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Global Risk Watch Newsletter

Shaken by Greece and China

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Overview Macroeconomic and Financial Risks (Trends & Topics)

◆Shaken by Greece and China (Tsuyoshi Oyama, Partner/Head of Center for Risk Management Strategy at Deloitte Touche Tohmatsu LLC)

A tumultuous month has passed. The turmoil in Greece and the collapse of the Chinese stock markets have overshadowed the recent recovery in the advanced economies, thereby changing the tide of world economies from a risk-on to a risk-off trend. The market appears to be regaining its composures thanks to the approval of austerity measures in the Greek Parliament, and desperate stock price-keeping-operations (PKO) by the Chinese authorities (as of July 16th). The question remains, are these 'shocks' sparked by Greece and China just a transient effect or will they have longer lasting repercussions?

Regarding the forthcoming of the situation in Greece, it is evident that prior austerity measures imposed by Germany were essentially too much of a burden to bear for Greece. Greece is currently on life support under the schemes of 'Grexit avoidance' and 'European solidarity'. However, a careful observation is critical to prepare for when and how these schemes may disintegrate. From the systemic risk point of view, we have already seen the impacts of Greece resonated with bond yields of the southern peripheral countries in Europe during the sovereign debt crisis in 2010. This time, the Greece issue could resonate with another European weak spots, namely, the political fault-line between Germany and France/Italy. This is also a critical scenario to be carefully monitored in the near future.

Chinese authorities have taken drastic countermeasures in response to the stock market crash. However, such measures could result in a loss in confident in the soundness of the market functions among domestic and foreign investors. Consequently, distorting the optimal allocation of resources and raising the concerns for more downward pressures on the potential growth rate. Chinese authorities are currently facing the challenges of whether stop the PKO at some point to face the risk of another decline in the market, or continue PKO and potentially face the consequences of widening imbalance in the market.

Considering these situations, the days of constant fear of a collapse will continue to loom over these two bubbles for some time– 'Euro Bubble' arose from a divergence between expectation and reality in the Eurozone's economy; and a 'China Bubble' materialized from a divergence of its past economic achievements and downward kink in potential growth rate in the foreseeable future.