



March 15, 2007 - China's Stock Market Fall – An Engineered Drop?

China's Shanghai Composite Index fell 8.8% February 27, its largest fall in a decade. This sparked a global stock market sell-off around the globe. The fall is important for two reasons; why it happened and its impact on the rest of the world markets.

For the 1st time, China's stock market was the trend setter for the rest of the world. Normally, the U.S. exchanges lead the way for global trading patterns. Not on Feb. 27. So what triggered the sell-off? It seems to have been triggered by news that communist leaders plan to reduce the level of speculative investing. This should serve as a reminder that China still runs a government controlled economy. The numbers that come out of Beijing are from a communist regime that tells us only what they want us to know. We have no way of knowing if China's economy is actually growing at 10% per year. How much of this so-called growth is from inflation? How much from spending on their military build-up? It does not matter what part of the economic cycle they are in, their growth always seems to come in around 10%. Makes me say hmmm?

History shows us that economic growth is anything but consistent. Economies naturally go through ups and downs in the growth cycle. Not China, according to their government, it is virtually always around 9-10%. A study by the University of Chicago believes the actual growth rate to be closer to 6%.

Many of you may recall back to the cold war days when the Soviet propaganda machine told us the Soviet economy was a humming along as well as ours. Some economists were elated to see the idea of a planned economy working so well. It is my understanding that the CIA even bought into the Soviets numbers. The Reds, of course, were telling us what they wanted us to know. When Reagan finally pushed Gorbachov to "tear down this wall" we saw an economy devastated by military overspending. Lots of tanks, vodka and inflation but that was all. My grandfather always told me to never trust the communists...he also said "I would rather be lucky than good." I miss him.

So what happened on Feb. 27? Apparently, the Chinese government has been concerned about the levels of money going into the Chinese stock market from politically connected government officials who started dud companies that are completely non-profitable. These people are taking out huge loans and investing in the stock market. Ordinary citizens have also started borrowing in order to play the market. The result has been a runaway stock market with less basis in fundamentals. Sound familiar? This sounds like the U.S. market in 1929 and 1999. It is amazing how history tends to repeat itself. Stock markets are run by humans so the same old emotions that took the market to unsustainable heights in 1929 and 1999 seem to possibly be at work in Shanghai in 2007.

So on Feb.26, the Chinese government started to pull on the reins of speculative investing and launched a special task force to slow down this highly speculative investing as well as slow down the flow of borrowing to these investors. The result was a massive sell-off.

Investors who do not want to miss out on the great China stock market boom may be investing in inflated growth statistics. The Pentagon recently determined the defense spending in China was well understated. If China is under reporting their defense spending, who is to say they are not fudging their GDP* growth figures in order to get more Americans to send over portions of their retirement portfolios? We don't. No one knows what is going on inside of a police state. Be careful out there!

* GDP is the monetary value of all the goods and services produced within a country's borders. It includes all of private and public consumption, government spending, investments and exports less imports.