Letter n°160

4 factors of instability in the markets

"In this unstable and turbulent environment, only one thing remains constant: change." Dalai Lama.

Despite the war in Iran, the OECD has revised its global growth forecast for 2026 upwards by 0.1 percentage points to 2.9%, with growth of 6.5% in India, 2.1% in the United States, 4.2% in China, 1% in the eurozone and 0.7% in Japan. At first glance, this news is reassuring, but 4 factors of instability are disrupting the markets' tranquillity: economic instability generated by China, financial instability generated by the deterioration of government debt, stock market instability generated by AI, and geopolitical instability generated by Trump.

***Economic instability generated by China**:*

3 illuminating figures. In the 3rd quarter, consumption rose by just 1.1% year-on-year, industrial production increased by 5.5%, and exports surged by 36% year-on-year, the highest figure recorded since 2010.

In other words, exports are more than ever the country's growth engine. Industrial production is growing 5 times faster than consumption, and without external markets, China would be in recession or close to it.

The Chinese model is typically one that relies on supply and production, rather than consumption. China may call itself communist, but Xi is fundamentally opposed to the development of a welfare state, which he considers an incentive to laziness. As a result, education, healthcare and retirement remain largely the responsibility of the Chinese themselves, especially outside major cities. Worried about the future in an ageing country whose population is expected to fall from 1.4 billion to 633 million by 2100, according to the UN, and weakened by the property crisis that has persisted since 2019 and is eroding their wealth, the Chinese have the highest savings rate of all major countries, at 40% of disposable income.

The wealth generated and public debt, which is growing rapidly to 135% of GDP (doubling between 2019 and 2024), finance investment in infrastructure and industry. In just a few decades, China's share of global industrial production has risen from 3% to more than 30%. In both traditional and high-tech industries, China's dominance is often overwhelming, but overcapacity is massive.

The conquest of foreign markets, both emerging and developed, is driven by subsidies amounting to as much as 3 percentage points of GDP, according to an OECD study, low-interest loans, and is facilitated by a currency undervalued by 20 to 25% despite appreciating by 5% this year against the $. According to McKinsey, Chinese costs are therefore only 58% of those of their competitors. Moreover, companies keen to gain market share in markets plagued by overcapacity tolerate losses, probably because they can count on state-owned banks, which have recently been recapitalised by the government for the 2nd time in just a few years, to the tune of $54 billion. According to the National Bureau of Statistics, nearly 30% of companies with operating revenues exceeding $3 million were loss-making in August, compared with 20% 5 years ago.

This is a factor of instability because all global competitors are being weakened and are now seeking to protect themselves. We have seen this recently in the German automotive industry and among European solar and wind power players. China is well placed to repeatedly proclaim its support for free trade and multilateralism, as it is the primary beneficiary. Elsewhere, however, the loss of industrial jobs is fuelling populist movements and weakening democracies.

Financial instability generated by the deterioration of debt levels:

Since 2000, net public debt as a percentage of GDP has tripled in the United States and the United Kingdom and doubled in France and Japan. In each of these countries, debt is expected to continue rising because populists are in power or on the verge of taking power, and debt, in a low-growth environment, is one of the means of buying social peace.

Global public debt alone reached 94% of GDP in 2025, 10 percentage points higher than on the eve of the Covid crisis. This year, OECD countries need to borrow $18 trillion. Central banks hold nearly one-third of the public debt of developed countries.

According to the IIF, developed countries paid $3.5 trillion in interest on debt in 2025, more than they spent on defence ($3.1 trillion), energy ($3.4 trillion) and AI ($2.6 trillion).

European borrowing, according to the European Court of Auditors, rose from €236 billion in 2021 to €739 billion in 2025 and could reach €1 trillion in 2027. Elsewhere, the trend is similar.

Market concerns are reflected in rising risk premiums. Since the end of February, long-term US interest rates have risen by 130 basis points, Japanese rates by 100 basis points, German rates by 95 basis points and French rates by 150 basis points. The US 10-year yield stands at 5.11%, the UK 10-year yield at 5.40%, the French 10-year yield at 4.9% and the Japanese 10-year yield at 2.9%. Real interest rates, after accounting for inflation, were negative for a time but have risen significantly. More than 80% of global bonds now offer yields above 4%, compared with less than 20% between 2010 and 2021, according to BlackRock.

The stock of public and corporate debt is approaching $300 trillion, according to the IIF, equivalent to nearly 3 times global GDP. Rising interest rates are likely to lead to an increase in default rates and, at the very least, a slowdown in investment in real estate and other sectors.

Stock market instability generated by AI:

The appreciation of global stock markets is essentially driven by just 2 of the 13 major sectors: technology and energy. All the others are posting modest gains or are often even declining. In September, excluding technology, 80% of stocks fell. The decline was particularly pronounced among small-cap stocks. This can be explained by the combined effects of rising energy prices, rising interest rates and increasing financing difficulties, as AI companies are draining liquidity from the market.

- This is a factor of instability because, although IPOs are numerous, totalling $147 billion this year compared with $44 billion at the same time last year, thanks to SpaceX at $86 billion and SK Hynix at $26 billion, subsequent share price performance is often disappointing, averaging -4% excluding SpaceX and SK Hynix in a market up 12%. According to BCA, technology IPOs this year are down by an average of more than 20%. The banks are being blamed for setting IPO prices too high in order to secure mandates.

- This is a factor of instability because, among technology stocks, the Magnificent Seven account for an unprecedented proportion of the S&P 500. The 10 largest companies by market capitalisation are worth $27 trillion.

