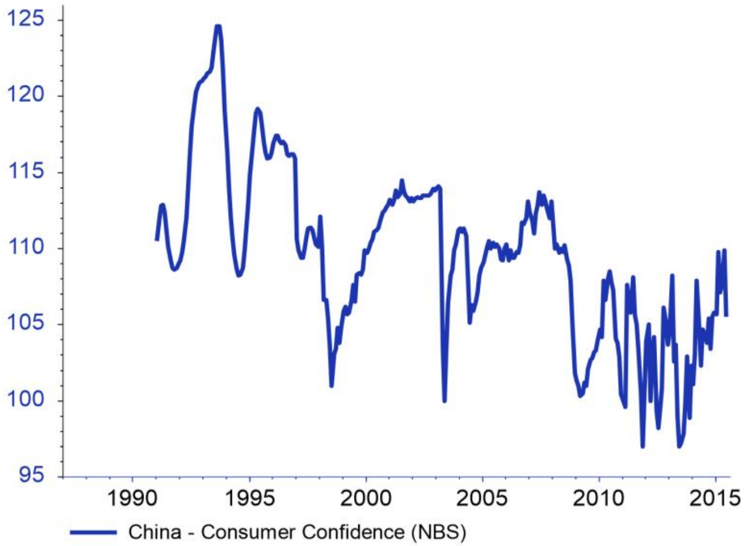

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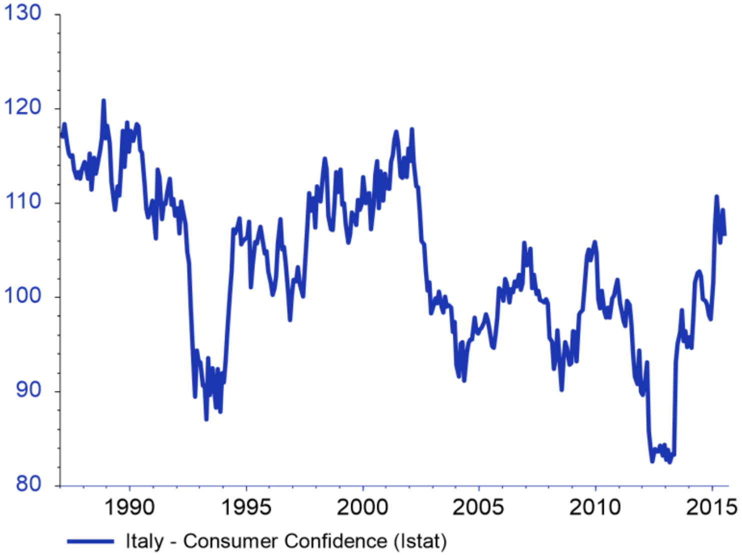

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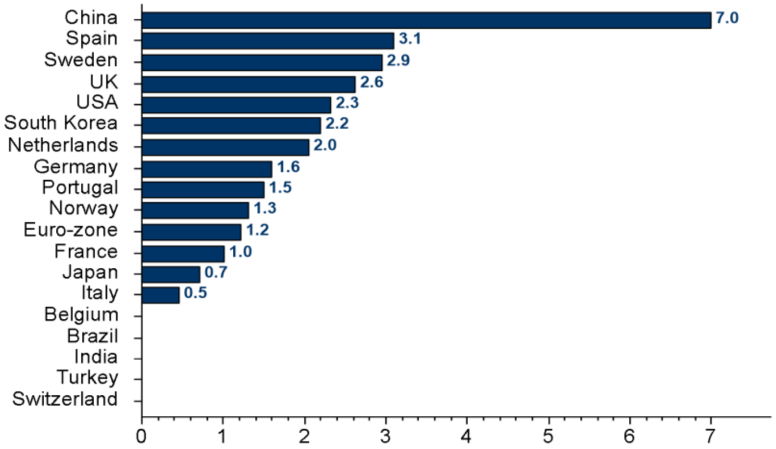
Real GDP growth

%YoY- Q2 2015



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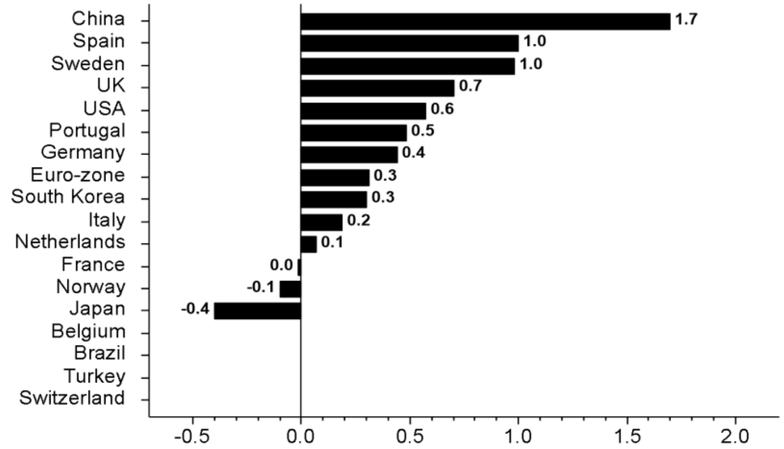
%QoQ - Q2 2015
(India is not included)



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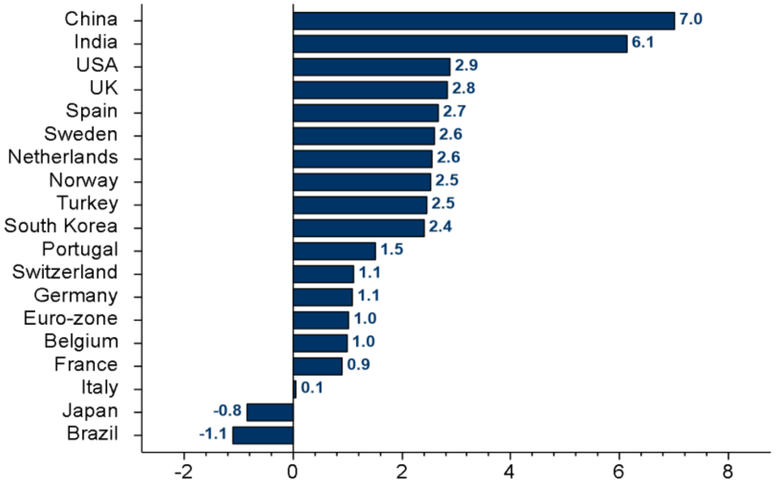
% YoY - Q1 2015



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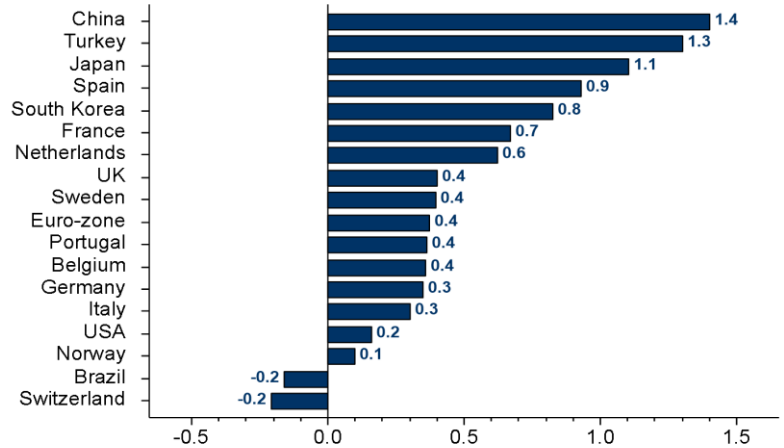
% QoQ - Q1 2015
(India is not included)



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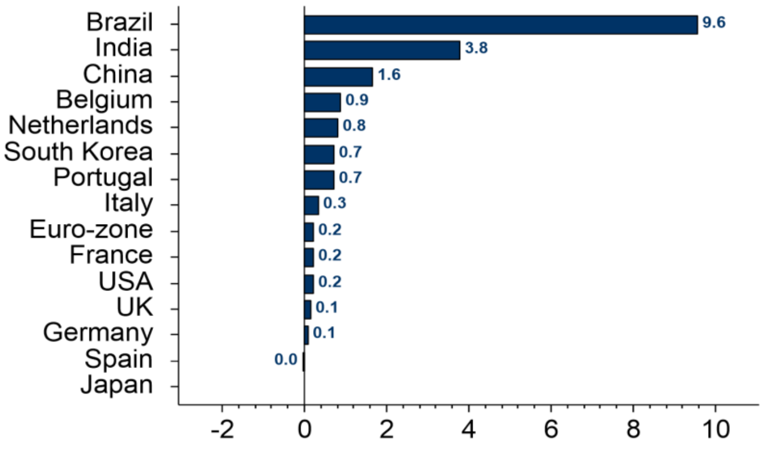
Consumer price inflation

% YoY - July 2015



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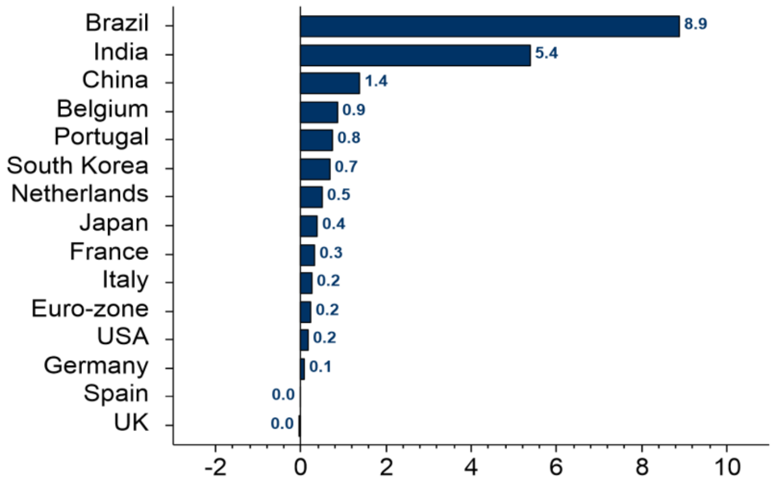
% YoY - June 2015



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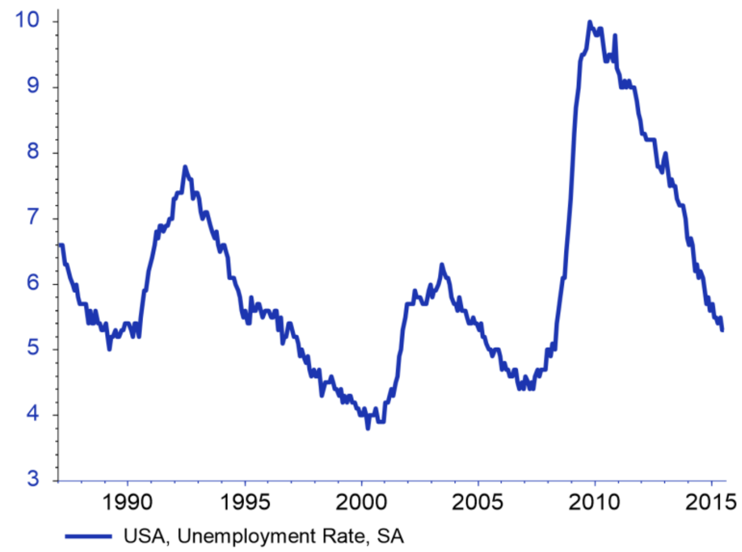
Unemployment



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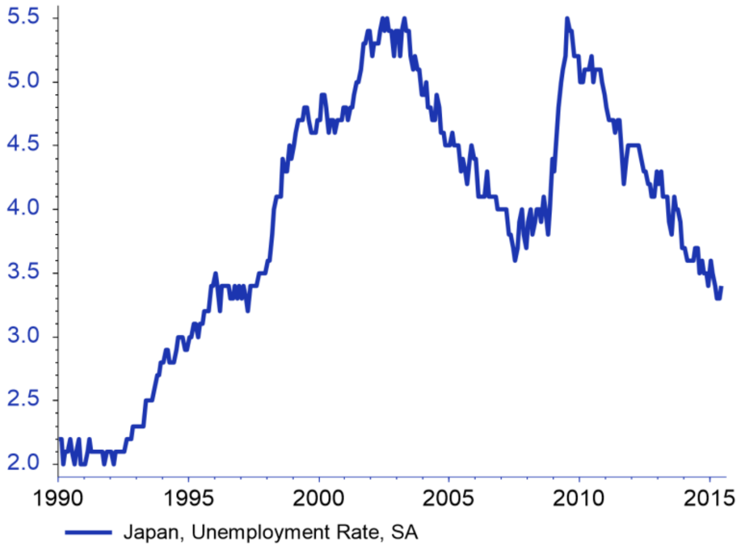

