EIR Economics

China moves to head off new 1929-style crash

by Mary Burdman

On Dec. 16, official Chinese government agencies imposed strict controls on individual stock price movements on the Shenzhen and Shanghai exchanges, and published a front-page commentary in *People's Daily,* China's newspaper of record, which warned: "The present overheated state of China's share markets makes us think of the stock crash in America in 1929." The commentary was reported on national television the night before, and was subsequently covered in other Chinese press, including the international *China Daily.*

These steps were taken just days after U.S. Federal Reserve Chairman Alan Greenspan on Dec. 5 attacked the "irrational exuberance" of the stock markets. The fact that those two words triggered significant volatility in various markets around the world over the following days, is a clear marker of how precarious the international financial situation is. Whatever Greenspan's ultimate intentions may have been, his words, and the market volatility following them, were noted carefully in China.

While the Chinese stock markets are small compared to Western markets, over 20 million Chinese are investors, most small-scale. The government still terms the stock markets "experimental." Since April 1996, speculation has been rife, with the Shenzhen market going up 340%, and Shanghai 120%.

In addition to the market controls, China's Securities Regulatory Commission announced that it had stripped two state-run newspapers, the Shenzhen *Securities Times* and the Shanghai *Securities News,* of their status as required outlets for listed companies' public statements, because these papers had failed to print an official editorial aimed at calming the markets.

The most public warnings since 1994-95

These have been the most public warnings in China on the dangers of a financial crash, since the turn of the year 1994-95. In November 1994, Prime Minister Li Peng of China was the first head of any government in the world, to make the danger of a new "Black Friday" financial crash a matter of open diplomacy. In a meeting with the directors of the American Dow Jones & Co. at that time, Li responded to a question about future convertibility of the Chinese currency by saying: "If our currency is convertible, another Black Friday crash in the U.S. would hurt China." He added that China's stock markets were "still at a trial stage," and that the government has a "cautious attitude" toward developing these markets.

Li Peng spoke in the wake of a series of scandals, in which Chinese commodities traders were lured into massive speculation on the London and other markets by Lehman Brothers and other City of London and Wall Street firms. Chinese regulators imposed strict controls on speculation, and a spokesman of the China International Trust and Investment Corp. (CITIC) noted that "certain foreign counterparts" who promoted derivatives speculation "have got some screw loose in their own house." The subsequent debacle in Mexico, and the collapse of Britain's Barings Bank, confirmed the official's concerns.

Lyndon LaRouche's analysis of the ongoing world economic collapse, has had a big impact in China. Articles on the dangers that "financial AIDS" pose for China, using extensive documentation from *EIR,* by Jonathan Tennenbaum, and on the decades-long battle between the forces of the "Just New World Economic Order" and the British free-trade empire, by this author, were published early this year in one of China's leading economic journals.

However, despite the clear commitment of China's government to real, physical economic development, as epitomized in the strategic policy of the Eurasian land-bridge, Beijing is not prepared, at this time, to "rock the boat." China is making every effort to protect itself from "financial AIDS," and, with its huge population, basic self-sufficiency in food supply, and infrastructure development, could weather the coming disintegration better than almost any other nation. But, while not "joining the club" of the collapsing world economy, in the way that Southeast Asian, Ibero-American, and other developing sector nations have, China is still giving credibility to the importance of futilely trying through certain institutions, such as the Bank for International Settlements (BIS), which are futilely trying to save the doomed international financial system.

When the BIS invited China to become a member last September, the People's Bank of China welcomed the invitation, because membership will enable it "to closely follow the major international financial developments," and to broaden Chinese regulators' contacts with their financial counterparts throughout the world, which will help improve the Chinese financial industry's regulatory and supervisory system, *China Daily* said.

