

The Driving Factors and Mechanism Behind the Global Financial Markets Turbulence

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Abstract: Global financial market witnessed some extreme volatilities in recent months. From the European gas price, to the Treasury bond yield of the developed economies, as well as Nasdaq and other stock markets also experienced unusual turbulence. How exactly the ‘epic perfect storm’ which hit worldwide financial market looks like? And what’s the driving power and mechanism behind these impressive phenomena? Research has shown that the Russia-Ukraine conflict, the inflation problem, and the shifting attitude of the FED consist the complex and interacting driving factors.

Keywords: Financial market; Interest rate; European gas price; Ukraine; War; China; Fed; Inflation; Covid

1. The Suffering Three Major Economies

The world economy looks troubling in the coming months, lasting to Q2, 2023. The three biggest economies-- the U.S., Europe, and China-- will either enter or are already in recession, albeit via different catalysts. For the U.S., a clear recession will likely be caused by monetary austerity, and we have already witnessed the 10-year Treasury bond yield climbed up to 3.55% in Sep., which is beyond the world’s imagination months ago. For China, it is the zero-Covid policy, under which the economy fell into the state of “lying-flat” especially in 2022, because tens of millions of people were not allowed to leave their houses.

It gave the prosperous economy of China a punch since some new virus were found in 2021, and that changed the story of Covid totally-- before, it was a proud victory for China, domestic social and economic order was quite well, and during that period the west suffered from the loss of both people and producing capacity; now, the west economy saw major recovery and the pandemic has little impact to the normal social and economic order, the U.S. announced “the pandemic is over”, and the United Nations also held a meeting to declare the Covid pandemic state does not exist. But the zero-Covid policy insists in China, and no sign of change can be detected now.

2. Energy Price Problem for Europe

In hindsight, Europe has never prepared for Russia’s strategy of energy-weaponization. The people in Germany, France and Britain are now suffering from the soaring price for gas and electricity. There are more bad news. The natural gas crunch has developed into a much wider energy crisis with wholesale and retail electricity prices surging since June.

To make it worse, the severe drought Europe saw this summer makes the cooling water out of supply, which sharply reduced nuclear power generation capacity at plants in France, compounding the energy shortage.

It is fair to say that many German or French families have to make a hard choice between heating their homes and putting food on tables. The energy price is forcing European consumers to cut spending on other goods and services, which are not so important in the face of surviving, implying that a consumer-led recession seems near. The latest PMI indicators of Germany and Britain hit a year-low, implying that the economy recession is now a on-going event for the west. Thinking the recession would come is one thing, the on-going state of recession is another. As for the global financial market, investors may lower their expectation furthermore, and one cannot expect a sudden turn-over in the beginning of a recession.

Speaking of survivorship, one can not ignore the on-going war of Russia-Ukraine. Though Russian leader still define the conflict a “special military operation”, world citizens are aware now that it is a real war, and the driving factors of this war has prepared themselves and cultivating energy subtly for years. The formal refusal of a peace agreement has finally enraged Russian leadership,

making a war of response inevitable. The war has not shown a sign of de-escalation since its burst-out this February. What's worse, it has profoundly escalated recently. The Ukrainian soldiers fought bravely with modern weapons the west supplied.

With the advantage of more flexible military strategy and, of course, the familiar geography of Ukraine, the defence-side soldiers organized a scale counter-offense this September, and the booty is impressive-- at least 2000 km² occupied territory has been re-seized, and the battle-line has been pushed to Russian side for kilometers, at some point it even reaches the Russian territory. This war has made millions of Ukrainians homeless, and tens of thousands people has lost their lives, men and women, soldiers and innocent residents. Survivorship is a priceless gift now in Ukraine.

3. Impact Of The War On The Global Financial Market and the Fed

The impact of this war is huge on the global financial market. First, as mentioned above, European energy market suddenly fell into a crisis. It slows down the consumers' demand and the economy in Europe, and the stock market crushed as the Russian troops moved across the boarder. What's worse, the soaring price made the European and other west economy's CPI climb into a level the west has not seen for decades.

As controlling the inflation is the core mission for the Central Banks, a offensively high CPI (and PPI) leaves the Central Banks few choices. The tightening of the monetary policy makes the famous "negative rates" a past. As the U.S. 10-year Treasury Bond yield reaches 3.7%, and we must remind that two years ago it was 0.7%, the U.S. Dollar Index reaches to 113, which is a 20-year high record. That makes the future income less valuable under the dividend-cash-model valuation of equity, and a lower PE valuation can make a stock price lose up to 50% or more of its price now.