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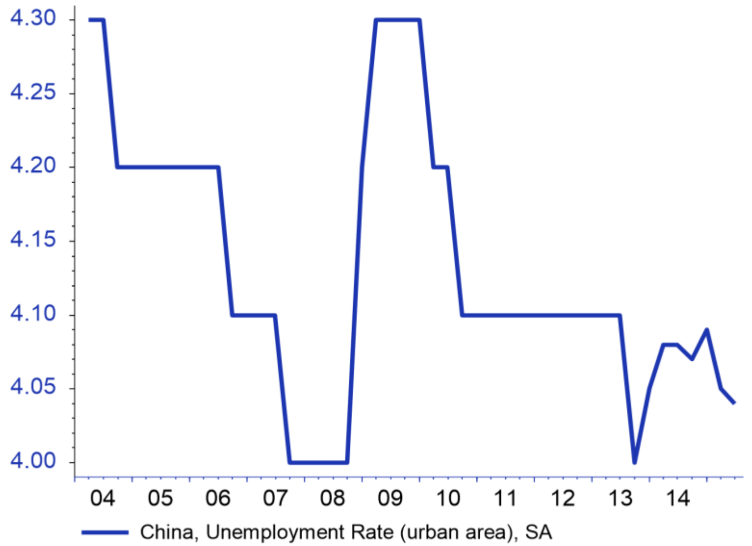

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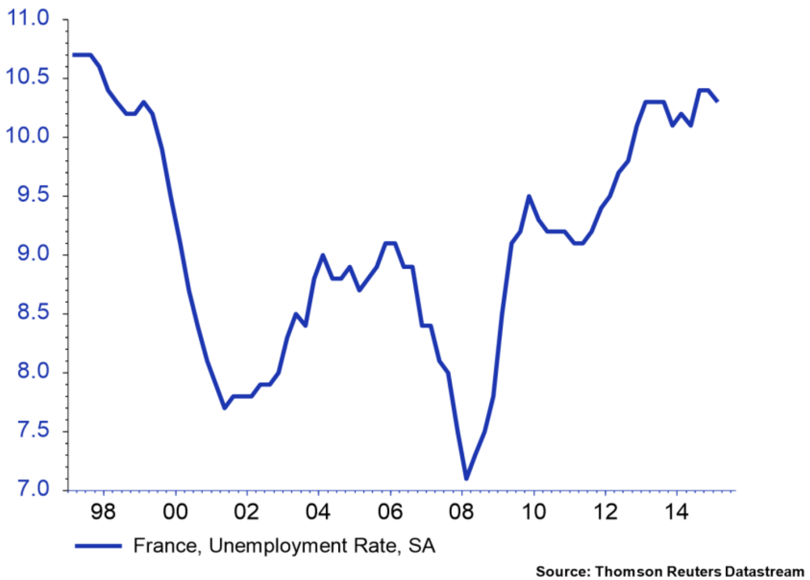
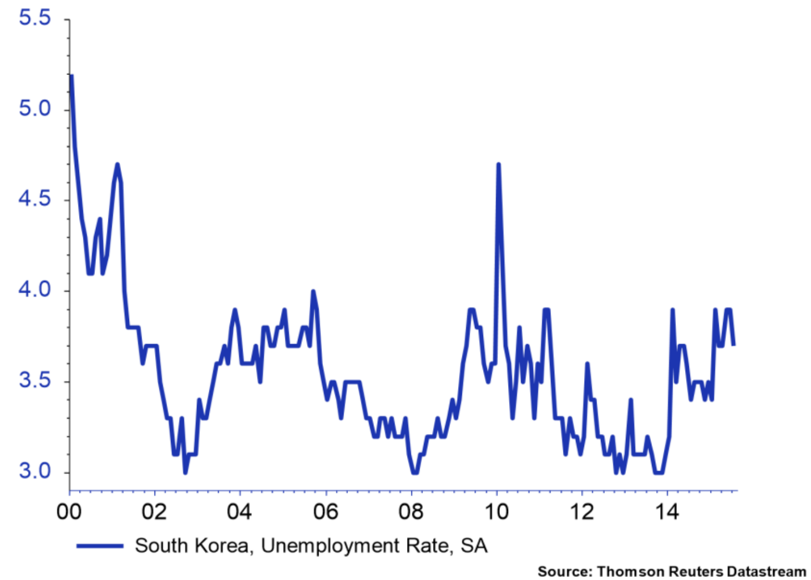
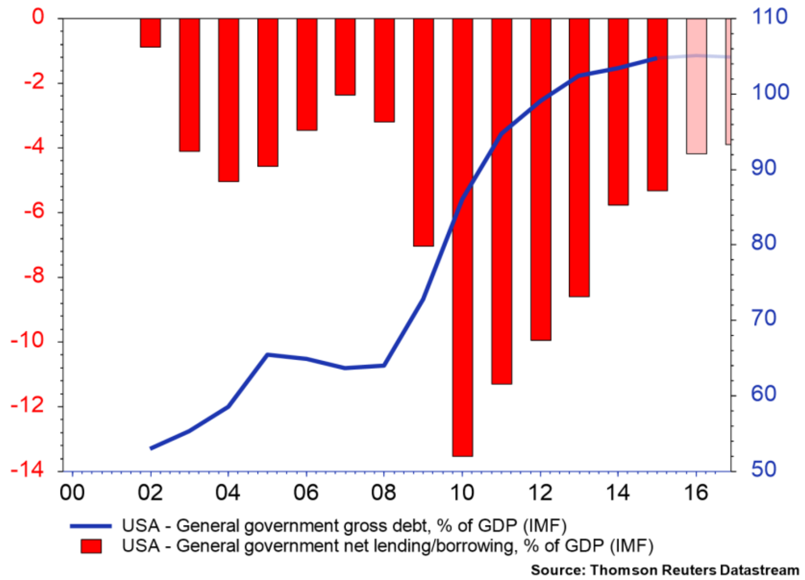
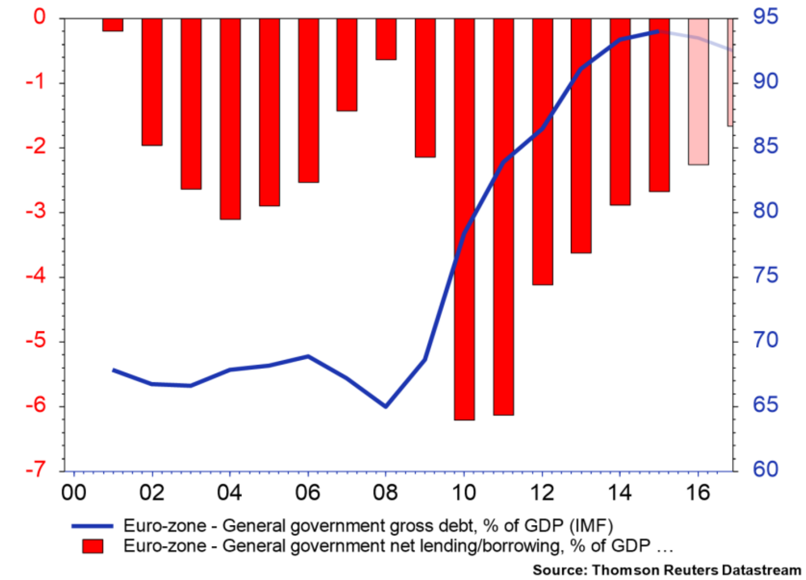
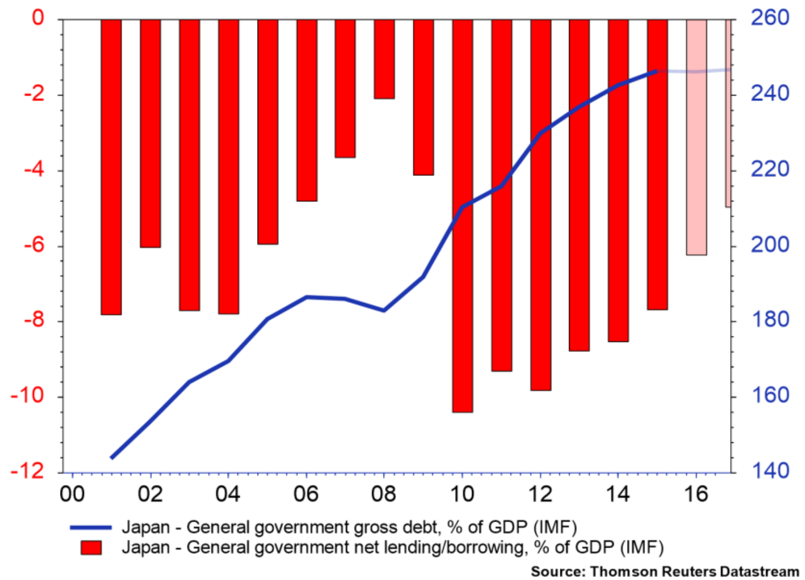


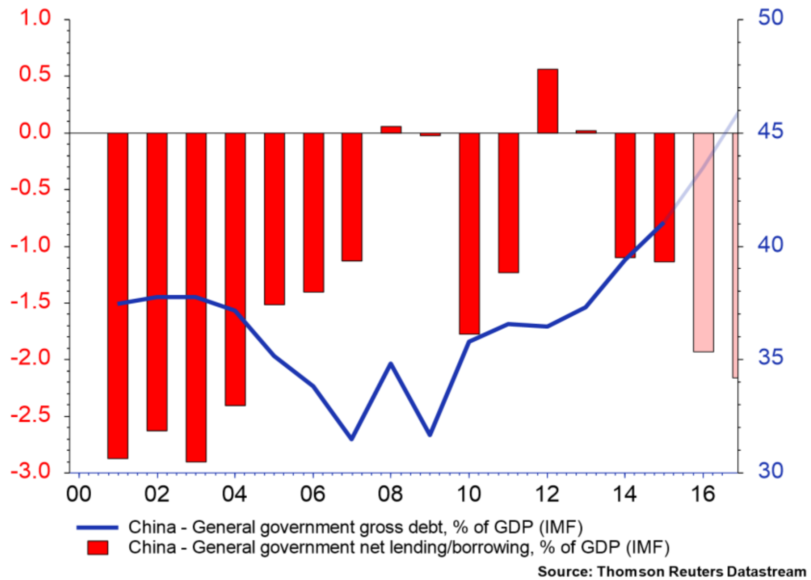


Public Sector Balances









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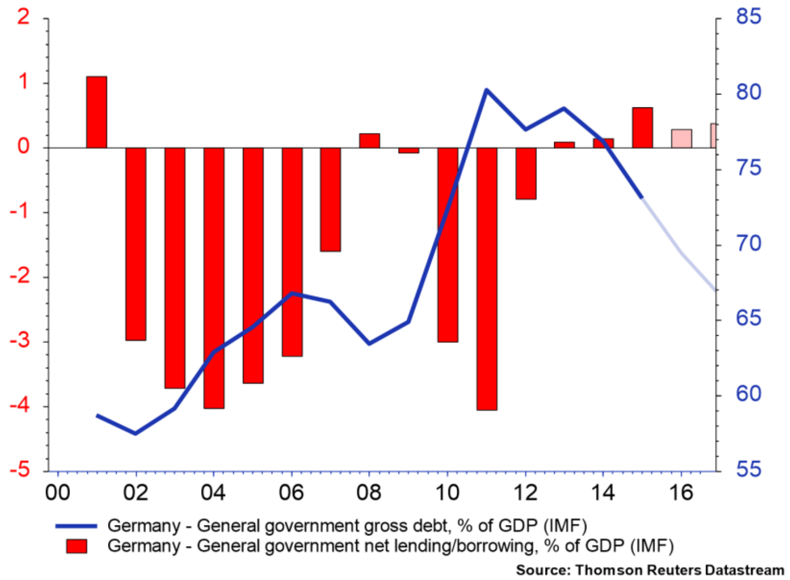

