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Consideration on Plunge in Chinese Shares

- It will take some time until stocks stabilisation measures become effective in the market mostly traded by individuals.
- Keys of the effect on Chinese economy are private consumption and stability in financial systems.
- Japanese stocks remain favourable and it is important to consider each issue carefully at current risk off markets.

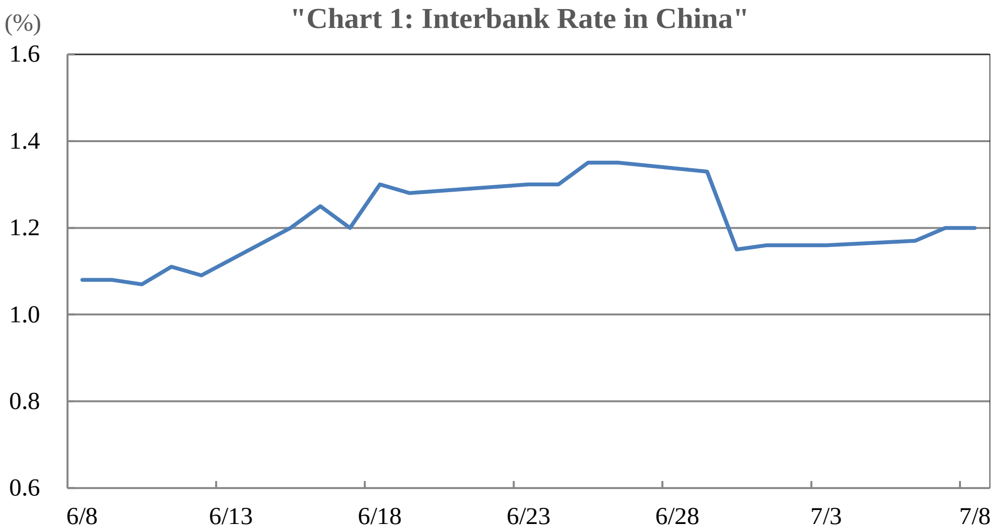
It will take some time until stocks stabilisation measures become effective in the market mostly traded by individuals

Shanghai Stock Index declined amid profit taking on a rapid rise after the index soared to its high of 5,178.191 on June 12th. The Chinese stock markets are mostly (70%) traded by retail investors and would often lead to a panic sell-off with a large volatility because they tend to sell their holding shares on fears reacted by a negative sentiment.

Chinese government promptly released measures for stabilising the stock markets, which included a freezing Initial Public Offerings (IPOs) schedule on July 4th (see Table 1). However, the stock prices continued declining even after the actions by the government and dropped to below 3,500 on July 8th. More than 40% of the stocks on Shanghai were suspended on the day and this seemed to deteriorate a sentiment of investors further.

Keys of the effect on Chinese economy are private consumption and stability in financial systems

There are two things to consider the effects of lower Chinese stock prices on the economy. The first one is the effect on consumer sentiment. A plunging share prices would result in further slowdown in the economy and the private consumption, as individuals with losses on stocks would be reluctant to spend much money. Therefore, more focus should be made on the consumption data on this point. The second one is the effect on entire financial systems. This might expand to tumble the entire financial systems if corporate loans backed by their own shares became bad debts due to decrease in share prices and banking system losing its credibility. In this case, China will experience much more serious slowdown. The Public Bank of China (PBOC) stated that the bank aggressively supplied liquidity and interbank rate remains currently stable (see Chart 1). Therefore, the effect on the financial systems seems to be limited.



(Note) Data period is from June 8th to July 8th.
(Source) SMAM, based on Bloomberg L.P. data.

"Table 1: Measures on Stock Market Stabilisation by China"

Date	Measures on Stock Market Stabilisation
June 27th	PBOC cut policy rates
June 29th	Approved public pensions to invest in stocks up to 30% of the portfolio Soverign Wealth Funds purchase RMB10 billion ETFs
July 1st	China Securities Regulatory Commission eased margin requirements Shanghai and Shenzhen exchange reduced 30% of transaction commission
July 4th	21 Brokers announced to purchase RMB120 billion ETFs IPOs schedule was freezed Accociation of investment funds plans to set up funds investing in stocks
July 8th	PBOC announced to supply sufficient liquidity

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In terms of the effect on lower Chinese stocks on Japanese stocks, this would not negatively impact to Japanese shares directly, as capital transactions are strictly regulated between China and other countries. However, we should keep in mind an indirect effect through merchandized trade; Lower Chinese stocks slowdown China's economy, which decreases China's imports. This will negatively affect Japanese economy and lead to lower Japanese stocks. In addition, Japanese shares might decline on concern over such a negative flow, even before it occurs in real economy. On an exchange rate, USD/JPY is likely to soften on expectations that later US Fed's liftoff lowers US Treasury yields amid concern over lower Chinese shares and Greek debt crises.

Chinese stocks might hover at a low price range for the time being, until stock market stabilisation measures effectively penetrate the market. Chinese authorities will try to improve investors' sentiment by additional stabilisation measures and monetary easing. Meanwhile, Japanese stocks are expected to remain firm on solid fundamentals regardless of low Chinese stocks, whereas the companies are more likely to focus on shareholders' value under ongoing regulatory reform on equity investments. As a result, Japanese stocks are likely to be influenced by a risk off environment globally, but it is the time to consider carefully each issue of lower Chinese stocks and Greek debt crises.

*** Please note that the original Japanese report was released on July 9, 2015.**