

Financial Markets Destabilized again amid the Continued Economic Slowdown

AKI FUKUCHI
ECONOMIC RESEARCH OFFICE

26 JANUARY 2016

(ORIGINAL JAPANESE VERSION RELEASED ON 22 JANUARY
2016)

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
A member of MUFG, a global financial group

China started a turbulent new year with the Shanghai Composite Index declining by around 10% in the first week of the year and the Chinese yuan depreciating further. In the background for the falling stock prices there were such factors as; (i) a rekindled uncertainty over the economy following the deterioration of the economic indicators, including the manufacturing PMI for December (data published by Caixin), (ii) concerns over the deterioration of supply and demand balance that may be caused by prospective selling of stocks by large stockholders and (iii) heightened investor's attitude for risk aversion.

Let's confirm the developments of the real economy. The real GDP growth rate for Oct.-Dec. quarter of 2015 slowed down to +6.8% YoY, decelerating from the previous quarter and the latest economic indicators for December generally showed continued softness especially in production and investment (Table 1). But there is still no change in the trend of gradual slow down, not so much aggravation as to notice a significant deviation that would trigger such financial turmoil as plummeting stock prices or falling exchange rate of the yuan.

On the other hand, it cannot be denied that the concerns over deterioration of supply and demand balance in the stock market and reactive policy approaches of the government spurred the market turbulence. The government authorities introduced just after the turn of the year a "Circuit Breaker" system to prepare for possible market fluctuations following the end of the suspension period (due on January 8, 2016) of stock selling by large stockholders, which had been tentatively implemented in the middle of last year to support stock prices. However, the tumbling of stock prices triggered by the concerns over the deterioration of supply/demand balance following the lift of the ban on large-lot stocks sales produced a vicious cycle of applying the circuit breaker and panicky stock sales, which led to the continuation¹ of the restriction on the stock sales by large stockholders and also the suspension of circuit breaker mechanism just a week after the turn of the year. These measures contributed to stave off the plummet of stock prices for the moment. But cautious attitude should be taken in looking at the future developments of the market in light of the historical examples of the burst of stock bubbles since they are not backed by the economic fundamentals (Chart 1).

In addition, the PBOC's setting lower central parity rate for the yuan at the start of the year likely exacerbated concerns as it was interpreted that the PBOC was maneuvering to lower the yuan. Concerns over the outflow of short-term capital are also persistent as it was suggested by the declining foreign exchange reserves, mainly due to foreign exchange interventions by

¹ On January 7, Chinese Securities Regulatory Commission (CSRC) published a regulation to restrict stock selling by large stockholders, requesting them to apply for permissions to the authorities 15 days ahead of their stock sales, and setting a ban on sales of stocks exceeding 1% of total number of stocks issued by the listed companies every three months (enforced on January 9).

the PBOC, recorded a decrease of \$107.9 billion in December compared to the previous month, the largest-ever decline. Continued attention should be paid to the possibility that the reactive policy measures by the government may further intensify the adjustment pressures on stock prices and exchange rates through loss of market confidence and risk aversion behaviors of the investors.

Table1: Main Economic Indicators (China)

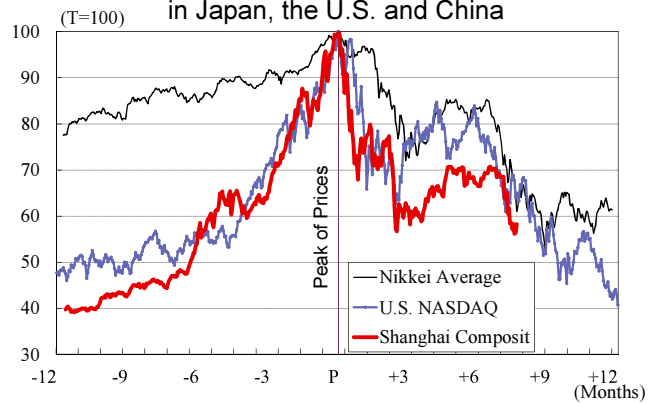
	2015					
	Jul	Aug	Sep	Oct	Nov	Dec
Exports (YoY, %)	-9.1	-5.7	-3.8	-7.0	-7.1	-1.4
Imports (YoY, %)	-8.5	-13.9	-20.5	-18.9	-9.0	-7.6
Fixed Assets Investment (YTD, YoY, %)	11.2	10.9	10.3	10.2	10.2	10.0
Retail Sales (YoY, %)	10.5	10.8	10.9	11.0	11.2	11.1
Industrial Production (YoY, %)	6.0	6.1	5.7	5.6	6.2	5.9
Manufacturing PMI	50.0	49.7	49.8	49.8	49.6	49.7
Non-manufacturing PMI	53.9	53.4	53.4	53.1	53.6	54.4
CPI (YoY, %)	1.6	2.0	1.6	1.3	1.5	1.6
PPI (YoY, %)	-5.4	-5.9	-5.9	-5.9	-5.9	-5.9

Note: 1) Manufacturing PMI and Non-manufacturing PMI are from China National Bureau of Statistics.

2) Shadowed portion indicates lower growth rates or decline in indicators from previous months.

Source: China National Bureau of Statistics, BTMU

Chart 1: Stock Prices in Bubble Period in Japan, the U.S. and China



Note: The peaks of stock prices were recorded on Dec. 29, 1989 for Nikkei, on March 10, 2000 for the U.S. Nasdaq, and June 12, 2015 for Shanghai Composite Index
Source: Compiled by the Economic Research Office of the BTMU based on the statistics of each stock exchange