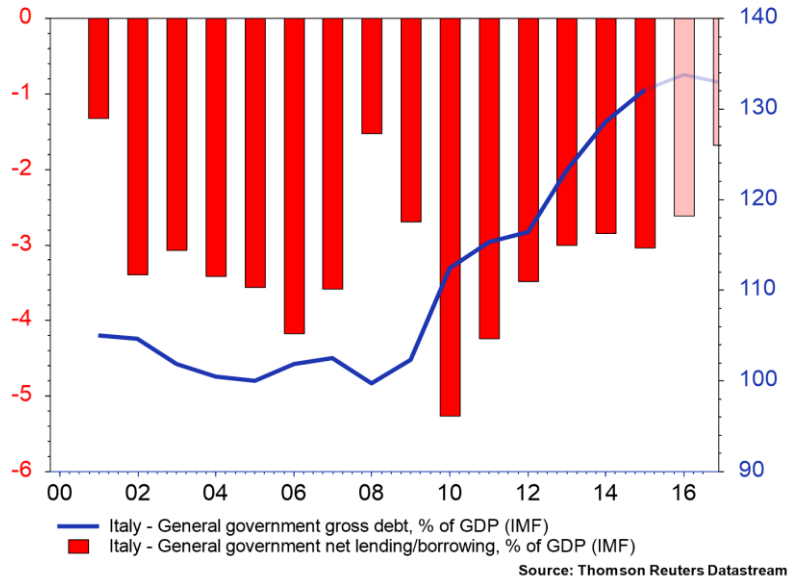

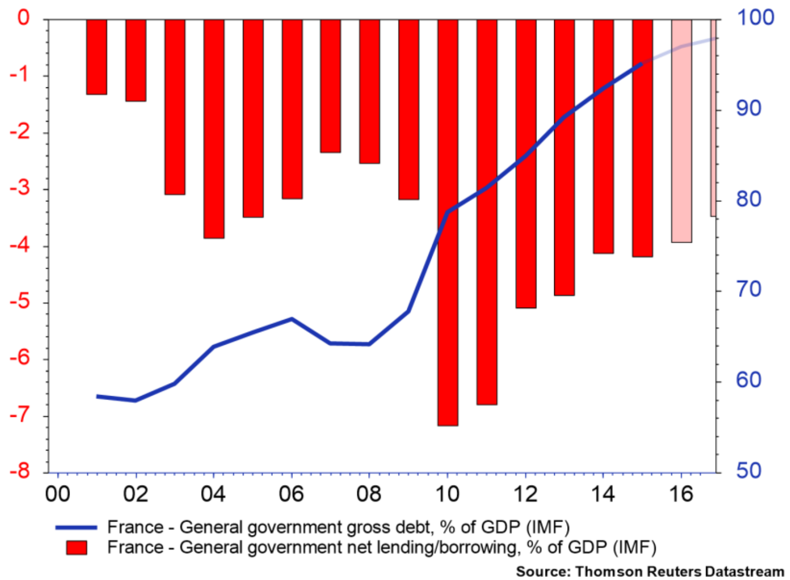

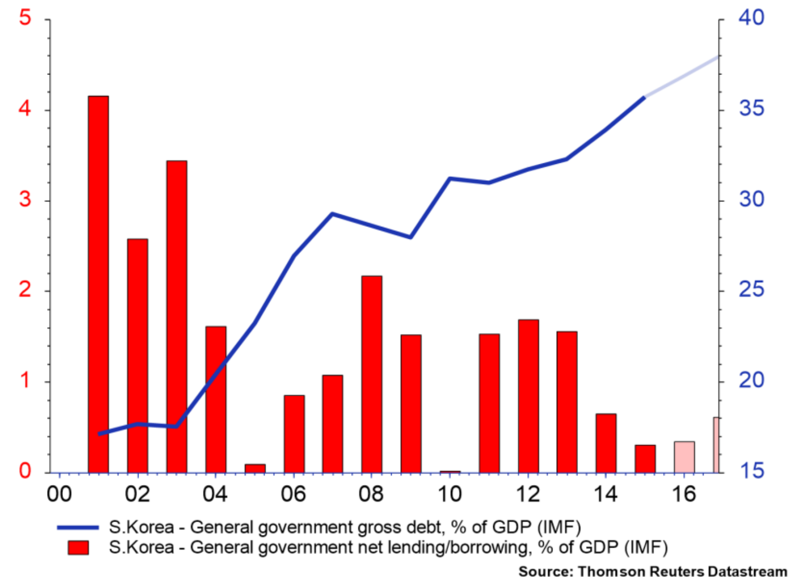

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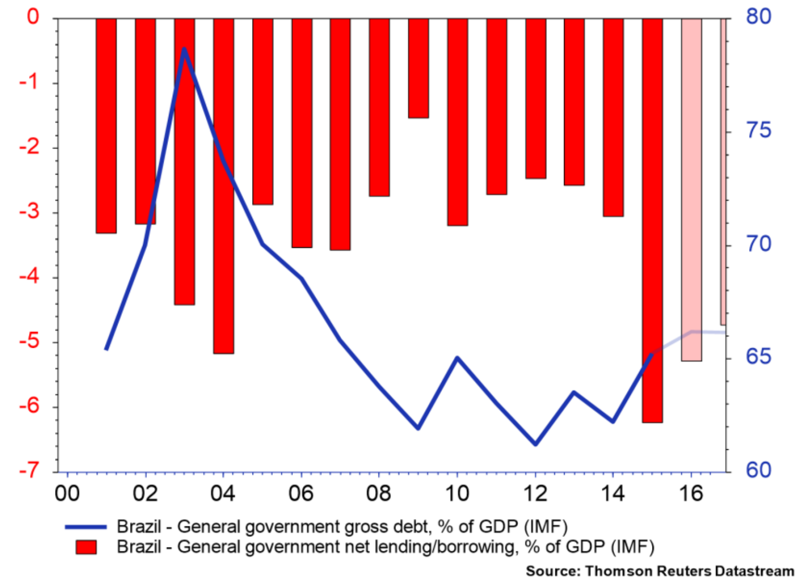
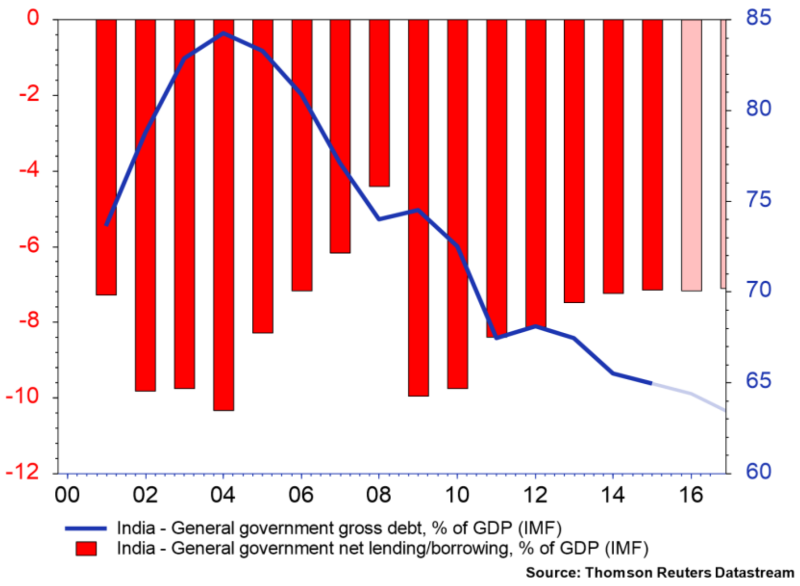
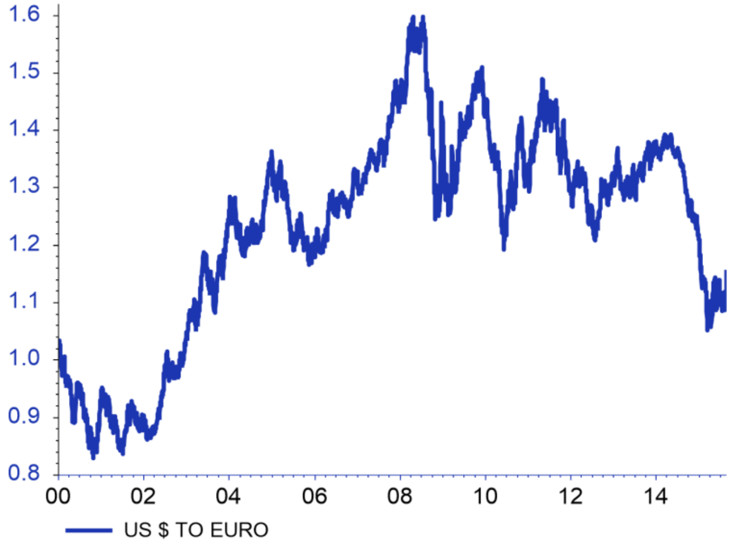




Foreign Exchange Market



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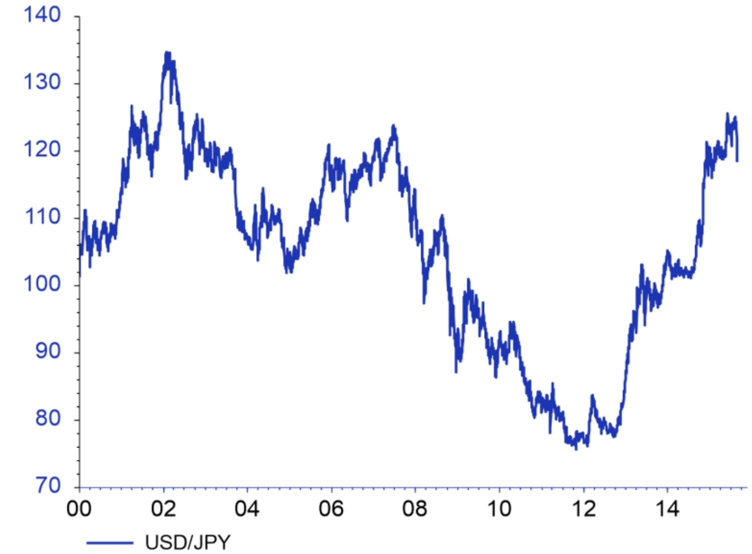

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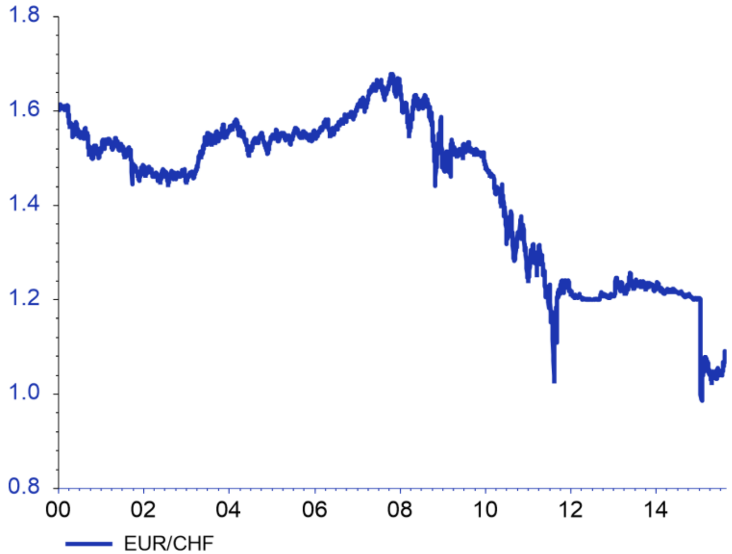

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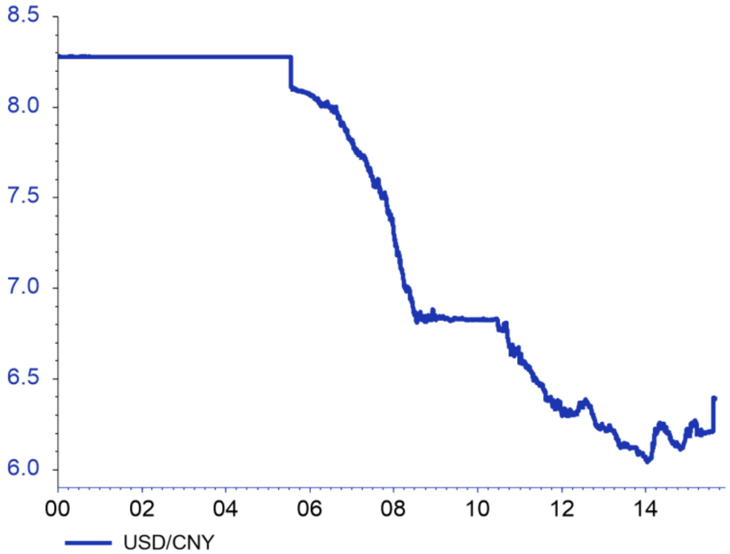

