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The Chinese Market: The Role of Government and the Impact on Economy

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Abstract- This paper explores the China's market turmoil in many aspects. It discusses the beginning of the problem and what it caused to the economy. It also includes different types of techniques that the Chinses government have implemented to solve or minimize the effect of the problem. Additionally, it explains the impact of the China's market turmoil on the society and the foreign investors. At the end, I will include my thoughts and opinions about what the Chinese government should consider in order to solve the issue efficiently, with a brief conclusion.

Introduction

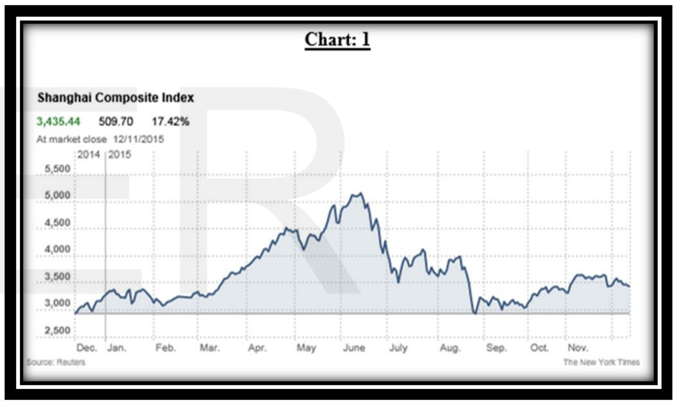
The Chinese market crash is the second in size after that of the United States. There are many factors that led to the Chinese stock market crash or China "Black Monday". In the effort to reduce the economic slowdown in the country, The People's Bank of China devaluated the Chinese currency, Yuan by almost 2 % on August 10. This led to negative consequences on the stock market, where the prices of shares decreased sharply in the days following the decision of devaluation. As a result, the stock market crashed, and billions of dollars were lost due to the market turmoil (Mchugh, 2015).

On August 21, the Dow Jones Industrial Average lost 531 points, which is considered as the worst losses since 2011. On August 23, the Shanghai Composite lost 8.5% overnight and the stock market opened on the following day (Black Monday) with a drastic decrease. The experts and analytics worried about the effects that the Black Monday would have on New York Stock Exchange, Hong Kong, Japan and other stock markets globally (Mchugh, 2015).

Nigel Green, Chief Executive of the financial consulting firm, deVere Group, told Reuters the factors that led to the worldwide economic slowdown. "These include China-related issues, such as the recent devaluation of its currency, the stock market's boom and bust in recent months, and slower GDP growth" (Mchugh, 2015).

Millions of working and middle-class Chinese families were investing heavily in the stock market, focusing on cheap stocks of small and medium-size companies. The reason and assumption that investors were relying on was the continuous increase in stock prices. They did not make a logical and right decision based on the analysis of financial statements and how companies have performed over a period of time. The market was getting overheated and prices reached a peak due to huge demand from investors who had no significant reason to buy a stock (Bradsher, 2015).

After that, the market experienced periods of weakness, and investors were losing faith and trust in the stock market. In order to restore confidence, the Chinese central bank reacted by cutting the interest rate due to the drop of Shanghai and Shenzhen markets to more than 7% on June 26. After a lot of government actions and measures, stocks increased on July 9. However, the main Shanghai share index shrunk significantly and the index closed 8.5 percent lower on August 24 (see chart 1). Subsequently, the government took aggressive actions and introduced new measures to stabilize the market and recover the economic slowdown (Bradsher, 2015).



What is China doing about the sell-off?

The second chart below was created by Bloomberg Intelligence economist, Tom Orlik. It shows the rise and fall

of the equity market in China between 2014 and 2015. The two trillion Yuan debt swap helped the market to reach a peak of more than 5,000 points. However, the marker decreased drastically to 3,800 points due to the absence of confidence and trust in the market. Tom Orlik said, "Along the way there have been five rate cuts, a raft of interventions from the government aimed at stabilizing the market and a global stock correction with China at its core" (Orlik, 2015).

Different Actions and Government Decisions

With the efforts to contain market plunge, the Chinse government have implemented various strategies and a series of measures to improve the stock market. The questions arose about the effectiveness of these actions and measures, and whether these efforts will help to solve the economic, political and social challenges or not. The main problem is associated with the investors who put all their money, expecting to gain a high return. Many of them have borrowed loans from the banks and could not repay them back since the stock market has fallen severely. As a result, they could lose their jobs, houses and feel depressed for losing almost all of their investment. The contingent effect of that can fly further to include the whole society, causing a slowdown in the economy. In order to prevent any further consequences, the central bank has funded investor with extra cash to buy shares. Additionally, the government ordered brokers to invest billions of dollars in the market. The China's Communist Party leaders took many steps forward to restore confidence and stabilize the market. For example, "On Wednesday, China's Ministry of Finance pledged to "adopt measures to safeguard the stability of capital markets," and in particular protect state-owned financial enterprises. The move signals that this broad-based effort is being directed from the very top echelons of the state" (Barboza, 2015).

