

2.c. Hard landing in China:

China's problems turn out to be much deeper than official figures suggest. The yuan devalues in a disorderly fashion. Major Chinese companies default on their foreign-currency debt. Chinese domestic spending collapses, resulting in oil imports actually shrinking, rather than just slowing. Lower Chinese growth drags down oil demand in other emerging markets.

Likelihood

Unlikely

Comment

We continue to think that China's problems are significant but solvable in an orderly enough fashion to limit the impact on the rest of the world. China is still expected to cause just under 30% of global oil-demand growth in 2016, or about 0.3-0.4mb/d. For oil demand to actually shrink, China would need to experience a very hard landing and, probably, a sharp currency devaluation (as a result of which the oil price in yuan would fall less than when measured in U.S. dollars).

If China were to fall off a cliff, oil would probably be only one of many worries for the global economy. The impact on developed-market consumer prices would most probably be deflationary and there could be real risks of deflation spreading. Emerging markets would be among the first to suffer.

To sum up the conclusions from these hypothetical scenarios

Low oil prices might be a positive development (if mainly caused by too much supply) or a negative development (if reflecting shrinking demand in parts of the world) for much of the world economy. The impact on capital markets would heavily depend on how monetary policy responds. A hard landing in China or a U.S. recession would certainly warrant a response – but may also put the limits of what monetary policy can do into sharp focus.

Perhaps, the biggest challenge for both central bankers and investors is that an average oil price of around \$15/b in 2016 would not be the end of the story. Conventional oil production would probably be depressed for several years to come. In all likelihood, this would pave the way for a lasting oil-price recovery. Before too long, the result might well be the sort of oil shock we have long been used to – where sharp rises of oil prices cause pain among consumers around the world.

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