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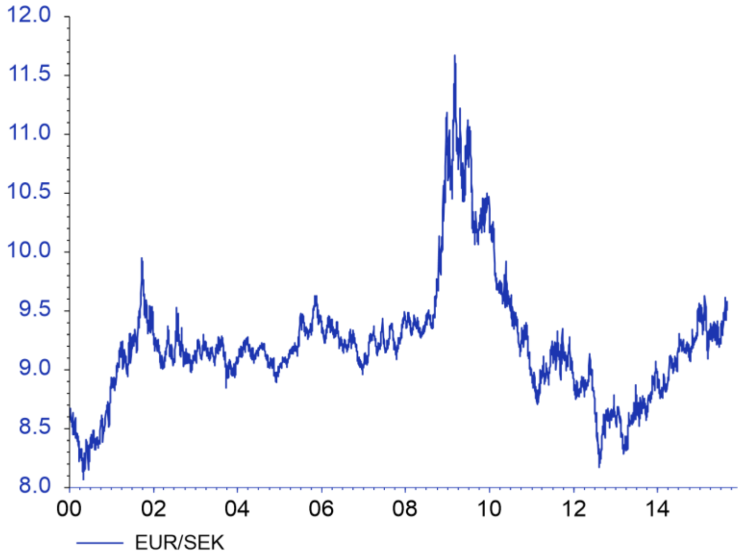

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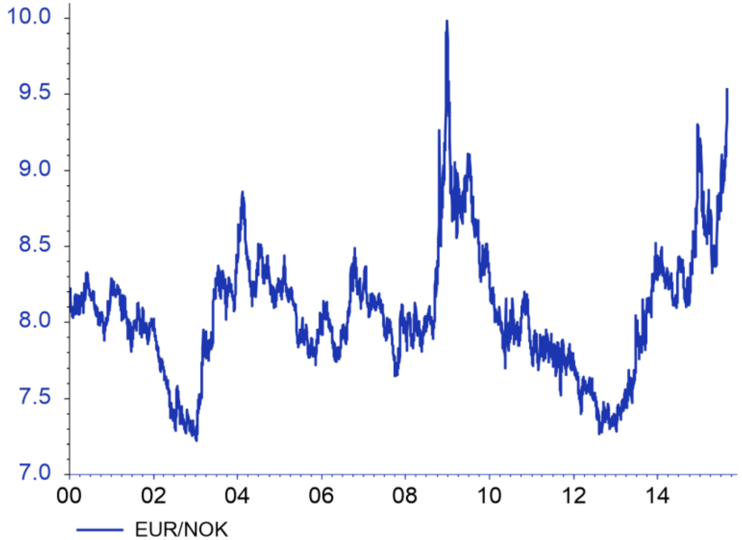

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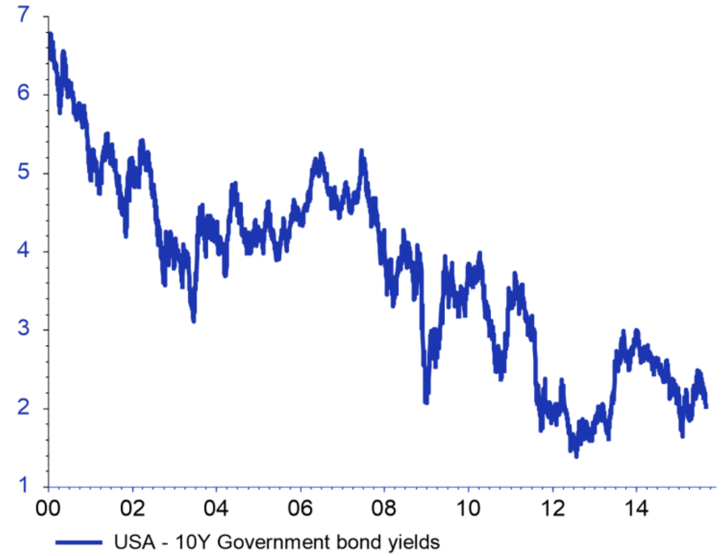
Government Bond Yields



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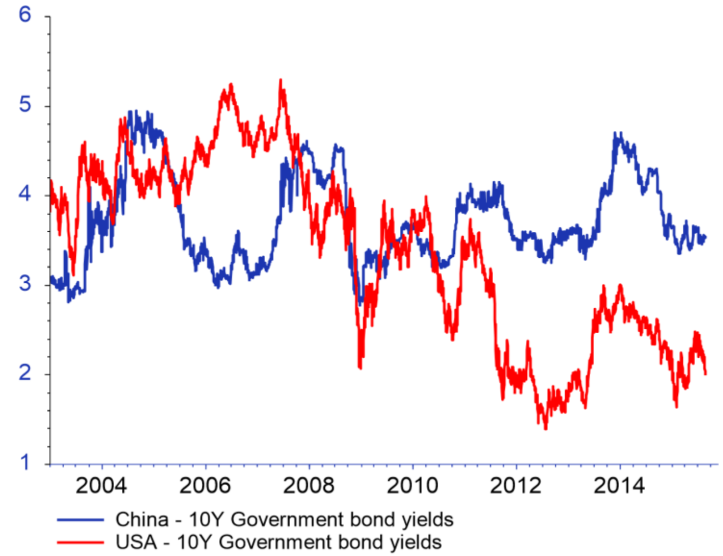

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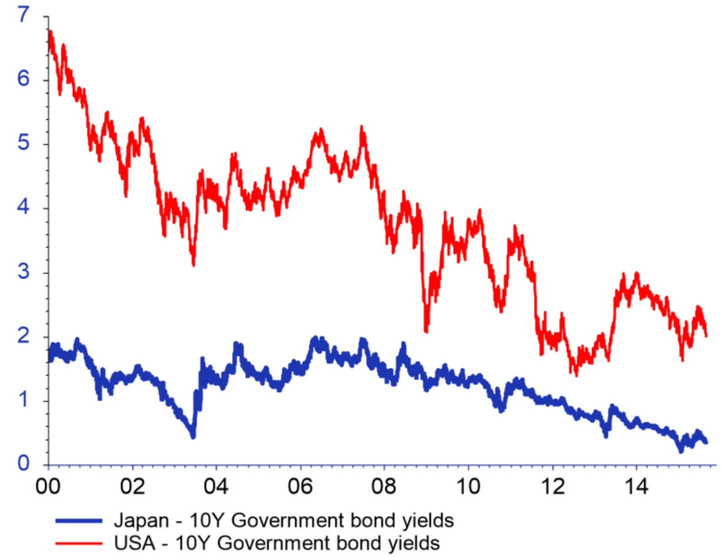

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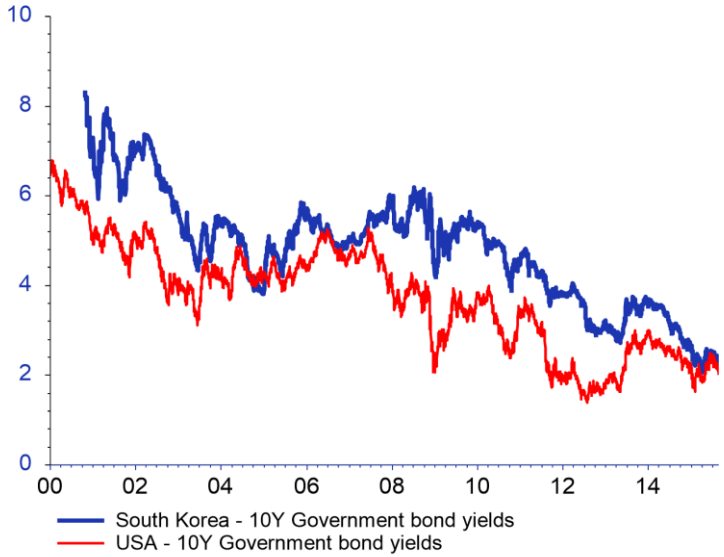

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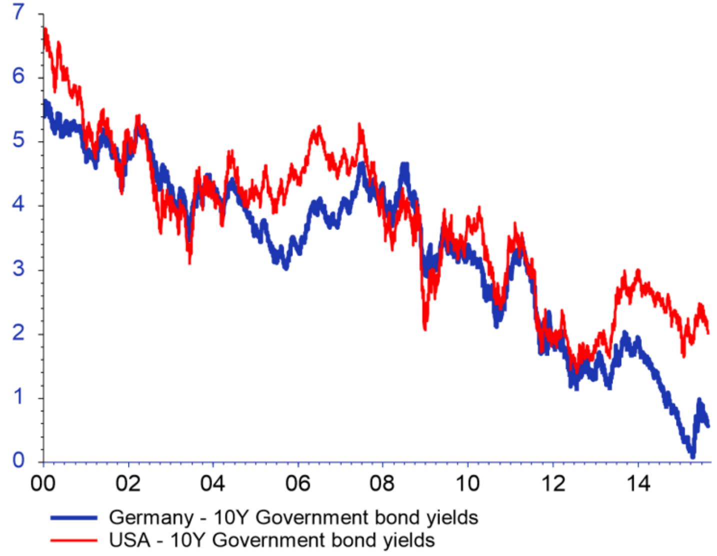

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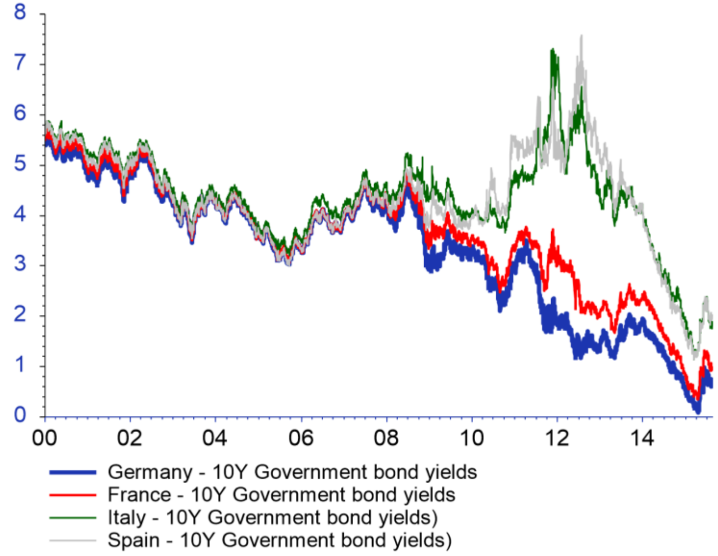

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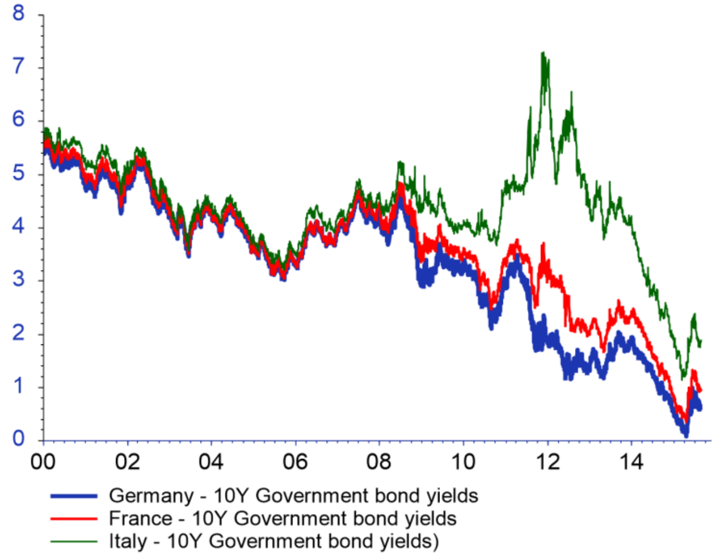

