China share rout hits global markets

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Chinese financial authorities have banned major shareholders, corporate executives and directors from selling their shares in listed companies for a period of six months. The ban is the latest in a series of increasingly desperate moves to try to halt the crash of the Chinese stock market, amid indications it is beginning to impact on the rest of the world.

Under the new regulations, investors holding more than 5 percent in a company have to keep their shares, while the ban on sales by executives and board members applies regardless of the size of their holdings.

The move was announced in the wake of a further decline in share prices yesterday, which saw the key Shanghai Composite Index close down by 5.9 percent, after losing as much as 8 percent during the course of the day. The Shenzhen index also lost 2.5 percent. For more than a week, the government and financial authorities have unveiled a series of measures to try to boost markets, but all have failed.

Concerns are now being expressed that government intervention may actually be making the situation worse. Mark Mobius, the chairman of the Templeton Emerging Markets Group, told the *Sydney Morning Herald* that the continuing intervention "suggests desperation. It actually creates more fear because it shows that they've lost … control."

Yesterday it was revealed that almost 1,500 stocks, comprising 50 percent of all listed companies, have suspended trading, freezing equity worth around $2.6 trillion. But even this figure is an underestimation of the market seizure. Under Chinese stock market regulations, a stock ceases trading once its price drops more than 10 percent. According to one estimate, some 90 percent of stocks have either been suspended or are hitting their daily limit.

Overall, more than $3 trillion in market capitalisation has been wiped out and the markets are down more than 30 percent from their peak a month ago. The amount of money that has disappeared is more than the market capitalisation of the French and Spanish markets combined, and almost equivalent to the gross domestic product of Germany, the world's fourth largest economy.

Clear signs of the global impact of the China meltdown emerged yesterday. Asian markets were down and the China-sensitive Australian share market fell 2 percent. European markets were either steady or slightly up, but Wall Street later recorded a significant fall.

The Dow Jones index ended the day 1.5 percent down, a five-month low, while the broader-based S&P 500 index lost 1.7 percent. Each one of the S&P's nine sectors was down, with basic material and energy stocks leading the way. The Vix index, measuring market volatility, rose 21 percent to 19.6, just below the level of 20, which is regarded as indicating investor nervousness.

At this point, the main transmission mechanism for the Chinese sell-off has been the sharp fall in commodity prices, especially for copper and iron ore, which have tracked the decline in Chinese stocks.

Yesterday, the price of copper, a key industrial raw material, reached its lowest point on the London Metals Exchange since 2009, in the immediate aftermath of the eruption of the global financial crisis. Iron ore had one of its worst market sessions on record, with the price plunging by 11 percent to just over $44 per tonne, down from $49.70 the previous day. Over the past five trading sessions, it has declined by 25 percent.

The fall in commodity prices is being driven by two processes: the liquidation of commodity trades, as share investors and speculators seek to bolster their immediate cash positions, and growing concerns that the China sell-off will lead to a crisis in its financial system, bringing much lower economic growth. Copper has been used as collateral to obtain financing, but now has to be sold to cover losses on equities.

The precipitous decline in the iron ore price, which is now down to less than one-third of its peak in 2011, reflects concerns about the longer-term impact of the share market crisis. Yesterday, fund managers in Australia warned that, at current prices, the viability of the smaller, second-tier, iron ore mining companies could be called into question.

In the absence of any sign that the market sell-off will end, the measures initiated by the government and regulatory authorities have become increasingly desperate, as has the language accompanying them.

Announcing the six-month ban on selling by major shareholders, the China Securities Regulatory Commission said there was a "mood of panic in the market" and pointed to a "large increase in the irrational dumping of shares, causing a strain of liquidity." It warned that it would "deal sternly" with any violators of its new regulations.

The People's Bank of China (PBoC) announced it was helping the state-owned China Securities Finance Corporation (CSF) to access liquidity so that it could "hold the line against the outbreak of systemic or regional financial risks."

The bank's reference to "systemic risk" indicates growing fears that the stock market plunge could set off a crisis in other parts of the financial system, while its reference to possible "regional" problems points to concerns over the stability of local government authorities across the country, which are heavily in debt under conditions of a slowing economy.

The significance of the PBoC statement was drawn out by a report in the *Financial Times*: "This is the clearest statement yet about what CSF is doing—buying shares directly using PBoC money, a big departure from its traditional role of lending to brokerages to support margin lending."

The CSF is also supplying credit to brokerages, almost $42 billion, to help them buy shares, and is looking to increase its own share purchases in smaller companies.

For the Chinese Communist Party regime, the inability of the government and financial regulators to stop the market crash is rapidly turning into a political disaster. In November 2013, in an effort to find a new growth path for the Chinese economy, President Xi Jinping announced that henceforth, the government would emphasise "the decisive role of market forces."

The plan was to increasingly open up the financial sector to international capital, and to encourage share trading by better off individuals in the country's middle classes. Seeking to cultivate this layer as an important social base, it actively lured them into share market activity.

The government's plan, based on "market forces" that are now wreaking havoc, has blown up in its face. It not only faces the hostility of millions of small traders, who have lost out in the stock market plunge, but also the prospect of social and political struggles by the working class, as the economy slows down.