Global marketsA tangle of anxieties

As markets slide, investors should worry more about some price drops than others

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ACCORDING to market lore January is a good month. As bourses open to greet the new year, investors funnel in new cash and share prices rise, creating a “January effect” which the savvy try to surf. But punters seeking a quick buck have been disappointed this year, with the main stockmarket indices in the G7 economies all down (see chart 1, below). Many have had their worst January since 2008. It is not just share prices that are tumbling; oil, gas and metals are falling too. There are many reasons for the rout, but the predominant one in recent days is a fear that the world economy, already feeble, is slowing yet more.

On January 13th the World Bank cut its prediction for global growth in 2015 from 3.4% to 3%. As in 2010, there are worries about a Greek exit from the euro zone (see article). But five years ago Germany’s economy was expanding at close to 4%, and Brazil, Russia, India and China (the BRICs) boasted an average growth rate of 9%. That vigour has gone. In 2014 the German economy grew by just 1.5% and the BRICs have slowed to little over 5%.

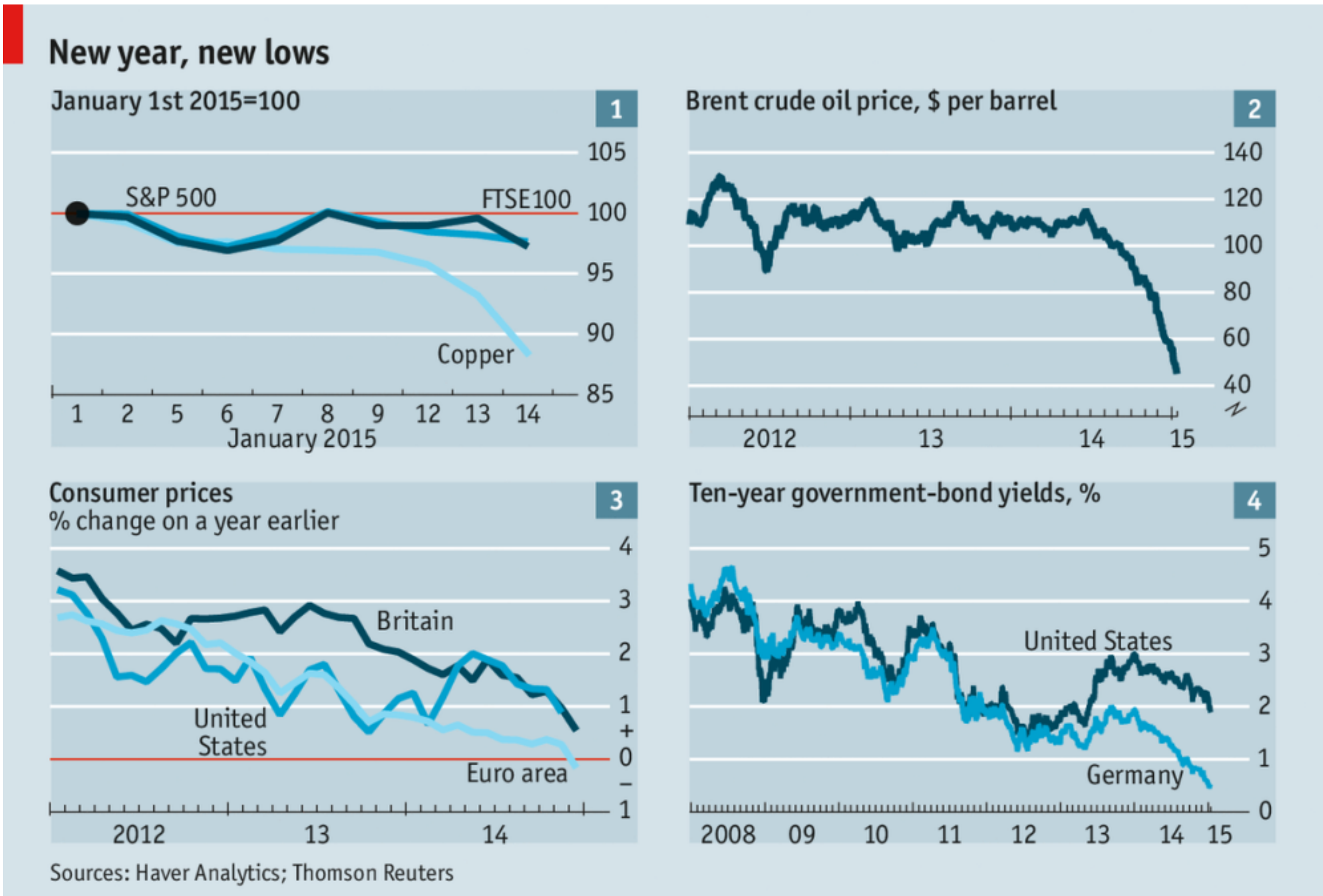
Sagging demand and the fear of more weakness to come explains why the decline of many commodity prices has suddenly accelerated. Worries about China loom large, since almost half of the metals used by industrial firms—aluminium, copper, lead, nickel, tin and zinc—are bought by Chinese companies. Forecasts for China’s growth are being pared back (the

World Bank now expects growth of 7.1% in 2015). The result has been a market rout: the price of copper has plunged to a five-year low (see chart 1). And with anaemic demand sapping metals prices, mining companies have been hit hard: on January 14th shares of Glencore and Anglo American, FTSE-listed miners, both fell 9%.

Ominously, even hitherto strong economies are showing signs of weakness. In Britain business investment, previously a contributor to growth, is waning. In America retail sales for December were down 0.9% on the previous month, suggesting American consumers may be pulling in their horns.

One reason for this could be weak wage growth. Average pay is up a mere 1.6% in America and 1.4% in Britain over the past year. Despite a healthy pace of job creation and an unemployment rate down to 5.6%, average American wages fell in December.

But all this gloom must be set against some big reasons for cheer. The dramatic slump in the price of oil has far more to do with plentiful supply than unexpectedly weak demand. **A year ago Brent crude, the global benchmark, stood close to $110 per barrel. Today it is below $50 (see chart 2).** America's oil production has grown by more than half, pushing reserves to their highest level for this time of year for the past 80 years, according to America's government. Naturally, that surge in supply has weighed on the price.



The low-cost petrol, diesel and heating oil that should follow will be a tonic for consumers. If petrol prices drop by two-thirds as oil has done, an American family could save around $2,000 a year, equivalent to a pay rise of around 4.5%. Cheap oil also allowed India's central bank to cut rates in a surprise move on January 15th. Yet it risks tipping rich countries into deflation (see chart 3).

The tension between reasons for optimism and pessimism is obvious in financial markets. Lower input costs and the fillip that cheaper fuel gives consumers ought to boost the profits both of firms that use energy intensively and those that sell to consumers. At the same time America's energy firms make up a big chunk of the stockmarket's capitalisation.

The VIX, a measure of expected volatility dubbed the "fear index", jumped on January 14th. Other measures of investor jitters are rising too. Gold prices are creeping up. And the yields on the bonds of countries deemed a safe bet have shrunk: ten-year German bunds pay less than 0.5%, a record low (see chart 4).

There is huge uncertainty about what central banks will do next. Falling inflation calls into question expected rate rises this year in America and Britain in 2015. On January 15th the Swiss National Bank shocked markets by removing its ceiling for the franc, which promptly jumped 14% against the euro (see article). This week a preliminary legal ruling helped clear the way for the European Central Bank to try quantitative easing. Whether sinking markets will win over the hawks on its board remains unclear.

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