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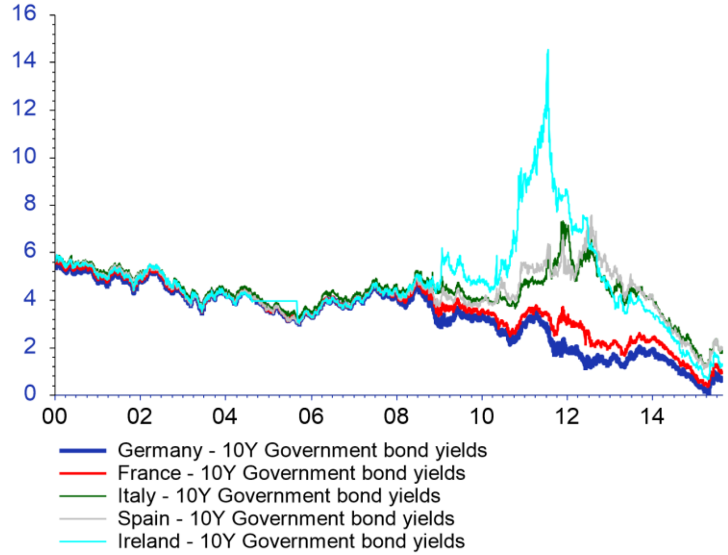

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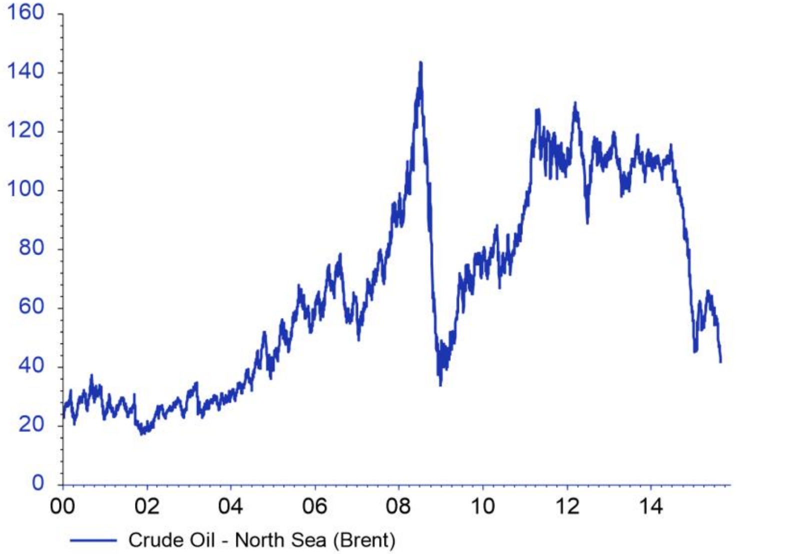
Commodity Markets



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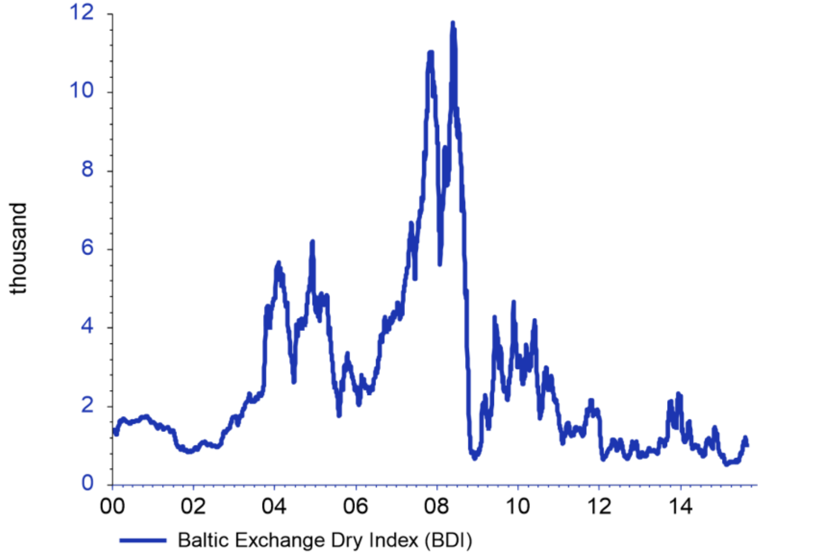

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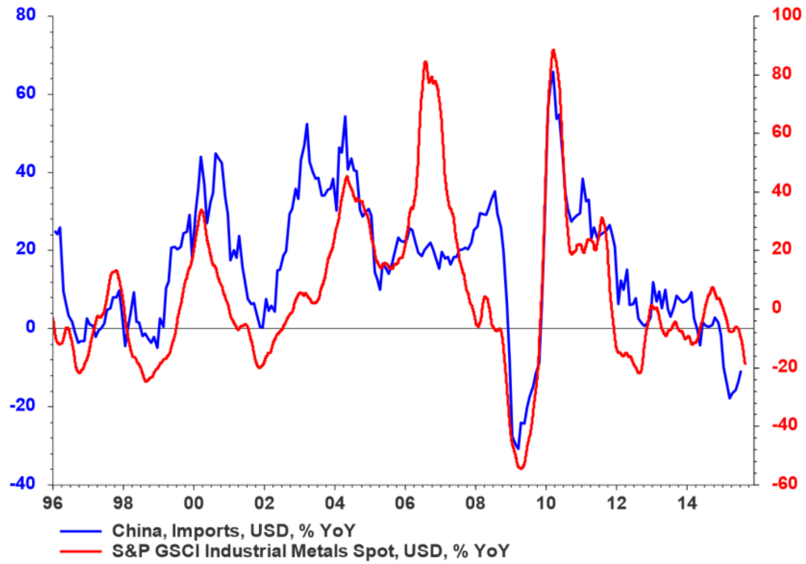

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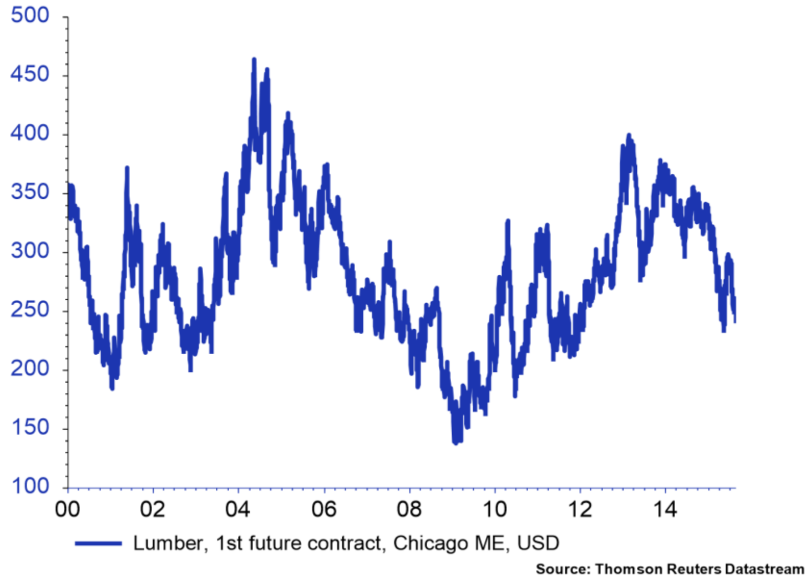

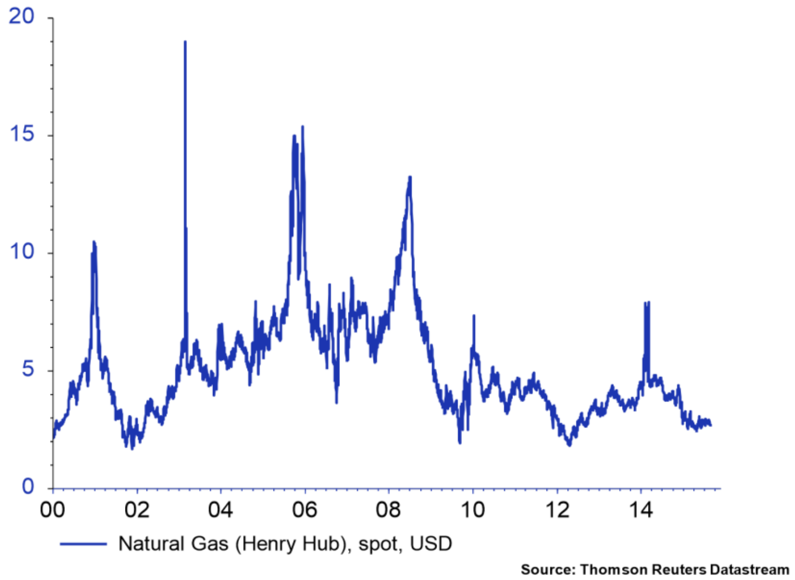

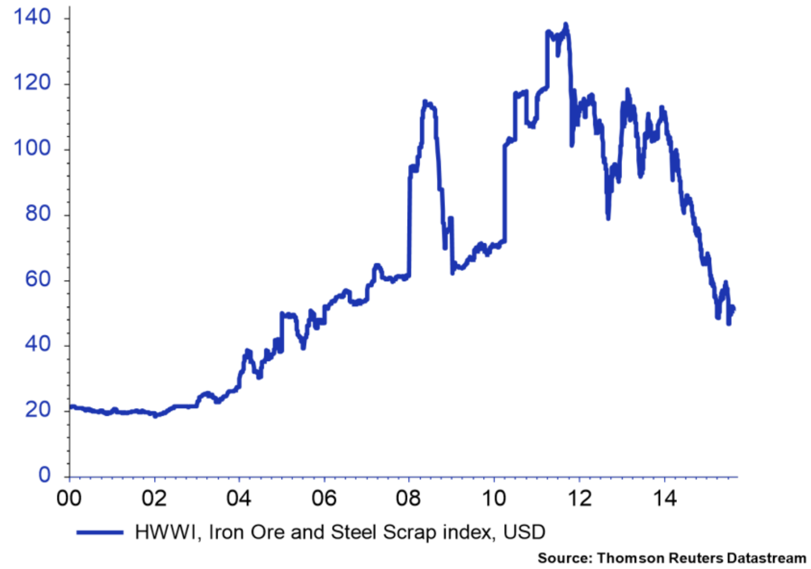

Commodity Markets (continued)

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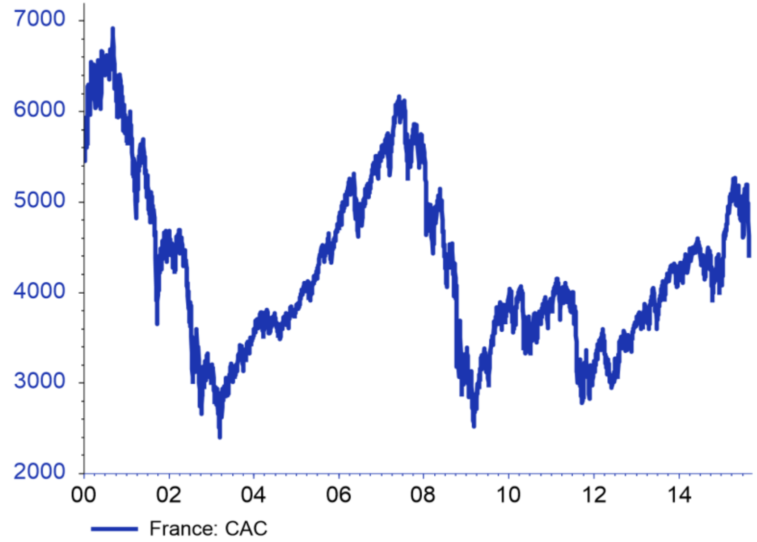
Equity Markets

Source: Thomson Reuters Datastream



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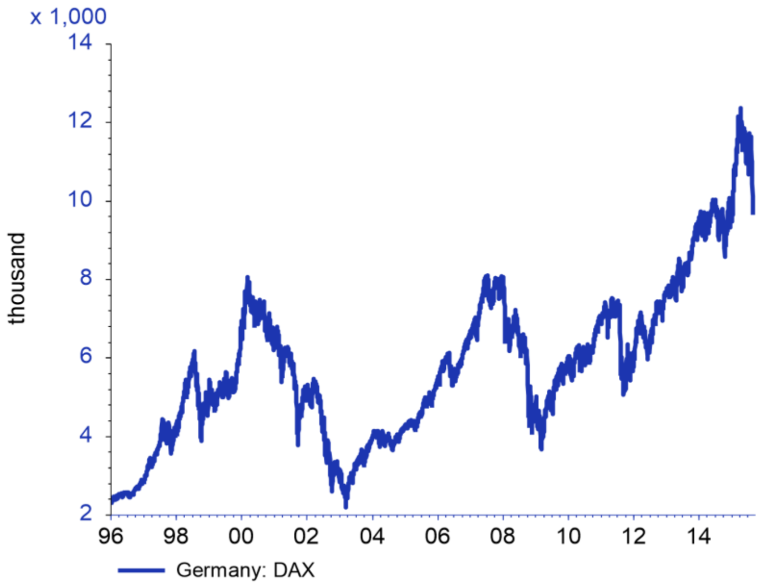