The main problem is that there was no buyers, only sellers. So, the government continued to buy, hoping to improve the stock market. Despite the efforts to handle the situation, the stock prices in both Shanghai and Shenzhen markets fell harshly. Besides, the damage spread to other regions such as Hong Kong and Japan, where stock prices decreased sharply (Barboza, 2015). As a result, the government realized the need for more corrective actions and measures since the former did not help to make a positive progress in the market.

To limit losses of huge selling, China's major stock exchanges limit any stock from falling more than 10 percent in a single day. However, the reactions of investors made it useless and ineffective. Many investors sold other shares which expanded the sell-off. Then, they continue getting rid of the shares that were previously stopped (Barboza, 2015). The aggressive investors caused the problem because they buy shares with borrowed funds, or on margin with a total amount of $550 billion. A further action by the Chinese government was made in late June when it cut the interest rates in order to discourage people from depositing their money in the banks. This is a good indication that stock market will be more attractive to investors compared to bank deposits, but the results were disappointing (Barboza, 2015). Since then, the authorities have taken more actions and implemented additional measures to increase prices. Some of the new measures and actions taken by authorities are:

- The reduction of stock trading transactions.
- IPOs were suspended.
- A huge amount of funds to purchase more shares.
- A promise from brokerage houses to buy more stocks.
- China's insurance regulator lessened rules, so insurers could invest in stocks easily.
- The authorities continued to announce more measures, to face further selling (Barboza, 2015).

China's State-Owned Assets Supervision and Administration Commission asked big state corporations to keep holdings of their stock. "The China Securities Regulatory Commission even issued a notice encouraging major shareholders, directors and executives of companies to increase their holdings of their companies' stock. The commission emphasized that rules about the timing of insider stock transactions that might deter such purchases would not apply" (Barboza, 2015). More measures could come, as the authorities trying to stimulate the economy and resolve the sell-off issues.

How exposed are foreign investors?

As per Bradsher, "The Chinese markets have only recently started to open up to outside investors, so overseas players are not heavily exposed to the downturn. Such investors own an estimated 4 percent of Chinese shares." Also, the foreign investors are focusing on large corporations which have not faced huge volatility, compared to small and medium companies (Bradsher, 2015). However, China is a big importer of commodities and products from different countries in the world, so there is a big chance that these countries and their citizens could be affected badly as we saw with Hong Kong, Japan, USA and other countries.

A comment on these measures

As we have discussed, the China's Community Party leaders and government authorities have implemented different strategies, actions, and measures to prop up stock prices.

While some of these efforts led to positive results, many of them had no benefits to stimulate the economy and improve the stock market. The investors' confidence in the government role and the market has collapsed. As the government trying to solve part of the problem, another issue is created. This is because the government is focusing on pumping more and more funds in the market, concentration in large corporations (Wei, 2015). On Wednesday, China Securities Finance Corp extended 260 billion Yuan to 21 big public listed companies while leaving the small and medium companies. This caused a collapse in the stock market because more debt is being pumped into it. Fortunately, economists believe that the effect of the stock-market turmoil on China is not heavy. This is because the stock market accounts for only 20% in China's overall household wealth while the bank deposits represent 54% (Wei, 2015).

Conclusion

Summing up, this paper discussed the China's market turmoil in many aspects. It started with an explanation of the problem and what caused the "Black Monday". Then, it deliberated what Chinese government authorities and leaders did in order to recover the economy and prop up the stock prices. It also explained the Chinses market and policy timeline using charts in order to see the past actions and their effects on the current market crash. It also included a part about the foreign investors, if they are exposed or not, and up to what extend the market crash is affecting them. Furthermore, it discussed the effects it has on China and other countries.

As we have seen, the Chinese government is implementing many actions and measures at the same time, which could have a conflict with the goals created for. I believe that the key success factor for China is to focus on small and medium investors, instead of only pumping more funds to help large corporations and investors. Also, it is easier and better to focus on one or at most two area and implement a strategy to solve one part of the problem. Once the result is satisfactory, the government can continue working on solving another part of the problem. These strategies could help China to restore the confidence that was collapsed because investors believe the government is not working efficiently and effectively to improve the economy and recover the stock market.

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