Chinese government desperate to halt market slide

Nick Beams
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The Chinese government has announced a series of emergency measures aimed at halting a plunge on the country's stock markets as the leadership becomes increasingly concerned over the slide's impact on the stability of the economy and the regime itself.

In a brief statement issued last night, the China Securities Regulatory Commission said the central bank would provide liquidity to China Securities Finance, a state entity that makes finance available to brokers, in order to "uphold market stability."

No information has been given on how much money will be provided, but according to a report in the *Wall Street Journal* "people with direct knowledge of the plan said no upper limit had been set."

The decision came after a series of meetings over the weekend involving Premier Li Keqiang, financial regulators and officials.

The level of concern over the stock market is indicated by the fact it is the first time the central bank has been directed to fund organisations other than the country's banks.

The announcement followed a turbulent week on Chinese markets, which continued to drop despite previous government measures. Since June 12, the market's high point, share values on the Shanghai and Shenzhen stock exchanges have fallen by almost 30 percent, wiping out nearly $US3 trillion from market capitalisations.

In another move, initial public offerings (IPOs) by 28 companies, which had been approved already, were suspended and 25 fund managers issued a pledge they would try to help stabilise the market. The suspension of IPOs, where quick profits can often be made, was aimed at preventing the draining of funds from the market as a whole.

Over the past three weeks, the government has taken a series of measures. These include cutting interest rates (for the fourth time since last November); threatening to punish those spreading rumours; allowing the national pension fund to buy shares; and warning it will investigate short-sellers, who organise deals on the basis that the market will fall. None of the measures had any effect.

According to China capital markets analyst, Fred Howie, cited by the *Financial Times*: "Almost every one of these measures reeks of panic and is very short-sighted. It's going to be another crazy week."

Over the weekend the Chinese Communist Party newspaper the *People's Daily*, which does not normally comment on such matters, warned investors not to "lose their minds" and "bury themselves in horror and anxiety," insisting that the "positive measures will take time to produce results."

The statement underscored the mounting political crisis confronting the regime as the share plunge continues. The government promoted the escalation of the market more than a year ago when it ended a ban on margin lending—the ability to borrow funds to make share purchases.

The move had two objectives: to boost the economy in the face of the ending of a real estate and property boom and to open up a source of wealth for sections of the middle class and upper-middle class, which form a crucial base of political support for the regime.

These layers were drawn into market with the promise that the Communist Party regime would be able to control its operations and they could rapidly increase their individual wealth. Now, the gyrations of the capitalist market have led to disillusionment in the regime's capacities.

It has been estimated that small-scale retail traders account for 80 to 90 percent of the market, with millions of new accounts opening in the past year. During May alone, some 12 million accounts were established.

The rise in the market, which increased by around 150 percent before reaching its peak three weeks ago, has been fuelled by debt.

Margin lending through securities brokerages climbed to 2.3 trillion renminbi ($371 billion) from 403 billion renminbi a year earlier, an amount equivalent to 3.5 percent of the country's gross domestic product. According to Goldman Sachs, Chinese margin lending has been "easily the highest in the history of global equity markets."

Even this is an understatement of the amount of leverage in equity markets because additional funds have been provided via the so-called shadow banking and financial system—estimated to be as much as 1 trillion renminbi.

Last month, the government made some moves to restrict the escalation of margin lending, hoping to contain a growing financial bubble. But its actions appear to have been responsible, at least in part, for setting off a slide that so far has spiralled out of its control.

While the hope has been expressed in financial circles that the government's new measures, based on an implicit pledge of unlimited central bank support, will contain the panic, no one is certain. And concerns were raised in the meetings with Premier Li by finance ministry and central bank officials that the provision of funds would build up more problems because it would lead to the view that the government would come to the rescue every time there was a crisis.

The officials also pointed out that the measures cut across the government's intended goal of lessening state intervention in the financial system and opening it up more to international capital flows.

This goal is part of the government's longer-term objective of shifting the Chinese economy from dependence on massive investments in infrastructure and real estate to greater reliance on domestic consumption by boosting the wealth of better-off sections of the middle classes.

The investment boom was promoted in the wake of the 2008 global financial crisis as the Chinese government initiated a $500 billion spending package and rapidly expanded credit, especially to local government authorities, for infrastructure programs.

The attempted re-orientation has run into major problems, however, resulting from the failure of the global economy to make a significant recovery from the recession of 2008-2009. For more than two decades, the Chinese economy was powered by the rising value of exports. That source of growth ceased to operate after the financial crisis. Investment spending, based on credit, then became the main driver. The growth of unsold housing and apartment stocks has brought that phase to a close, however.

Today, the Chinese economy is expanding at its slowest rate in almost 25 years. Growth, which fell to 7.4 percent last year and 7 percent for the first quarter of this year, is expected to decline further.

According to the government, the economy has entered a "new normal" of moderate expansion. The slowing economy, however, and the accompanying deflationary pressures, both within China and internationally, are exacerbating the financial problems. Lower growth and inflation mean that the value of the debt held by local government authorities and financial institutions starts to rise in real terms.

The danger for the government is that the fall in the stock market—inflated by a massive expansion of debt—could be the signal for the start of a collapse in other highly-leveraged areas of the broader economy.