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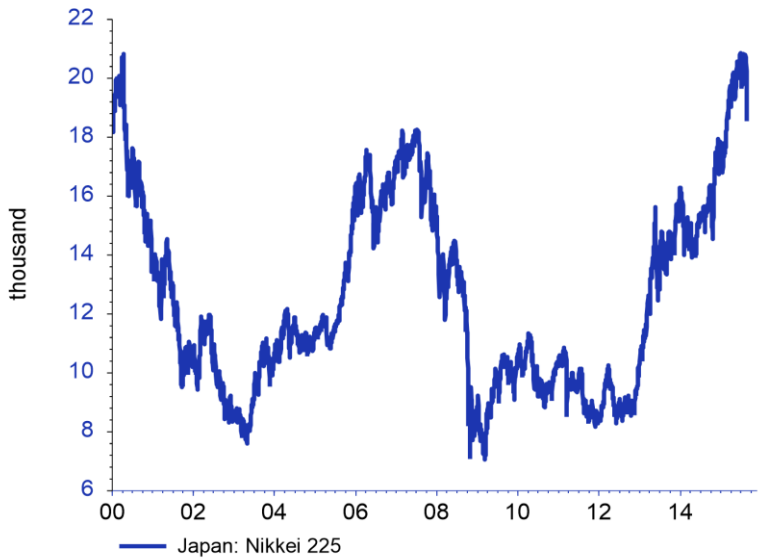

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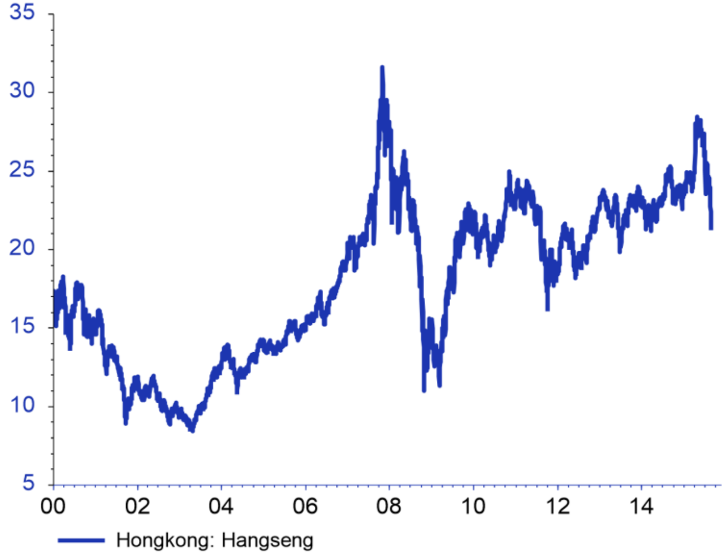
Equity Markets (continued)



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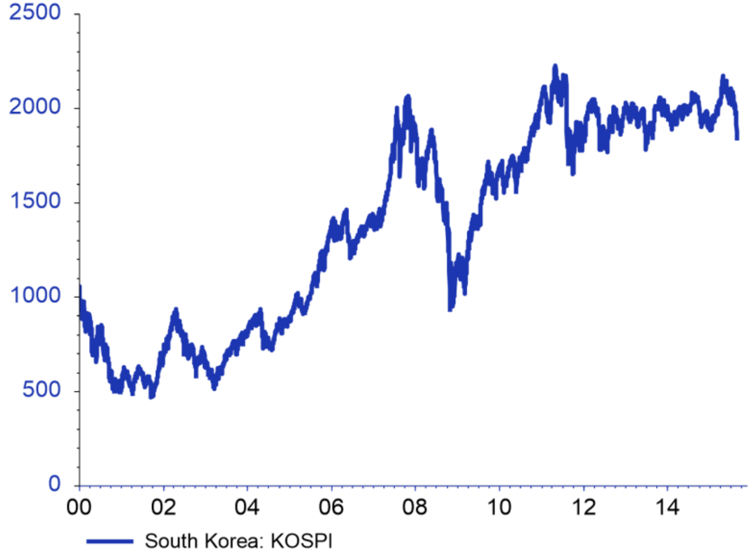

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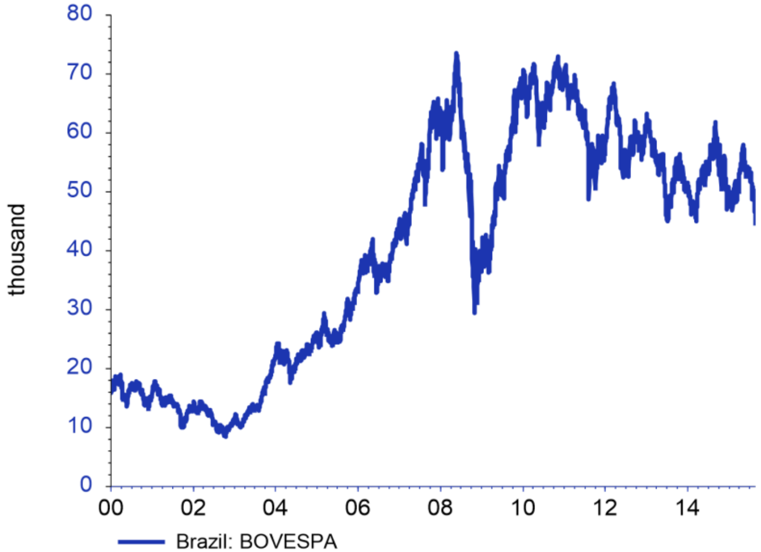

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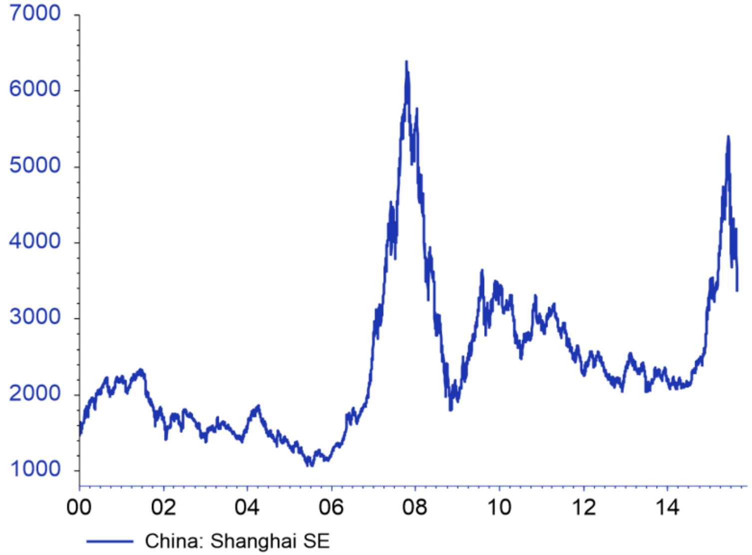
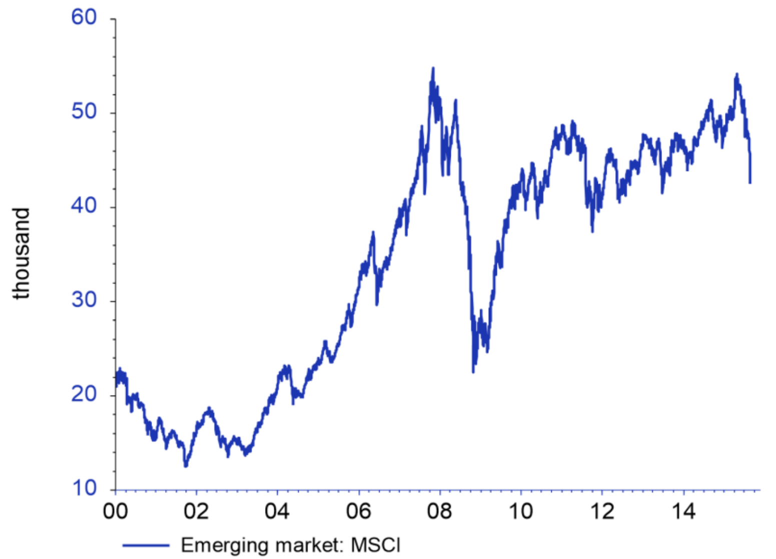


Source: Thomson Reuters Datastream

Equity Markets (continued)



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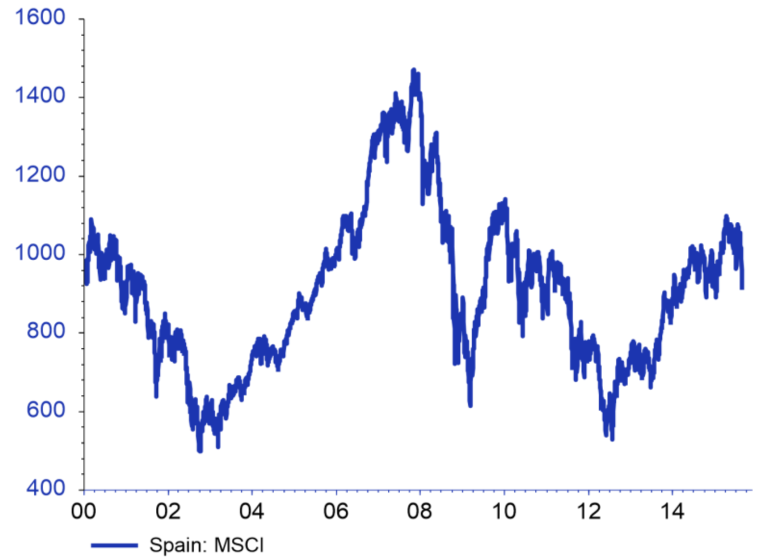

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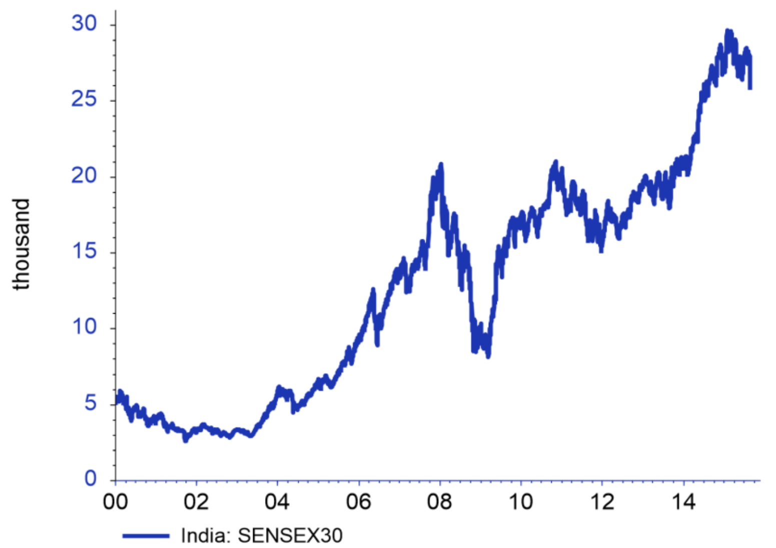

