Chinese stock market volatility

After panic selling on Monday, when equity trading was halted after the stock market fell by 7%, Beijing weighed in to prop up its stock and currency markets yesterday.

It's unclear what caused the panic on Monday but the initial trigger came from Chinese manufacturing data showing the manufacturing sector shrinking for a 5^{th} consecutive month in December. This was the fundamental reason leading to the initial sell off. The Chinese authorities were due to lift a ban on sell shares by large investors on Friday, the prospect of which caused concern for investors. This technical move together with the fundamentals created a perfect storm resulting in a the Shanghai Composite index settling 6.9 per cent lower while the Shenzhen Composite shed 8.2 per cent, its biggest fall in nine years. As a result of this, the lock-in, due to expire in Friday, may be extended by the government, who have also sent in state banks to buy shares.

Yesterday, investors were rattled yet again by a further weakening of the Chinese Yuan, falling to its weakest level in five years. Investors are nervous after the central bank set a weaker Yuan guidance rate for the eighth day pushing the Yuan to 6.5646 per US dollar, its lowest level since March 2011. This indicates that Beijing is looking to boost its exports as the economy is growing slower than expected.

After the second trading halt the regulator published new permanent rules restricting share sales by large shareholders, as well as by corporate management and director. Starting on January 9, large shareholders can sell a maximum of 1 percent of a company' shares every three months. They must also disclose stake-cutting plans 15 days in advance. These new measures are expected to help stem panic selling in future.

The question remains as to whether the volatility seen this week is the new normal. Since the financial crisis of 2008, central banks in developed markets have deliberately implemented measures to stem any signs of volatility in the market. The U.S. Federal Reserve showed signs of deviation from this policy in the recent Fed rate announcements. China has long provided support for the global economy and as Chinese growth slows, with forecast GDP at 6.5% for 2016, it may be that this is a one off adjustment to new market fundamentals. The Chinese government has been taking measures to try to stabilize the depreciation of the Yuan by buying up the currency. Analysts are predicting that depreciation of the Yuan will not reach rates seen in 2015. With this, it is hoped that the recent stock market shocks are initial teething problems as we enter a new year where Chinese growth is unable to support global growth to the extent it has in the past.