China’s financial sector won’t suffer hard landing

By Sun Lijian

The potential risk of financial panic has been occupying the headlines in foreign media reports recently. Amid stock market fluctuations and an increase in bond defaults, some investors' confidence in China's financial market has been shaken. But this lack of confidence will not limit China's progress.

China's financial market is facing dual pressure from internal reform and external trade tension provoked by the US. However, since the capital account is still relatively closed, China's financial sector is not likely to experience a hard landing.

Weak confidence in financial markets can be seen all over the world. Every now and then, excess liquidity and asset bubbles in developed countries create financial crises that hit the global market. This damages consumption in the developed countries, and has a negative effect on emerging markets.

Risk aversion is therefore common, and it exacerbates the fragility of financial markets. Bearish signals can lead to a massive sell off in the stock markets, which then makes the situation worse.

As a result, numerous emerging markets have begun to seek their own solutions. Limited by their development stage and income level, most of them resort to government bailouts. This happens in developed countries as well, but it can undermine the stability of asset prices worldwide.

As a result, with trade protectionism having increased globally, countries such as Argentina, Turkey, Brazil and Russia are facing looming currency risks and the potential outbreak of financial crises.

The governments in those nations can do little to stop the crises from happening because their capital accounts allow outflows of cash.

This is unlikely to happen in China since the opening-up measures haven't extended to the capital account yet, and the effects of external factors can be resisted to a large extent.

Considering the domestic situation, there are two main reasons for the low confidence in China's financial market.

First, in order to regulate improper behavior, China's stock market is undergoing reform, and this has had an impact on asset management.

In the past, some listed companies took advantage of the relatively loose monetary environment, counting on government bailouts. But shadow banks and other rule-violating businesses will be

hit by the effects of the new asset management guidance issued by China's financial regulators on April 27. This is part of the inevitable cost that must be paid in the process of optimizing our financial markets.

Second, the Sino-US trade friction has challenged our innovation-driven strategy and has affected economic fundamentals. A number of listed high-tech companies are having to stay on their toes and their future growth is full of uncertainty. Due to the close correlation between trade friction and these companies' performance, more investment barriers are expected.

We are now experiencing both of these factors. The current situation requires proper implementation of the new asset management guidance according to the current trade tension. Otherwise there could be systemic risk.

Before our capital account is fully open, the Chinese government can stabilize the market. We are completely confident in keeping to the bottom line of our financial market. There is little risk of the Southeast Asian financial crisis or the bursting of the bubble in Japan being repeated in China.

But keeping the capital account closed in the long term would definitely affect the process of the yuan's internationalization. China will keep its promises and will stick to financial reform and opening-up, but we will control the pace carefully. By comparing the cost of financial market collapse with the benefits of the yuan's internationalization, I believe China will form its own judgment.

Source: People’s Daily/Global Times