INTERNATIONAL CHINA

# In China's stock market, good news is bad news

by Geoffrey Smith @Geoffreytsmith JULY 15, 2015, 4:43 AM EDT


**Shoppers walk past signs for a sale at a fashion outlet in a shopping mall in Beijing on July 15, 2015. China's economy expanded 7.0 percent year-on-year in the second quarter,.**

Photograph by Greg Baker — AFP/Getty Images

## The economy grew 7% year-on-year in 2Q, beating expectations–but the market resumed its downward slide.



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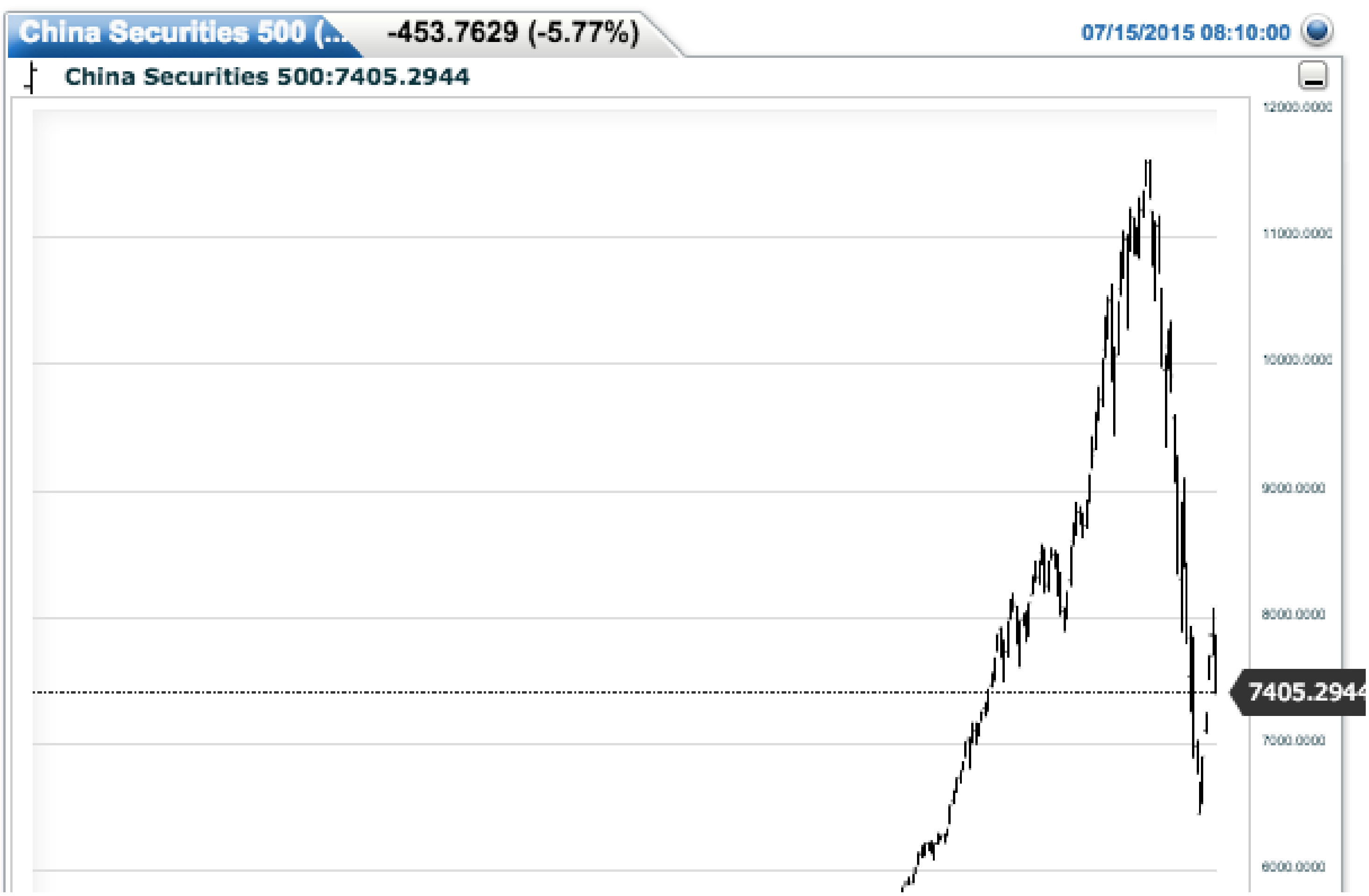
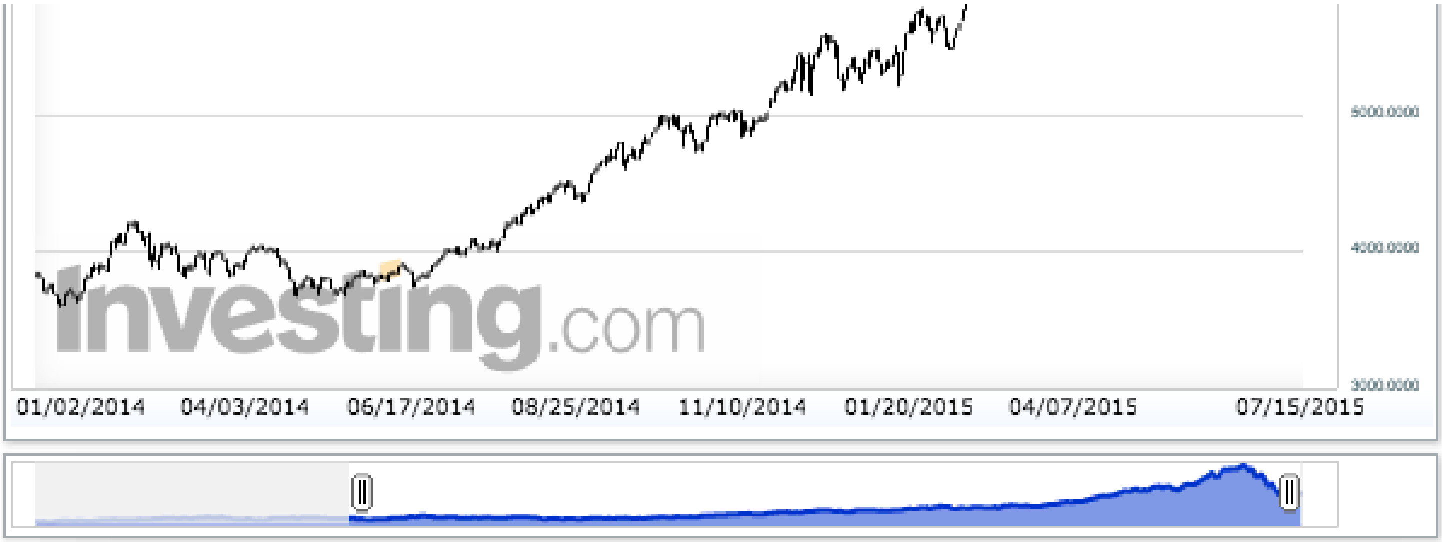
Mainland Chinese stocks fell heavily Wednesday, even though the country's second-quarter gross domestic product forecasts beat expectations, showing that the economy grew 7% from a year earlier. Analysts had forecast only 6.8%.

