China seen resilient amid global selloff

Chinese investors 'spooked' by Dow's plunge but may find opportunities among stocks with low valuations, solid fundamentals

People look at stock price movements at a securities company in Beijing on Feb 7. Although China's markets have limited foreign investment, investors still react to the turbulence on foreign markets. AFP

By **KARL WILSON** in Sydney
karlwilson@chinadailyapac.com

China's stock markets were not immune to the selloff in global equities on Feb 5-6, but analysts said they remained positive on the long-term outlook given China's resilient economic fundamentals.

The benchmark Shanghai Composite Index saw its biggest one-day fall in nearly two years on Feb 6, while the Shenzhen ChiNext Index, which tracks stocks listed on the startup board, suffered even heavier selling, dropping 5.34 percent and hitting a three-year low.

The global selloff on the Monday and Tuesday was sparked by a major fall on New York's Wall Street the previous Friday, Feb 2, when the Dow Jones Industrial Average fell 666 points just two weeks after hitting an all-time high, surpassing the 26,000 mark.

On Feb 5, Asian markets were the first to feel the full impact of the Dow's rout, recording significant falls, followed by European markets.

Later that same Monday, in New York, the red ink spread across the board and the Dow suffered its worst points decline in history, ending the day down by 1,175.21.

By Feb 7, it seemed markets around the world started to consolidate. However, on Feb 8 the Dow took another tumble, diving more than 1,000 points.

Analysts said Chinese investors had been "spooked" by the earlier falls.

China's markets are tightly controlled and have limited foreign investment. Even so, investors still react to the swings and roundabouts on foreign markets, analysts say.

Chen Jiahe, chief strategist at Cinda Securities, said: "Opportunities may emerge because of the plummeting prices, especially stocks with a low valuation and solid fundamentals.

"After all, China has a nominal per capita GDP of 15 percent of that of the United States, meaning that the growth potential is still huge for this country and its listed companies," Chen said.

The catalyst for the US market plunge was the country's job figures, which showed wages grew faster than expected, sparking investor concern of the greater possibility of inflation and faster-than-expected interest rate hikes by the Federal Reserve, the US central bank.

In China, there have also been concerns that intensified financial tightening and the clearing up of risky assets in the country's rapidly growing shadow banking sector may exert pressure on the stock market.

Chinese financial regulators will likely announce new regulations for the asset management industry in March, as part of the country's ongoing efforts to curb systemic financial risks, Chinese business magazine *Caixin* reported on Feb 6.

Inflation concerns

The regulators have required some financial institutions to suspend the offering of investment products with complex structures and high trading leverage, Chinese media reported, citing people with knowledge of the matter.

Given that current market valuations are still within a reasonable range, most analysts believe the likelihood for a substantial market stampede in China's equities market is much lower than in the summer of 2015 when the A-share market witnessed a dramatic rout.

Andrew Tilton, chief Asia economist at Goldman Sachs, said it is encouraging that China managed to maintain a good growth rate last year and policymakers have moved to rein in the country's rapid debt buildup.

So what was behind the selloff?

During the 2008 financial crisis, central banks in the world's major economies — China, the US, Japan and Europe — started to pump trillions of dollars into their economies in a bid to stimulate growth.

At the same time, central banks cut interest rates to historic lows. But as the global economy appears to be picking up and inflation is rising, central banks are starting to raise interest rates.

Investors are now beginning to wonder how much of their investments are in companies with strong fundamentals. Or how much is simply holding up an asset bubble that was created when interest rates were at historic lows and money was cheap.

For weeks, economists and analysts have been warning that inflation levels in major economies will start to rise this year beyond the 2 to 3 percent that central banks believe is good for developed countries.

Official US figures turned those concerns into a selloff on Feb 2 after average wage rises in the US had reached 2.9 percent. The data heightened fears that shop prices would soon rise further, increasing the pressure for high interest rates to calm the economy.

Members of the US Federal Reserve have been stoking rate rise fears, arguing that three 0.25 percent interest rate hikes this year might not be enough and the Fed should be looking at four or five rate rises.

Frederic Neumann, co-head of Asian economics research at HSBC, said that after a sharp rally at the start of the year, investors are now starting to reassess the outlook for US inflation.

"After years of subdued price pressures, inflation is starting to return, prompting adjustments in market expectations about central bank action," he told *China Daily Asia Weekly*.

"At times, such adjustments can lead to spikes in market volatility, even as the growth fundamentals in the world economy remain robust."

Global equities corrected on inflation and rates concerns.

In a note to clients on Feb 6, Singapore-based DBS Bank said to expect further volatility in the coming weeks, but added "this does not mark the beginning of a bear market".

Elvira Sojli, an associate professor at the University of New South Wales Business School, said: "Institutional investors didn't see this coming — and they are trying to find excuses.

"High frequency trading isn't to blame — it's risk management mixed with investors reallocating resources across markets," she said.

Much attention has been focused on high-frequency trading, where computers are programmed to trade stocks in microseconds.

"But robot traders don't trade in a vacuum, and instead the cause of the chaos may be an investment and risk management strategy," Sojli said.

Market correction

Rajiv Biswas, Asia-Pacific chief economist with IHS Markit, said there was no need to panic.

"Global equity markets are correcting to price in the outlook for more aggressive Fed tightening following the spike in average hourly earnings growth in the US payrolls data for January," he said.

Biswas said the US unemployment rate is at 4.1 percent, the lowest since 2000, and the Fed was puzzled during 2017 about why US wage pressures had remained so constrained despite low and falling unemployment rates.

"With US growth strengthening and the unemployment rate expected to approach 3.5 percent over the next couple of years — well below most estimates of US 'full employment' — US inflationary risks are decisively on the upside."

Biswas said because of strong US economic growth, tightening labor markets and rising wage growth, IHS Markit now expects the Fed will hike US policy rates four times in 2018, versus the three rate hikes previously expected.

"Asian central banks will be focused on the risk of potential financial markets volatility if the Fed is perceived to be behind the curve and needs to play catch-up with more aggressive policy tightening," he said.

"During this period of high markets volatility, Asian central banks may temporarily postpone planned policy rate hikes till markets calm down. Asian central banks may also intervene in currency markets to smooth sharp fluctuations in currency markets due to volatile capital flows."

He said the global growth outlook, however, remains favorable, with the US consumer looking robust and eurozone economic momentum strengthening.

"In Asia, the Chinese economy is showing sustained strong expansion and Southeast Asia is also showing rapid economic growth, helped by strong exports, buoyant consumer expenditure and rising infrastructure investment in key economies such as Indonesia, Malaysia and the Philippines," Biswas said.

"It is therefore likely that financial markets will stabilize once portfolios are adjusted for the new more aggressive Fed rate hike trajectory expected in global financial markets."

Additional reporting by Li Xiang.