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Greek and Chinese Risks Combined to Shake World Economy

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This week, the Greek debt crisis and China's economic growth deceleration emerged as the two greatest downside risks for the world economy and were combined with each other to plunge stock markets in the world into turbulence.

The Greek debt crisis emerged as a risk as 61% of Greek voters voted "no" to austerity measures proposed by the European Union for budget consolidation in a national referendum on July 5. The EU-Greece negotiations on the Greek debt problem toward the end of June had once been expected to produce agreement. But the negotiations came to a stop as Greece's Alexis Tsipras administration suddenly announced the national referendum on the EU-demanded austerity measures (including pension and value added tax reforms). The EU and Greece thus chose to wait until the national referendum. As a result, the EU's financial bailout for Greece expired on July 1, leading Greece to fail to repay 1.5 billion euros in debt due on the day to the International Monetary Fund. The IMF then declared that Greece went into arrears to the fund. Effectively, Greece defaulted on IMF loans.

As a result of the national referendum, the Tsipras administration is to negotiate with the EU again with the backing of Greek public opinion. Media reports have stated that Greece submitted a new structural reform proposal to the EU side on the night of July 9, although details of the proposal remain unknown (as of the date the author wrote this paper). Future developments may depend on the details. The immediate focus of attention is how the EU would assess the reform proposal or whether EU leaders would accept it at their summit set for July 12. Although whether to accept austerity measures was at stake in the national referendum, voters were in a sense asked to choose whether to remain in or exit from the eurozone. The Greek side, tired of and discontent with the continuation of austerity measures since the emergence of the Greek debt crisis, might have taken a brinkmanship approach against the EU (lenders). The recent developments suggest that Greece without money to spare is using brinkmanship tactics while watching its relations with the EU and indicating its approach to Russia or China.

No optimism can be warranted regarding the results of the Greece-EU negotiations. But the results will have great implications for Europe and the world economy as well as Greece. A breakup of the negotiations is expected to come as a great shock to the Greek economy over a short term. Given that Greece accounts for only 2.5% of European gross domestic product, however, some people expect that Greece's bankruptcy may have no major impact on the European economy. But markets have been nervous about the Greek problem on concern that the problem could affect international confidence in the euro and the future course of the European economy plagued with a prolonged slump. In fact, stock markets around the world plunged after the Greek national referendum, being poised to encounter turbulence. As how the Greek problem would affect the world remains uncertain, stock market participants have created a risk-off trend.

Then, China's economic growth deceleration suddenly attracted global attention as an important problem. Amid the risk-off trend emerging from the Greek debt crisis, Shanghai stock market prices plunged rapidly in China where concerns had already existed about the deceleration. The two largest downside risks were then combined to rattle the world’s stock markets. Shanghai stock market prices had soared rapidly even amid the economic growth deceleration since last year, prompting market participants to point to stock bubble concerns. Behind the rapid stock hike had been funds flowing from the slumping real estate market and aggressive buying by individual investors who are dominant in the Shanghai stock market. Shanghai stock prices peaked on June 12. Later, however, Shanghai stock prices turned downward amid concerns about precariously high prices and continued a free fall. As the Greek problem triggered selling early this week, Shanghai stock prices fell by 6% on July 8. From the June 12 peaks, they represented a sharp plunge of more than 30%.

The Chinese problem can exert far greater impacts on the world economy than the Greek problem. Amid the risk-off trend, the Chinese economic problem along with the Greek debt crisis was identified as a risk, leading uncertainties to grow throughout the world. On July 9, the Chinese problem shook the entire world. In a manner to symbolize the shake, the 225-issue Nikkei average on the Tokyo Stock Exchange fluctuated wildly. At the day's opening, the Nikkei average posted a steep decline in line with the rapid Shanghai stock market fall on the previous day. Its loss widened to 622 points or 3% in the morning. When the Shanghai market rebounded with Chinese government support, however, the Nikkei average rose steeply. It closed the day 117 points higher at 19,855. The gap between the average's high and low for the day came to 740 points, representing a roller-coaster fluctuation. Given that the Shanghai stock market fluctuations triggered the wild global stock market fluctuations and that the Shanghai stock market has not necessarily bottomed out since the July 9 rally, we must keep close watch on future developments in the Shanghai stock market and the Chinese economy. We cannot deny that the fate of Greek debt negotiations next week could exert some influence on the Chinese problem again.

The stock market fluctuations affected crude oil prices this week. The benchmark West Texas Intermediate crude oil futures price followed a downward trend after standing at around $60 per barrel in late June and fell by $4.4 from the previous day to $52.53 on July 6. When the Shanghai stock market plunged on July 8, the WTI futures price slipped below $52.00. It rose back above the level on July 9. Crude oil prices are thus likely to fluctuate depending on future developments involving the Greek debt crisis and the Chinese problem. The two problems can affect crude oil prices by decelerating economic growth including energy demand growth and exert financial impacts on these prices by triggering a fund outflow from the market amid a risk-off trend and prompting the dollar to rise against the euro.

Crude oil prices are susceptible to the fate of the Iran nuclear negotiations as well as the Greek and Chinese problems. The deadline for the negotiations was once extended to July 10 and put off further. Many oil market participants have closely watched the Iran nuclear problem that is expected to exert great influences on the international oil market and crude oil prices. The coming week will be filled with key events for the world economy and the international energy market, including the EU summit, Shanghai stock market developments and the Iran nuclear negotiations.

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