The view among some circles in China, that such financial centers as Singapore might represent some kind of stability, due to internal regulation, gives credibility to claims of some in the West, that a financial collapse might be "controlled" by tough crackdowns on "erring" poorer nations. Western sources, for example, who argue that the Mexico crisis was due to poor management, seem to still have an ear in Beijing.

Most serious, is that, up to now, the Chinese government has not stated that a fundamental reorganization of the world financial system is essential, in order to finance development projects such as the Eurasian land-bridge. The furthest a Chinese leader has gone, were the statements by Chinese President Jiang Zemin, calling for a new world economic order. On May 13, 1996, in a speech to the Organization of African Unity in Addis Ababa, Jiang said that China and Africa should join hands to establish, at an early date, a just and equitable new international political and economic order, based on the Five Principles of Peaceful Coexistence, and also to advance world peace, development, and progress. "China steadfastly supports African countries in their efforts for economic development, and will continue to provide, within its own means, government assistance to them with no strings attached," Jiang said.

Defensive measures

The most recent steps taken in China are more defensive than offensive. Among these is the build-up of huge foreign exchange reserves, now at over $100 billion, second highest in the world. When Hongkong reverts to Chinese sovereignty on July 1, China will add Hongkong's $60 billion to that amount. In addition, the Bank of China, the official foreign exchange bank, holds about $60 billion in convertible foreign currencies.

It is reported that one reason the Chinese government acted to control speculation, was to prevent disruptions of China's financial system, by foreign and domestic speculators, who had planned to flood the markets with funds until the June 30, 1997 return of Hongkong to Chinese sovereignty, and then pull out. Hongkong's Foreign Exchange Fund, the basis of the Hongkong dollar's peg to the U.S. dollar, could be looted by capital flight, obviously a concern for Beijing.

Vice Premier Zhu Rongji noted on Dec. 23, that one of the reasons for building up these reserves was to prevent a speculative onslaught against the Hongkong dollar after July 1. "There will be no financial crisis like the Mexico crisis," the *Hongkong Standard* quoted Zhu saying.

In its Dec. 16 commentary, *People's Daily* raised the possibility of a total collapse, at least in China, on the scale of 1929. With the stock markets "skyrocketing," "we should have a sober understanding of the current situation of China's stock market," it said. While the rapid growth over this year reflects the rising global stock markets and improving domestic economic situation, "the sharp increase in recent months has been abnormal and irrational," with Chinese price-earnings ratios exceeding those even of Germany or New York. "Irregular activities" have been proliferating.

The commentary warned of "manipulation of the market by major institutional investors," most of them state enterprises, and irregular operations by banks and securities firms. The "media added fuel to the fire."

But, *People's Daily* warned, "a drastic rise is bound to lead to a drastic fall, and there is no exception to this in stock markets at home or abroad. . . . The overheated stock market in China reminds us of the 1929 stock crisis in the United States. [Then,] people of all strata were talking about stocks. . . . That was the so-called 'flock of sheep effect.'. . . The market witnessed a plunge that shocked the world. . . . As a result, many banks and companies went bankrupt, and large numbers of individuals were reduced to poverty and ruin. China's shareholders should draw a lesson from stock crises in the world."

The commentary cited the collapse of Japan's "highly bubbled" markets in the 1980s, and reviewed the drastic rises and falls of China's own stock markets in recent years. "The consequences of the drastic rise or fall of stock prices are serious to both the investors and the community. Taking the 'black Monday' in October 1987 for example, the Dow Jones index dropped by 23% in a single day, bringing the cumulative weekly decline to 31%. Market losses totalled $1 trillion. . . . At the end of 1994, Mexico experienced a financial crisis which shocked the world."

In China, many institutions and individuals with illusions about stock markets, also assume that the government "will never let the stock market plummet" in the face of such important events as the return of Hongkong to China and the 15th Chinese Communist Party Congress in 1997. This, *People's Daily* wrote, "is a very muddled view. [The government] will definitely not prop up the market when prices are falling."

