Stock Market Slump Will Have Only a Limited Impact on Economy

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The A-share market has been undergoing an unprecedented plunge since mid-June, with the benchmark Shanghai Composite Index having declined about 30% and the capitalization of listed companies having shrunk by about 20 trillion yuan (about $3.23 trillion). Despite of the downside pressure, the fundamentals of the Chinese economy still remain strong and the economic growth is still within a reasonable range. In the first quarter, GDP growth was 7%, and the growth rate for the second quarter is expected to range from 6.8% to 6.9%. Driven by the current proactive fiscal policy and prudent monetary policy, it has been forecasted that the growth in the third quarter will rebound to 7%, and will maintain at that rate. The full-year GDP growth target of 7% could be attained, and the goal of creating 12 million new urban jobs would also be achieved. The ongoing massive nosedive in stock indexes, therefore, runs counter to the stable performance of the Chinese economy.

Judging from the nature of the stock market, the slump could be defined as a natural correction of the huge surge in the past months. It was triggered off by a slew of factors, including profit-taking, offloading by executives of listed companies, position closing by leveraged funds and short sale for hedging in the index futures by institutional investors. These factors ultimately led to panic sell-offs by retail investors and the recent massive declines. Both the enormous surge in the past months and the recent slump could be described as irrational, and reflects the facts that China's stock investors are still not mature enough and that government regulatory departments failed to fully perform their function in regulating the securities market. In particular, when leveraged financing from non-official channels ran rampant, the regulatory departments failed to spot the danger, issue warnings, or take measures to prevent risks. When new shares were over-speculated in their debuts, the regulatory watchdogs failed to take effective measures to rein in such a rampant and common phenomenon. And when the stock indexes started to plunge and the market became panicked, relevant government departments resolutely took measures to intervene in an attempt to prevent irrational and unprecedented declines. For the government, this is a must-do action, otherwise the consequences could be unimaginably disastrous.

The government rescue measures include: the central bank promising ample liquidity for the stock market; securities brokerages pooling 120 billion yuan to buy stocks and promising not to offload before the Shanghai Composite Index rebounding to the 4,500-point mark; China Securities Finance Corp Ltd buying stocks of 30 blue-chip listed companies such as PetroChina Ltd, China Petroleum and Chemical Corp and the “Big Four” State-owned banks so as to stabilize the Shanghai Composite Index; and the China Financial Futures Exchange limiting single-day new orders on CSI 500 index futures to curb rapid plunges in the small- and medium-sized enterprise board. The intervention measures taken by the government are aimed at restoring market confidence. On the one hand, the measures will help guide retail investors to shift towards value-oriented investment, and on the other hand, no purchases in small-cap stocks were made in a bid to avoid the effect of negative incentive. Generally speaking, stocks have shown an obvious trend of differentiation, with investors preferring blue-chip stocks and small-cap shares under sell-off pressure due to over-speculation and fast rally in the past months. Investment is now gradually turning to blue-chip shares. It is believed that with short sellers losing momentum, the market will gradually stabilize.

At critical moments, governments would appropriately intervene in the financial markets to prevent risk spillover or financial crisis, and this has been proven to be a common practice and effective option for all governments in coping with financial crisis. During the 2008 financial crisis in the United States and the 2009 eurozone crisis, the U.S. government and the European central bank all adopted the policy of active intervention, which helped mitigate economic losses incurred by the financial market turbulence. Of course, the intervention measures taken by the Chinese government this time were fairly restrained and well targeted – bolstering blue-chip stocks for an exemplary effect to restore market confidence and guide the reasonable flows of capital. At the same time, the government adopted different policies towards small-cap stocks so as to let the shares make self-correction and give investors a chance to learn the lesson. This will help investors cultivate and strengthen their risk awareness. On the other hand, reasonable declines in the prices of small-cap shares will help squeeze the bubbles and release risks of such stocks, and will be helpful for the future performance of such stocks.

In a word, the stock market turmoil will produce a very limited impact on the overall performance of the Chinese economy, and its impact on the global economy will also be very minor. After the stock market turmoil, the Chinese financial regulatory departments should earnestly draw their lessons, improve relevant laws, regulations and policies, better the financial supervision and management system, and elevate their capability in preventing and defusing financial risks. At the same time, investors should also draw a lesson from the stock plunges, improve and follow the concept of value-oriented investment, and become more rational and matured in their investments.