- This is a factor of instability because never in the history of capitalism have we witnessed such a wave of investment as a percentage of GDP.

- This is a factor of instability because no one knows who will emerge victorious from this investment race, and the losers will have to make substantial asset write-downs and may even struggle to repay their debts.

- This is a factor of instability because expectations of additional growth and productivity gains generated by AI are high but may be disappointed. All sectors will use AI to some extent, but what gains will the proponents of AI actually achieve?

- This is a factor of instability because even the largest corporations, which until recently were generating free cash flow, must now multiply bond issuances to collectively finance $800 billion in investment this year, probably $1 trillion in 2027, and likely similar amounts through to 2030–2031.

1st cause of the recent decline in some tech stocks, the slowdown in Anthropic's growth, at 45% in the 3rd quarter compared with 145% in the previous quarter. In 2025, Anthropic recorded a loss of $42 billion and a loss of $80 billion in the 1st half. The company plans $500 billion in investments, and a capital increase of $100 billion is being considered at the time of its IPO.

2nd cause, increased competition among semiconductor manufacturers, as Chinese company CXMT has launched a new DRAM architecture, heralding a price war with SK Hynix, Samsung and Micron.

3rd cause, rising interest rates, which increase financing costs. Tech companies issued $540 billion in bonds in 2026, compared with $90 billion for the whole of 2025. Access to capital is becoming more expensive for neoclouds because their business model, which involves renting credit-financed chips to powerful players who dictate their terms, while those chips lose their value within 4 years, is fragile.

4th cause of the recent decline, the fall in CoreWeave's share price, an independent operator of 50 data centres. CoreWeave owes $50 billion to its creditors, more than its market capitalisation. Over 1 year, its debt has tripled, but sales have only doubled. Its bonds currently yield 15%. Its main customer is Microsoft (65% in 2025), ahead of OpenAI and Meta. Its order backlog stands at $129 billion.

Geopolitical instability generated by Trump:

Trump was elected on two promises that have not been fulfilled: lower inflation and no war. However, the outbreak of war against Iran has created chaos from which he does not know how to extricate himself, while triggering a resurgence of inflation and rising interest rates that is a cause for concern worldwide.

In Iran, he has failed to achieve any of his 4 initial objectives: regime change, abandonment of nuclear ambitions, an end to support for Hamas, and the elimination of long-range missile capabilities.

According to Aramco, the world has been deprived of nearly 3 billion barrels of oil because of the conflict with Iran, and it will take nearly 2 years to make up for this loss. OECD reserves fell by 300 million barrels in the spring and then by another 100 million recently. Demand has certainly declined, but oil companies have depleted their inventories. This explains why oil prices remain above $100 per barrel.

The supertanker fleet is heavily occupied, as many vessels have sailed around South Africa to avoid the Houthis. Transport costs have risen sharply. For example, the cost recently reached $35 per barrel from Hormuz to China, compared with $7 per barrel before the conflict.

Refining margins have risen from $20 to $70 per barrel in the United States and from $5 to $60 per barrel in Europe, because refineries in Saudi Arabia, Kuwait and the UAE have been damaged. Before the conflict, 20% of the flows leaving Hormuz consisted of refined products; today, this proportion is very low. The diesel crack spread in Europe has exceeded $100 per barrel, compared with $20 at the beginning of 2026.

Other consequences of the instability generated by the conflict with Iran include the price of gas reaching a mid-October high of €87/MWh, compared with €32/MWh at the beginning of the conflict. Germany and the Netherlands, with gas storage levels at 60% ahead of winter, are the most vulnerable. Similarly, the price of sulphur, which stood at $100 per tonne before the conflict, is now at $1,000 per tonne, which will have repercussions for fertiliser and food prices.

Conclusion: "Instability is the normal state of affairs." Paul Valéry.

Drawing on this pertinent observation by Paul Valéry, we will conclude with a few notes of optimism:

- A source of optimism: earnings expectations for the 3rd quarter point to an increase of 29%, according to FactSet. The S&P 500 P/E ratio stands at 19.3x, compared with 22x at the beginning of the year. Nvidia, the world's largest company by market capitalisation at $5.14 trillion, is not particularly expensive, trading at 15x compared with 23x previously. Since the launch of ChatGPT, its share price has multiplied by 12, while its earnings have multiplied by 28x. Micron, a semiconductor manufacturer, reported earnings of $37 billion, compared with $3.7 billion 1 year ago, and its P/E ratio stands at 12x despite a 330% appreciation over 1 year. TSMC, the Taiwanese group and world leader in semiconductor foundry services, reported 3rd-quarter net profit up 69% to $23 billion, with revenue up 51%. Its share price has

appreciated by 62% over 1 year, giving it a P/E ratio of 24x. Finally, Accenture, a major consulting firm, reported better-than-expected results and reassured the market. Its share price is now stable over 1 year following a 50% decline.

- Rising interest rates are a source of instability, but they do not inevitably lead to a decline in equity markets. In 1994, the 10-year yield rose by more than 1 percentage point over approximately 40 trading sessions. Although the stock market fell by 8%, it gradually recovered despite continued increases in interest rates. In 1999, 10-year yields rose by 1 percentage point, and after initially hesitating, the equity market continued to rise until the collapse at the end of March 2000. In 2016, both interest rates and equities rose simultaneously because higher rates reflected greater confidence in the economy. Nevertheless, we will remain cautious about highly indebted stocks.

- In practical terms, some AI stocks will experience price corrections, but a new source of momentum could come from AI users (financial, healthcare and industrial companies, etc.) when they begin to demonstrate cost reductions and additional profits generated by AI.

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