



## A Chinese equity rollercoaster

Volatility has continued on the Australian share market over recent days as investors have become increasingly concerned over the magnitude of the sell-off on the Chinese equity market. Over the past month, China's share market has suffered sharp price falls approaching -30% for the Shanghai Composite Index. However, due to the extraordinary strength of the rally prior to this fall, the Chinese market remains around 70% above the level recorded one year ago. Locally, the S&P ASX 200 Index has followed its 5.3% decline over June with large day to day swings in value. At the time of writing (July 9<sup>th</sup>) the S&P ASX 200 Index is trading close to its July opening level of 5,459 points. Mining stocks have been hit hardest on the Australian market with BHP Billiton and Rio Tinto falling by 5% and 7% respectively since the end of June.

### Should Australian investors be concerned?

Few Australian investors hold large direct exposures to the Chinese equity market. However, if the correction on the Chinese market was to have a materially negative effect on the Chinese economy, then both the Australian economy and investment markets could be heavily impacted. Over recent days we have already witnessed commodity prices falling, which is likely to be in response to fears that a slowdown in Chinese economic growth will reduce commodity demand.

Our view, however, is that the sell-off on the Chinese equity market is an event that is driven by Chinese market specific factors and there will be minimal fallout on the real economy. In the same way the earlier doubling of Chinese share prices did not appear to have a noticeable positive impact on economic growth, we believe the impact of the current correction in prices will be largely contained.

Head of Dynamic Asset Allocation for AMP Capital, Nader Naeimi, supports the view that the fall in Chinese share prices is unlikely to be detrimental to China's economic growth and has highlighted the following reasons for this view:

1. *Most Chinese consumers have limited exposure to China's share market:* It's worth highlighting that the average Chinese retail investor has only around 10% of their assets in shares. Compare this to US investors who have around 50% of their assets in shares.
2. *The share market sell-off is not showing any signs of liquidity or banking stress:* Corporate bond markets have remained well behaved, and interbank liquidity has, in fact, improved.
3. *China's central bank cut its key interest rates again in June:* This should help support economic growth over the next year. Policy reflation in China is far from over.
4. *China's residential property market is stabilising:* Property recorded a second month of modest price gains in June.
5. *The Chinese economy is not in a recession:* China's business surveys, such as the Purchasing Managers' Indices, suggest that China's real economic growth is still running around the 6.5% pace. Fundamentals are still sound, and the recent correction has not had any impact on company earnings.

Notwithstanding our view that the Chinese share price correction may have little longer-term consequence for investors, the current higher than normal volatility can increase concern and uncertainty; as well as create opportunities.

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