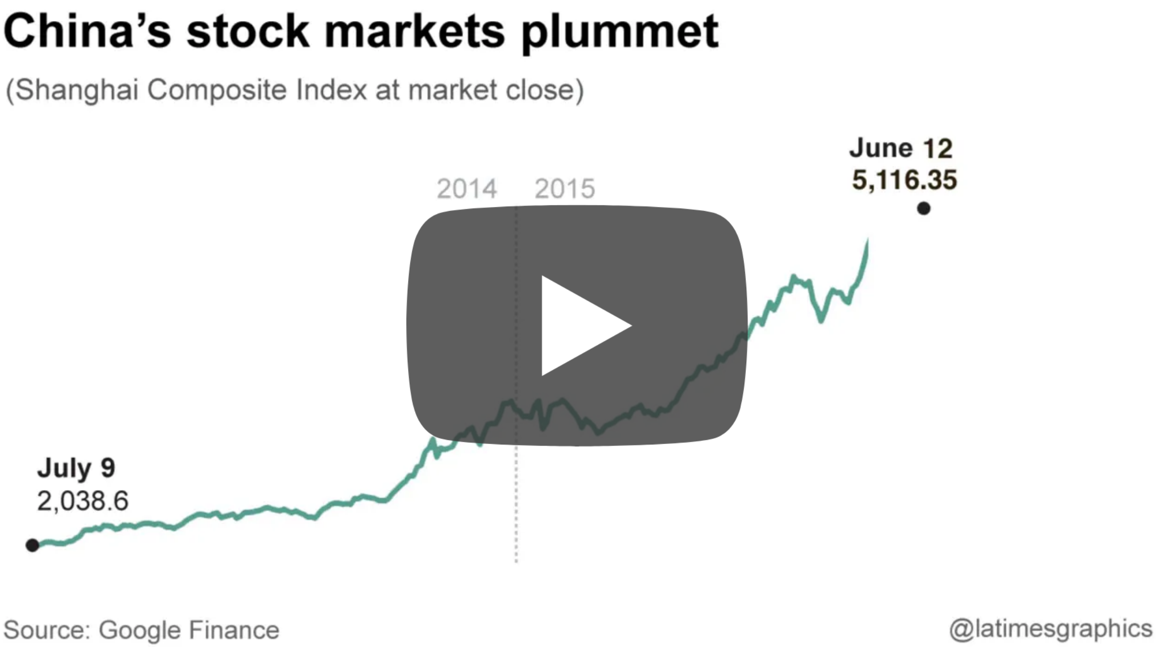
What China’s bursting stock bubble means for the U.S. economy



<p>China is a long way from Greece and the high-profile debt troubles of the Eurozone, but its stocks have been taking a far worse beating in recent days. But these problems aren’t a surprise to some people.</p>

BY DON LEE, DEAN STARKMAN

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Reporting from Washington — China is a long way from Greece and the high-profile debt troubles of the Eurozone, but its stocks have been taking a far worse beating in recent days.

On Wednesday, the growing investor panic over Chinese stocks shook confidence in Beijing’s ability to manage its slowing economy and threatened to cause problems for overseas markets, including America’s.

Despite increasingly desperate measures by the Chinese government to halt the slide, shares listed on China’s main stock exchange in Shanghai fell nearly 6% Wednesday, piling on losses that have plunged the market by about a third since mid-June.

“That’s incredible,” said John Lonski, chief capital markets economist for Moody’s Analytics. “That’s scary.”

Most Chinese stocks remain well above year-ago levels thanks to a raging bull market that began in November 2014 and was egged on by Beijing. China’s Shanghai stock market is still up 72% over the July 2014, despite the recent drops.

But the sudden nose dive has sparked concerns about growth in the world’s second-largest economy and has started to spill into other markets.

Stocks in Hong Kong fell even more Wednesday while markets slid also in Japan, South Korea, Australia and other economies with close links to China. The gloom spread to copper and other global commodity markets, which are hugely dependent on China’s economy.

U.S. stocks also opened sharply lower Wednesday, despite rising hopes that Greece might be able to avert a disastrous exit from the Eurozone.

The Chinese selloff has caught world markets by surprise as they focused on the slowly unfolding drama in Greece. But Lonski said the China bear market is potentially far more consequential by dint of China’s size and the potential contagion effects on the global economy and trade.

“If China hits the skids, I think the U.S. will suffer, the equity markets will suffer,” he said.

Treasury Secretary Jacob J. Lew on Wednesday downplayed concerns that the turmoil in China’s stock markets would pose an immediate threat to the U.S. economy.

“China’s markets are still pretty much separated from world markets,” Lew said during a forum at the Brookings Institution think tank in Washington. “They’re obviously moving towards being more integrated, but right now they’re not so …I don’t think you’re going to see the direct linkage there.”

Some analysts have likened China’s boom-to-bust market to the dot-com bubble in the U.S., when furious, irrational buying eventually led to a Nasdaq burst in 2000. But what makes China’s story unusual is just how rapidly prices soared and then fell, as well as the Chinese government’s not-so-invisible hand in the matter.

Leaders in Beijing have made public their desire to let markets play a bigger role in the Chinese economy, which is still dominated by state-owned enterprises and banks.

“Official publications were telling investors to get involved and buy stocks,” said Tim Condon, an economist at ING Group in Singapore. “There’s official complicity in boosting the market.”

Millions of ordinary Chinese jumped into the action, many of them borrowing funds to buy stocks. In recent months, government officials have sought to tamp down such leveraged purchases, and since June 12, when the Shanghai stock index reached 5178, the market has swooned, closing at 3506 on Wednesday.

The persistent fall is especially worrisome, analysts said, because it comes despite efforts by China’s central bank, the People’s Bank of China, to stem the stock slide through extraordinary measures, including declaring a halt to initial public offerings, and relaxing terms for margin borrowing. Both efforts have failed so far, and backfired by spooking foreign investors.

Condon thinks Beijing can stop the rout with back-stopping measures by the Chinese central bank, but other analysts wondered whether the latest episode in China’s evolving economy could set back financial and market reforms that many in the U.S. and other advanced economies have been calling on Beijing to continue.

Lew raised the concern Wednesday, questioning whether the market meltdown could delay efforts by the Chinese government to make the nation’s economy more market-oriented.

“If the reaction is to put the brakes on reforms it will slow that process,” Lew said.