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Chinese Economy Shaken by Wild Stock Market Fluctuations

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The Shanghai stock market has failed to end its wild fluctuations. On July 27, the Shanghai Stock Exchange Composite Index logged an 8.5% plunge, the fastest decline in eight years and five months since 2007. It continued to fall the next day. After widening its loss to 5% temporarily, the index rallied and ended down by nearly 2% from the previous day. The index lost 10% in two days, representing the second wave of selling following the first wave seen in early July.

As noted in my 227th special bulletin on "A Japanese Perspective on the International Energy Landscape," the Chinese government offered unusually strong measures to prop up share prices in response to the first wave of selling. As a result, the first wave seemingly ended, with the market restoring stability temporarily. In fact, the Chinese government mobilized strong market intervention measures that looked even desperate. They included approval of applications for listed companies' halt to trading in their own shares, restrictions on selling of shares in 111 major state-run companies, a freeze on initial public offerings, 21 major Chinese brokers' buying to drive up the Shanghai Stock Exchange Composite Index above 4,500 and tough restrictions on malicious short selling. These measures were not conceivable for any usual stock market, indicating that the Chinese government viewed the stock market plunge as a really serious problem.

After rallying under these strong measures, however, stock prices plunged on the second wave of selling. The indication is that strong intervention measures failed to put selling pressure in the market under full control. Western countries criticized the above mentioned China's bold market intervention even for supporting stock prices, making it difficult for the Chinese government to repeat such intervention. Lingering market fears and selling pressure might have led to the July 27-28 plunge. In response, government-backed financial institutions launched buying to support stock prices, allowing the index to rebound 3% on July 29. But the index lost 2% on July 30. The Shanghai stock market has thus remained volatile.

As market forces struggle with intervention or regulation, we cannot see how long intervention would sustain its effects or be sustained. Under such situation, stock prices seem to be destabilizing with selling pressure accumulating. Behind the situation is a Chinese economic growth slowdown representing a deterioration of economic fundamentals. On July 15, the National Statistics

Bureau of China announced China's annualized that gross domestic product growth in the April-June quarter leveled off from the previous quarter at 7.0%. The growth rate meets the annual growth target under the "new normal." But the growth came as monetary easing and infrastructure investment were implemented to avoid downside risks. The Chinese government is walking a tightrope in meeting the growth target. Some economists view real economic conditions as worse than indicated by the GDP growth.

China's domestic automobile sales in June widened the year-on-year fall to 2.3%. Its real estate market has remained slack. There are many other downside signs in the Chinese economy. A preliminary Purchasing Manager Index announced in July slipped below the boom-or-bust dividing line of 50 for production and orders for the fifth straight month, hitting a 15-month low. Under such economic situation, a stock market decline can foster a sense of uneasiness about the future course of the economy and trigger a vicious economic cycle. At a time when the Chinese economy has grown even more important for the world economy, it is desirable for the Chinese economy to stabilize under the "new normal."

Now that China's presence has increased in the international energy market as well as the world economy, its economic growth slowdown has great impacts on the energy supply-demand balance and its expected future direction. Energy demand is basically increasing in China that is still growing while decelerating growth. But China's guzzling of energy resources, which was a major driver of the commodities super cycle since the 2000s, has lost momentum. Major factors behind the loosening supply-demand balance in many commodities markets include the slowdown in China's demand growth and increasing unconventional resources supply.

In the current energy market, the supply-demand balance has remained loose. For example, crude oil prices have come under downward pressure again since early July. The benchmark West Texas Intermediate futures price slipped below $50/bbl on July 22 for the first time in some four months since late March and has remained below the level. Behind the crude oil price fall have been various supply/demand and financial factors. Supply side factors may include expectations of Iran's comeback to the international oil market after the future termination of Western countries' economic sanctions on Iran under the recent Iran nuclear agreement. This factor indicates a future oil supply increase that could have been reflected in the market. But the Shanghai stock market's plunge and destabilization and the underlying Chinese economic growth deceleration might also have contributed to the oil price decline. The market may be discounting a future demand slowdown into prices. Financially, a risk-off trend may be spreading.

China's economic trends will remain significant for the world economy and the international energy market in the future. Last October, the IEEJ released its "Asia/World Energy Outlook 2014" providing a study on the possibility and impacts of lower growth in China and India. If China's average economic growth up to 2040 slows to 3.9% under the Low Growth Scenario from

5.4% under the Reference Scenario with India's growth slowing, it may exert very great impacts on the international energy market. For example, oil demand in 2040 will be about 7 million barrels per day less than under the Reference Scenario. As the demand or export requirement decline leads the supply-demand balance to ease, crude oil prices may decline by about 10%, exerting negative impacts on particularly on resource-rich economies. These forecasts represent a scenario analysis. Given the recent Chinese trends, I feel that it is important and necessary for us to deepen analysis on the possibility and impacts of future downside risks.

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