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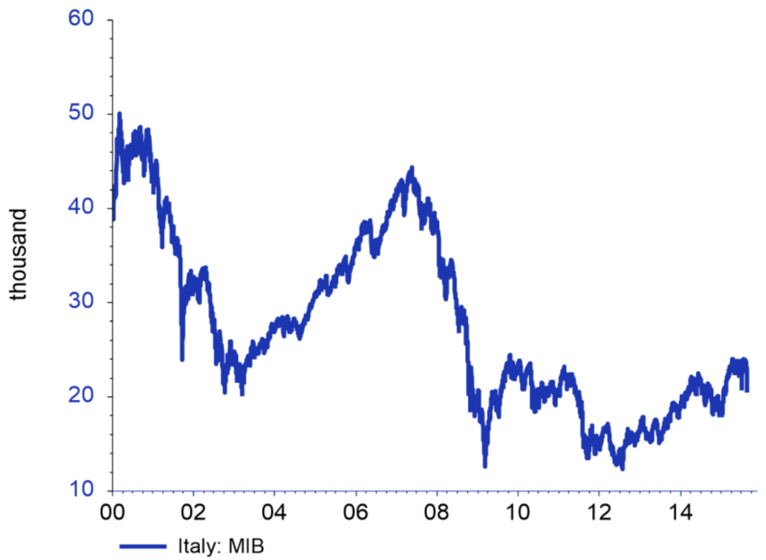
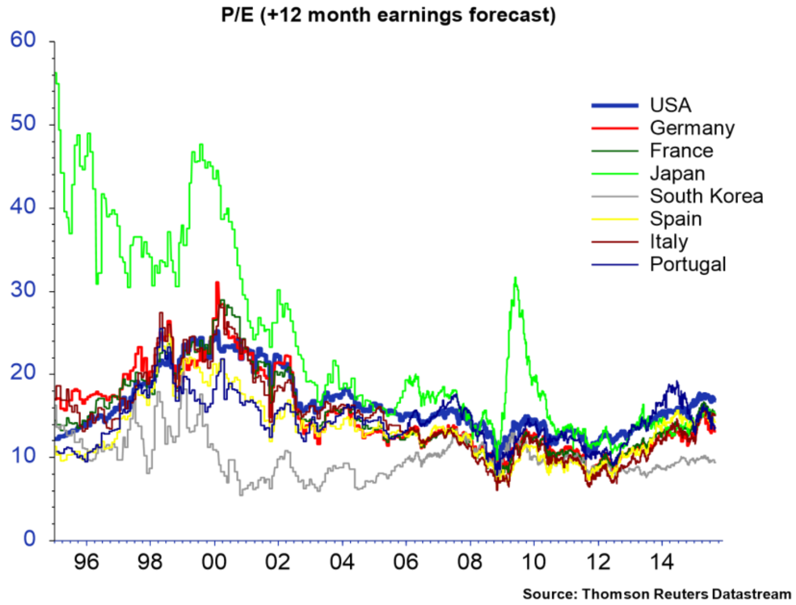
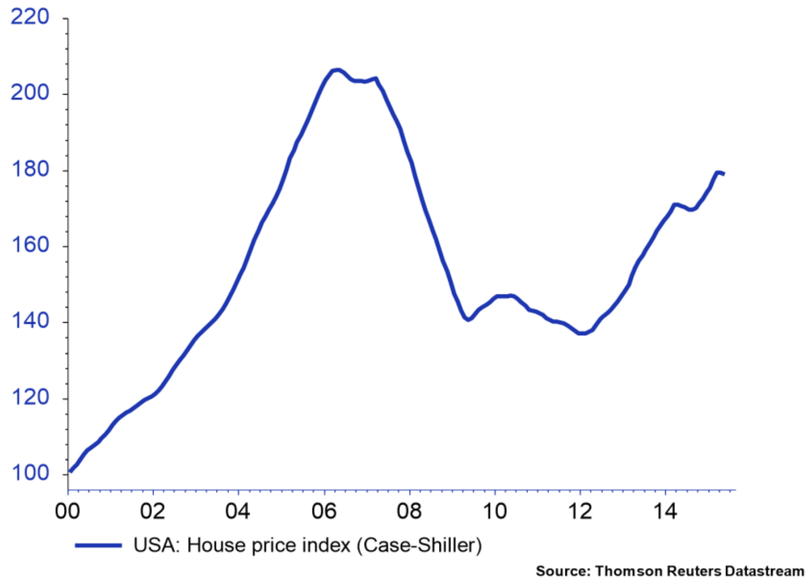


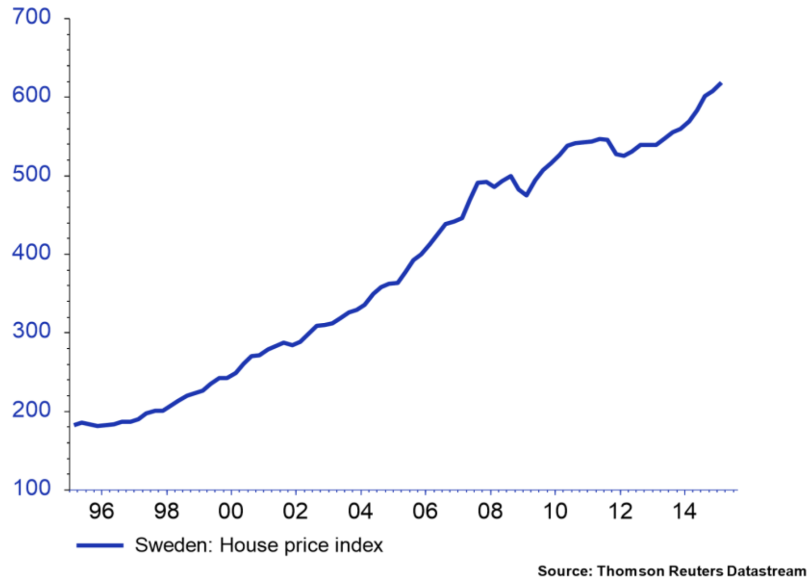
Source: Thomson Reuters Datastream

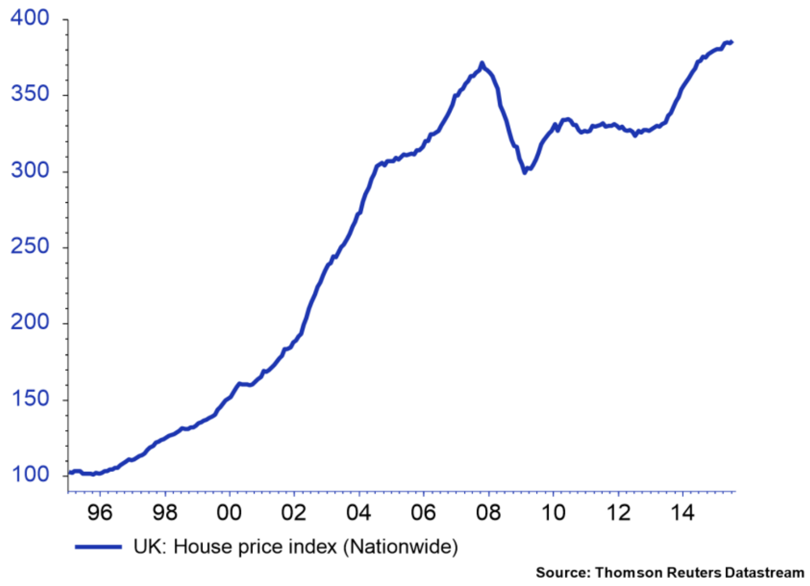
Equity Markets - Valuation

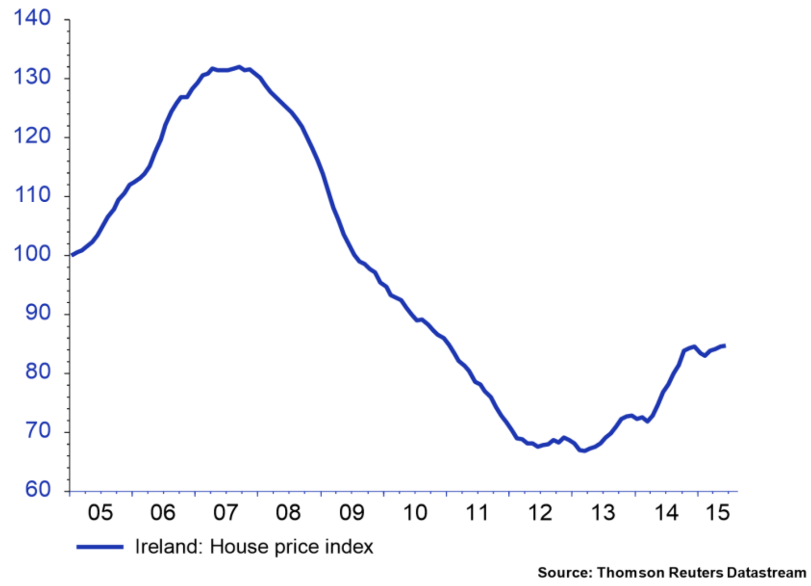


Home Prices

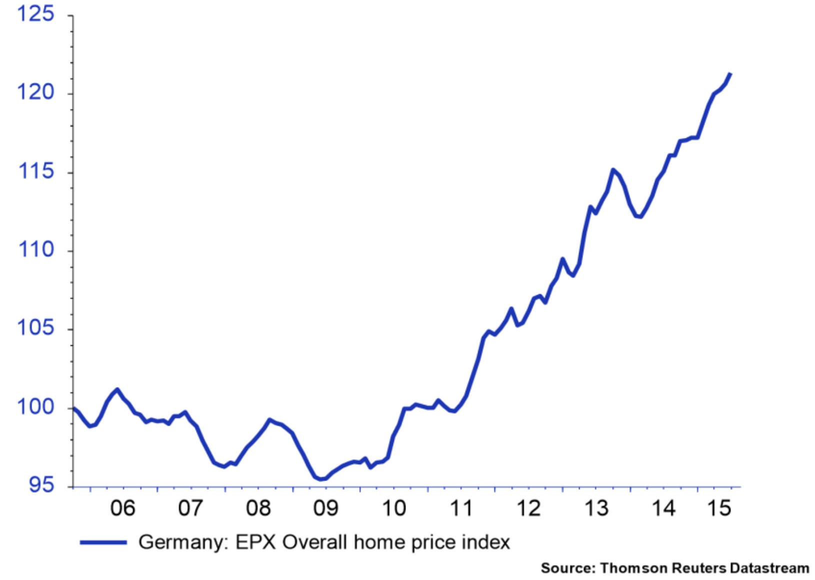

220
200
180
160
140
120
100
00 02 04 06 08 10 12 14
USA: House price index (Case-Shiller)
Source: Thomson Reuters Datastream

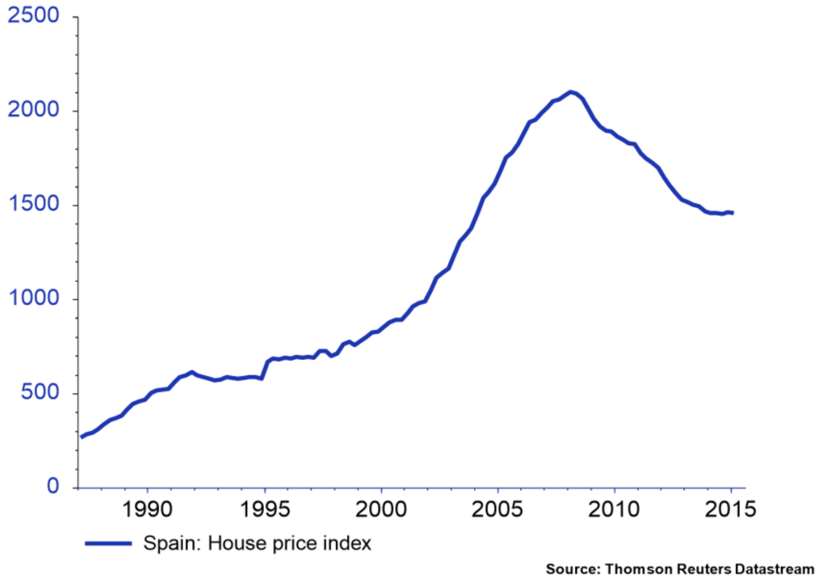

700
600
500
400
300
200
100
96 98 00 02 04 06 08 10 12 14
Sweden: House price index
Source: Thomson Reuters Datastream