Also, the war shocked the global investors in the stock market, and hit their "risk preference" badly. Last time a nuclear power got involved into a real war was the World War II, and more than 70 years has passed since then. In the Cold War the Soviet and the U.S. were not really shooting to each other. Few living people have the real memory of WWII, the financial investors worldwide seem too young and too naive and too simple comparing to the circumstance. So a wise choice is to leave the stock market and flee to a safe asset.

Gold can not play that safe role anymore, the ultra-strong dollar is destroying the gold value, and other currencies is depreciating to U.S. dollar, so the dollar cash may be the best investment this year. People who do nothing and take the dollar cash have a good chance to beat investors in all the other market. At least the dollar cash carriers do not suffer violent volatility and big falls.

4. The Unique Problem China Faces

What the China economy experienced in recent months and years was actually quite different from U.S. and the Europe. The west has little room for choice, and the monetary policy has to respond to the soaring inflation situation, or the fiat money system will face a shaping moment of collapse. But Chinese policymakers seek a higher goal, they want to control the spread of the Covid, in other words, they want to show great power in face of the nature force, although the effect of the virus has been proved to be slight and no-harming.

The government also find it out of capability to feed 100 million locked-down residents. You can hardly find enough food for them. People who can still mobilize in the country create demand and supply and GDP. So when the economy data shows that the GDP grows slow, people should surprise that there is still a growth rather than recession. The consumer data falls slightly, maybe people who can still move always throw big parties to spend more money, or if you take the static residents with almost 0 consuming into consideration, you will find it hard to imagine the beautiful data.

Not strange, some researchers and studies call the situation in China "man-made affair". And the real problem is, when will this "zero-Covid" policy change? And if it changes much slower than people expect, will something nonlinear happen? We have read the European Commerce Association's open letter for Chinese government asking for clear plan for reopen for the country and market, or they will reasonably shift their factory to some substitute destination such as Vietnam or India, which have similar regulations with the west, and policies are stable and predictable.

China may immune from some problems the west face such as the shortage of energy, the high inflation. But it meets more complicated situation. The export department plays an important role for growth, as the Covid made the west capacity out of use for a while. The year 2022 is quite different. The west is coping a severe recession scape, and the economy demand will cut dramatically, and Europe is complaining about its "unfair" position in trade with China-- China sells a lot to Europe, and buys little from Europe. With some west economy as well as Japan already transferred to South-East Asia, import demand from China falls. A theory is getting popular in the west. As to manufacturing, it's "In China For China". To maintain a market share in China, and the manufacturing process is mature thanks to the sound supply chain in the country, the factories do not want to give up their operations, but the unpredictable

policy makes them confused and hard to organise future plan.

The world's second largest economy also faces some other major problems. The real estate industry has long played an irreplaceable role in China, and the whole industry suddenly faced a challenge of survival since September, 2021, an important time node when Evergrand, the once top one real estate developer in Asia with the asset and liability scale of trillions of RMB, came into a dilemma of liquidity crisis and the giant corporation almost went bankruptcy overnight.

After the cash account being frozen and locked down, the developers found themselves hardly able to pay the workers' salary and maintain the basic operation of the company. The government's unexpected action put huge amount of employees and stake holders as well as financial investors in danger. The price of the developers' bonds fell dramatically, some from 100 yuan PAR to 30 yuan or less. The market has little confidence that the real estate developers can normally pay for their debt, considering they couldn't issue bonds or stocks to raise money, and banks have been instructed not to loan. Some of their finest assets are for sale now, at a price with impressive discount.

There are hundreds of millions of employees of the factories and industries strongly connected with real estate industry. The regulators' surprise attack has made tens of millions of people jobless, because their customers' demand disappeared, or went bankruptcy themselves. Major commercial activities stopped, not to mention the Covid's influence for normal economic activity and communication. Dozens of real estate stock price fell more than 70 percent, costing investors billions of dollars.

Also, in the forex market, as the U.S. Fed raise interest rate rapidly, and the People's Bank of China cut domestic interest rate to support the economy, the RMB depreciated apparently for the U.S. Dollar, and that brought panic for investors for domestic asset, because investors feared that the RMB would fall into a disordered and chaotic way.

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