But the Shanghai Composite index fell 3.1% and the China Securities 500 index, which comprises the small-cap stocks which have attracted the bulk of the hot money flowing in from leveraged retail investors, fell another 5.8%. It's down 36% from its peak in June (but still up over 40% since the start of the year).






**How far do Chinese stocks have to fall before they stabilize?**

That's because the markets are trading not in reaction to fundamentals, but in anticipation of fresh measures by the government and central bank to prop the market up. With the real economy outdoing expectations, the chances of more stimulus measures–in other words, more money thrown at the market to stop the bubble deflating–have fallen.

Earlier, the National Bureau of Statistics had said the economy showed "moderate but steady growth" in the quarter, in the face of "complicated external and domestic economic conditions and increasingly downward pressure."

Analysts reacted skeptically to the figures, which revived long-standing concerns about the reliability of China, especially when growth falls shorts of the government's targets.

Most of the individual components of growth appeared to be slowing down in the second quarter: investment growth slowed from 13.5% to 10.3%, and retail sales growth slowed to 10.2% from 10.5% in the first quarter.

Craig Botham, emerging markets economist for asset management firm Schroders in London, said it was "odd" that GDP didn't slow too–"our in-house model pointed to a consistent growth rate of around 6.3%, down from 6.9%."

Botham stopped short of accusing Beijing of "fudging" the numbers. But he pointed out that the factors that appear to have been behind the upside surprise are unlikely to be sustainable. The financial sector, he noted, had added 0.5% to GDP growth in the first quarter due to the boom in lending that supported the equity bubble. That went into reverse in the second quarter and is likely to continue in the next three months, he said. Additionally, he said, net exports probably contributed “a sizeable chunk” of GDP in the second quarter–not because export volumes are booming, but because the price of key imports such as oil and iron ore were collapsing. The NBS didn’t give a detailed breakdown of contributions to the GDP number.

“The performance in Q2 looks to have been built upon shaky foundations, rather than the solid rock of self-sustaining growth,” Botham said. “The biblical house built upon sand ultimately fell with a great crash as the weather turned against it – the same fate may not await China, but all sandcastles ultimately crumble.”

Perhaps Mr. & Mrs. Wu’s reaction in the stock market was right after all.