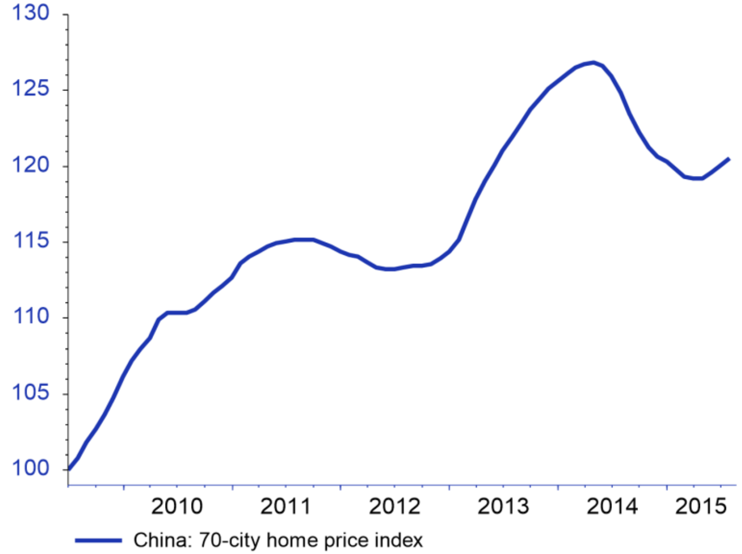

400
350
300
250
200
150
100
96 98 00 02 04 06 08 10 12 14
UK: House price index (Nationwide)
Source: Thomson Reuters Datastream


140
130
120
110
100
90
80
70
60
05 06 07 08 09 10 11 12 13 14 15
Ireland: House price index
Source: Thomson Reuters Datastream

Home Prices (continued)

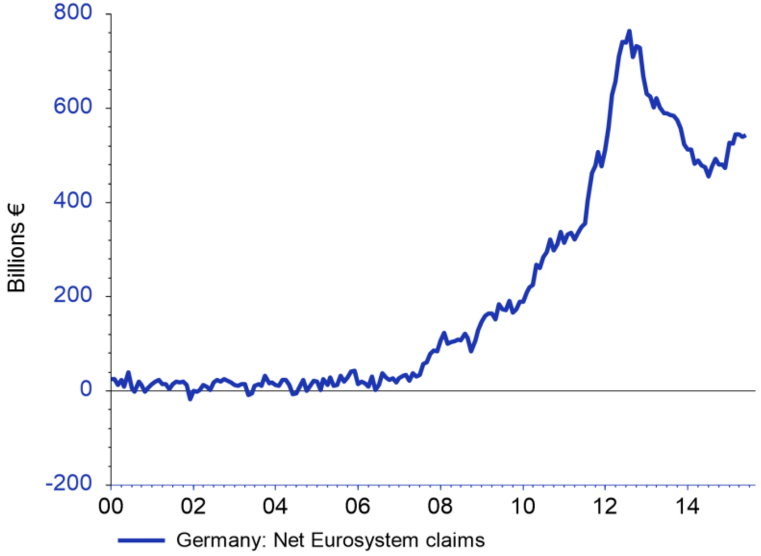






Source: Thomson Reuters Datastream

Euro-zone Crisis



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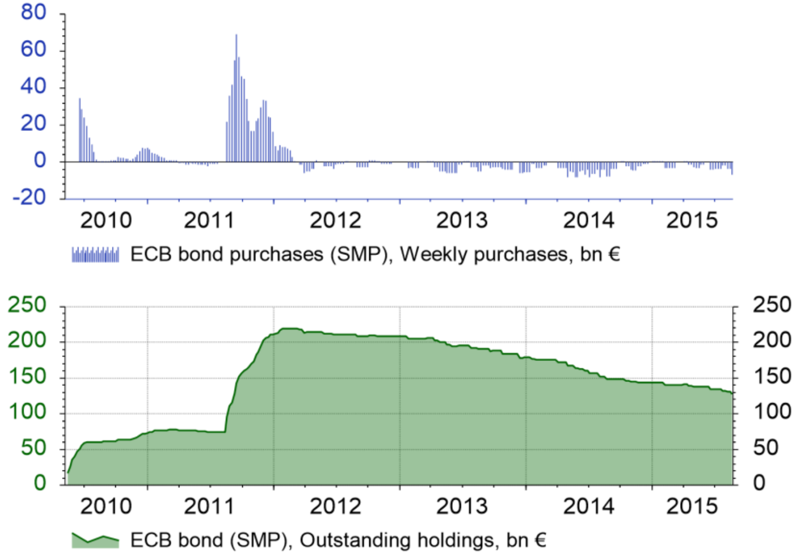
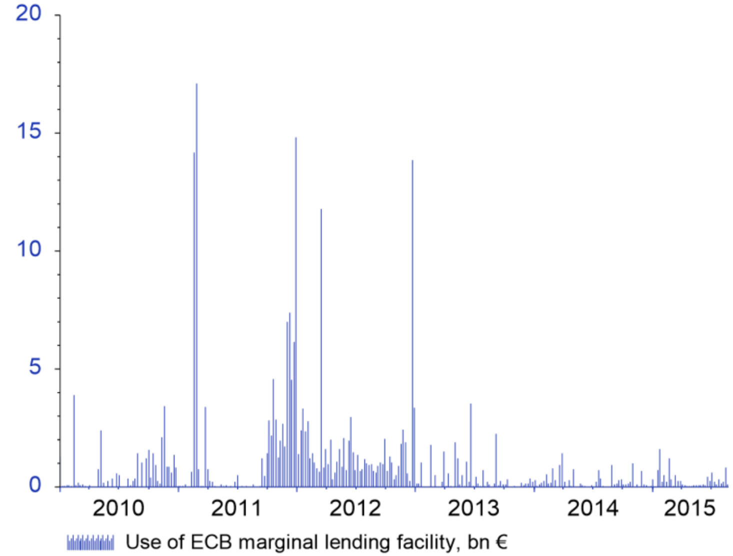


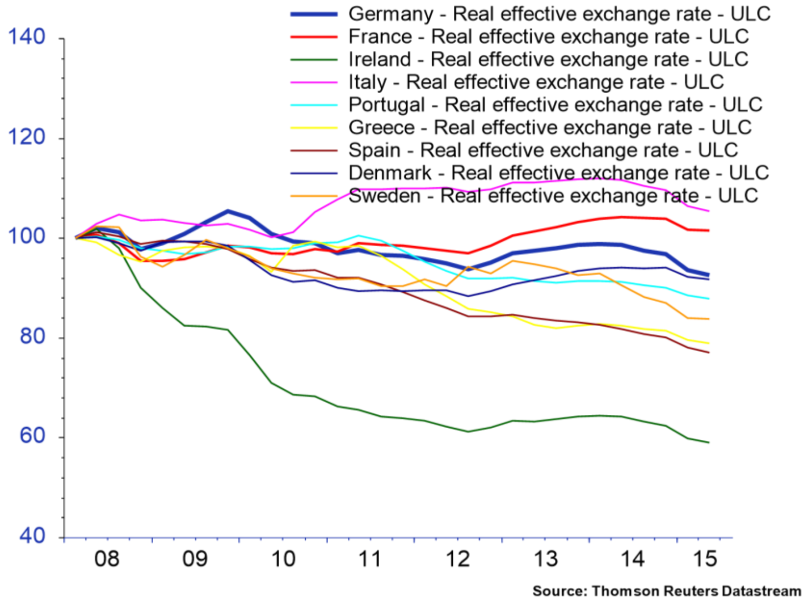
Source: Thomson Reuters Datastream

Source: Thomson Reuters Datastream



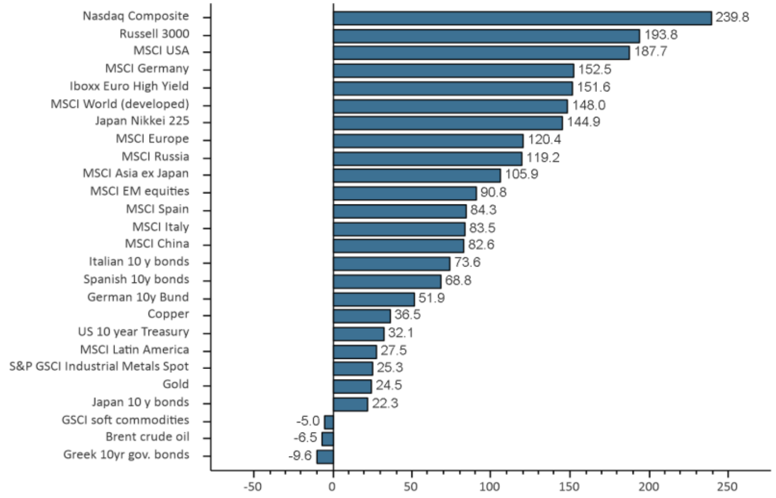
Source: Thomson Reuters Datastream

Labour costs



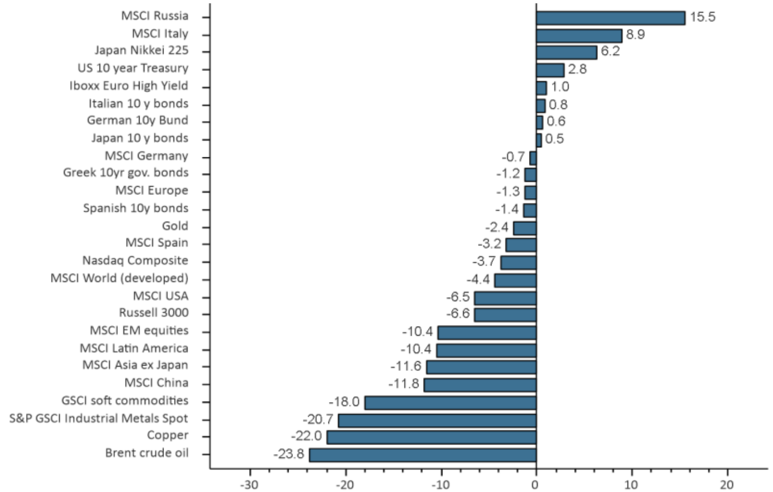
Performance of Asset types (local currency) – last update: August 24, 2015

% Return Index from 15/3/2009 to 24/08/2015



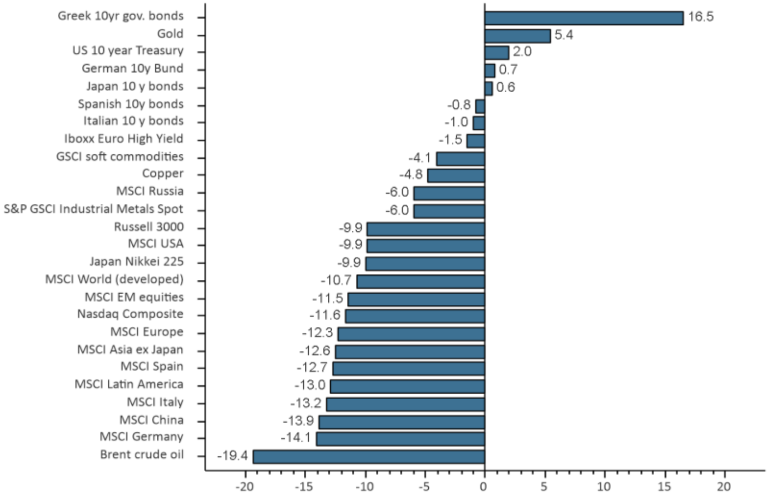
Source: Thomson Reuters Datastream

% Return Index from 31/12/2014 to 24/08/2015



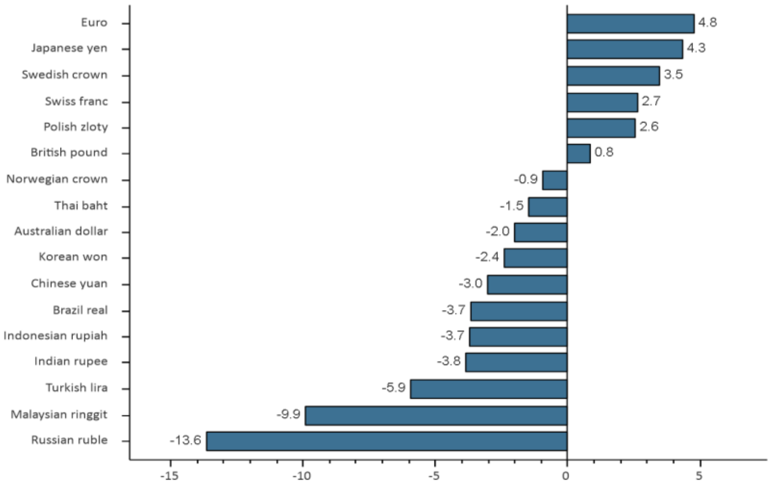
Source: Thomson Reuters Datastream

% Return Index from 31/7/2015 to 24/08/2015



Source: Thomson Reuters Datastream

% Return Index vs USD from 31/7/2015 to 24/08/2015



Source: Thomson Reuters Datastream

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