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WORLD

Chinese Government Struggles in Attempt to Stem Distress in Stock Market

Authorities rush more emergency measures to halt what is turning into crisis of confidence

By **LINGLING WEI**
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BEIJING—The Chinese government struggled in vain Wednesday to prevent the distress in the country's stock markets from spreading, as it openly fought market forces it has pledged to give a larger role.

Early Wednesday, the Chinese authorities rushed out another raft of emergency measures to halt what is turning into a crisis of confidence in leaders' ability to steer the economy. But before the day was over the equities selloff had spilled into offshore trading in the Chinese yuan and worsened a drop in global commodity prices.

Wednesday night, China's securities regulator said controlling shareholders and executives who own more than 5% of a company's stocks aren't allowed to sell their holdings for the next six months. Any violation of the rule would be "treated seriously," the regulator said.

It didn't help that China's central bank extended funds for loans to buy shares. Nor that the agency that oversees China's oil giants and other state enterprises forbade them from selling their shareholdings.

The benchmark Shanghai Composite Index ended Wednesday 5.9% lower, after falling as much as 8.2% early in the session. The drop meant that $3.5 trillion in market value has been erased since a mid-June high—or one-third of total capitalization.

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Even China's safe-but-dull government bonds tumbled as brokerages and mutual funds sold debt to raise cash to follow the government decree to buy stocks.

"Market confidence has collapsed," said Shen Jun, a strategist at BOC International Holdings Ltd., the investment-banking unit of state-owned Bank of China Ltd. Risks are growing that the stock-market crisis will "evolve into a financial crisis."

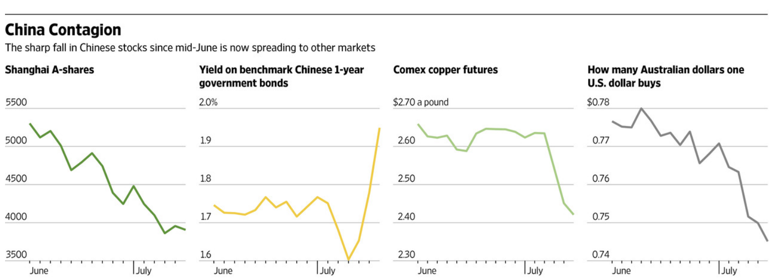
Until now, the Chinese government has been widely applauded for its deftness in managing economic matters. For instance, a stimulus program introduced in late 2008 helped the Chinese economy weather the global financial crisis.

It also saddled the economy with debt, a property bubble and wasteful projects throughout the country. As part of a strategy to help the companies unwind the debts they had taken on in that push, policy makers encouraged stock investing. Officials at the highest levels have talked up the stock market.

In March, when Premier Li Keqiang paid a visit to the State Administration for Industry and Commerce, the country's registration and licensing authority, he praised staffers at the agency for their effort to make it easier for companies to get listed, according to a video reviewed by The Wall Street Journal.

That "has created wealth for both the nation and the people," Mr. Li said.

At the root of the latest market swing is the rapid expansion of loans by investors to buy shares, a relatively new trading tactic in China. So-called margin financing soared over the past year to about 2 trillion yuan last month, official data show.



When Chinese stocks started to crumble in mid-June, the drop forced investors to unwind some of their leveraged bets, sparking more selling.

The government has rolled out one measure after another to stem the rout. But rather than reassure, the frenzy appears to have heightened anxiety.

"The more the government intervenes, the more scared I am," said Li Jun, who runs a fishing and restaurant business in the eastern city of Nanjing. Mr. Li has spent about 3 million yuan on stocks since early this year, using borrowed money for about a third of that amount.

He was among the legions of investors who have cut their shareholdings in the past few days. Mr. Li said he has steadily reduced his position every time the market "popped up a little" due to the government intervention.

"I have no faith" in the government's ability to halt the losses, he said.

China announced a flurry of new moves Wednesday to halt a stock market slide. *PHOTO: ASSOCIATED PRESS*

On Tuesday, the most recent day for which data are available, investors pulled out of 98.3 billion yuan of shares purchased with borrowed money on the Shanghai exchange, following nearly 100 billion yuan of such shares the previous day.

A spokesman for the China Securities Regulatory Commission, Deng Ge, described the market mood Wednesday as "panic sentiment."

Economists see little chance the stock-market turmoil will seriously hurt the world's second-largest economy. UBS economist Tao Wang notes that equities still account for only about 20% in China's overall household wealth, compared with 54% in bank deposits. "We don't anticipate the stock-market turmoil leading to a systematic problem for China's financial system," Ms. Wang said.

Participation by foreign investors is limited in China's markets, but China's stock woes could still affect other countries. "With China's economy already weak, falling stock prices could mean even lower import demand from China," said Eswar Prasad, a Cornell University professor and former China head of the International Monetary Fund.

But despite Beijing's drastic measures, many investors and analysts still criticize the government for not doing enough. For instance, they note, state-led buying has mostly focused on large-cap names such as the country's top-four state-owned lenders, including Bank of China, which rose 11% over the past five days, and Agricultural Bank of China Ltd., which was up 10%.

Small-cap stocks, such as those in battery maker Fuxin Dare Automotive Parts Co. and health-care provider Sichuan Maccura Biotechnology Co., have received little support from the government and rose 25% and 27%, respectively, over the past five days.

Zhong Zhengsheng, director of economic research at Hua Chuang Securities, a state-owned brokerage, said Beijing should take a page from Tokyo's aggressive response to its stock-market selloff in late 2010, when Japan's central bank started to purchase a large amount of exchange-traded funds in a bid to stop the rout.

That action later became a big driver for a stock rally in Japan, Mr. Zhong said, as it helped restore investor confidence and alleviated pressure on individual investors to keep selling.

"Confidence is more important than gold," he said.

The People's Bank of China has refrained from directly purchasing beaten-down shares but is promising what people close to the bank said would be unlimited liquidity support to China Securities Finance Corp., a company owned by the securities regulator to feed funds to brokerages for such buying.

On Wednesday, the securities regulator said the company is extending 260 billion yuan in credit from the central bank to 21 big securities firms to buy stocks.

But the more money China throws at the crisis, the likelier it is to create another pile of debt as it exhausts the stock-market option as a way to pump more life into the economy.

"The resources the Chinese government can mobilize are more than any other country in the world," said Li Xunlei, a vice president at Haitong Securities Co., a publicly-trade brokerage in China. Still, he said, "It will take time to tame the panic."

—Rose Yu and Grace Zhu contributed to this article.

Corrections & Amplifications:

Since its peak in mid-June, the benchmark Shanghai index has lost $3.5 trillion in value. An earlier version of this article incorrectly said the loss was 3.5 trillion yuan. (July 9, 2015)

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