"Pursuing a bubble economy regardless of the objective conditions would be lifting a rock only to drop it on one's own toes," the commentary stated, and it noted all the measures taken by the government since the end of 1992 to regulate "China's changing financial system."

The steps to be taken

People's Daily then listed the steps to be taken to bring the system under control. "It is imperative to do a good job of the following work based on the principle of *strengthening supervision, increasing supply, giving correct guidance, and maintaining stability*. . . . First, a general investigation will be carried out across the country to spot illegal and irregular activities in stock trading. . . . Second, *cases of irregularities will continue to be dealt with publicly*.. . . Third, *it is necessary to implement a system of setting limits for price fluctuations, and improving and perfecting the system of open market information*" (emphasis in original).

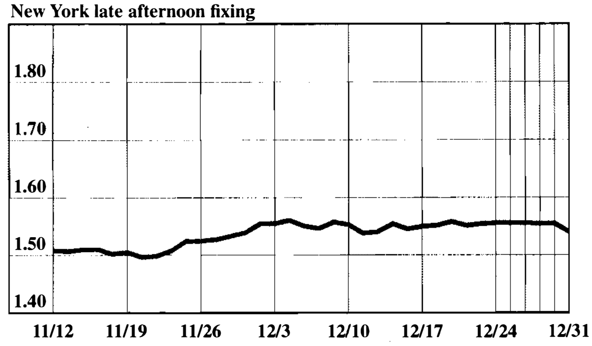
Control of the media, strengthening risk management, and increasing supplies to meet the demand of mass investors will also be carried out. But, *People's Daily* urged, "bank savings are still a stable and most reliable means of investment." Indeed, savings remain the preferred method of Chinese for investing their money. Savings deposits increased to RMB 3,791.7 billion ($475 billion) by the end of November 1996, up 31.5% from January.

The current crackdown on speculation follows the move by the central bank, the People's Bank of China, to close down 133 of 570 "non-bank" financial institutions Nov. 9. Another 58 of these "para-bank" institutions have had their permission to operate suspended until further clarification, while the rest will be allowed to re-register and continue operations.

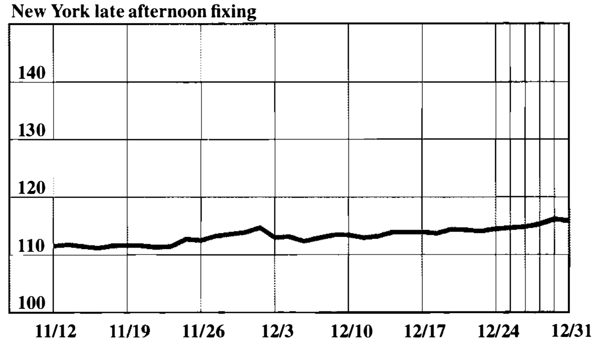
These measures were the result of an investigation carried out under the July 1995 banking law, under the direction of Zhu Rongji, during summer 1996. Among the institutions closed, or threatened with closure, are "subsidiaries" of the four biggest state-run banks in China (the Bank of China, People's Construction Bank, Agricultural Bank, and the Industrial and Commercial Bank), as well as numerous smaller provincial and city "credit cooperatives," which have set up these "para-banks" as the result of the strict credit controls imposed in 1993. The People's Bank issued regulations to increase supervision of such financial firms, and foreign-funded financial companies in China. Only very sound corporations will be allowed to set up financial institutions: They must have total assets of at least 1.5 billion yuan ($180 million), annual business income of 5 billion yuan, and profits of no less than 200 million yuan. Minimum assets of the financial firms must be 100 million yuan. While they are allowed to offer credit, settlement, and other services, including floating bonds approved by the central bank, they are forbidden to conduct transactions in futures, stocks, and other money-generating operations. Real estate investment is limited to the institution's own use, and they cannot buy shares or bonds not issued by their own member units.

Currency Rates

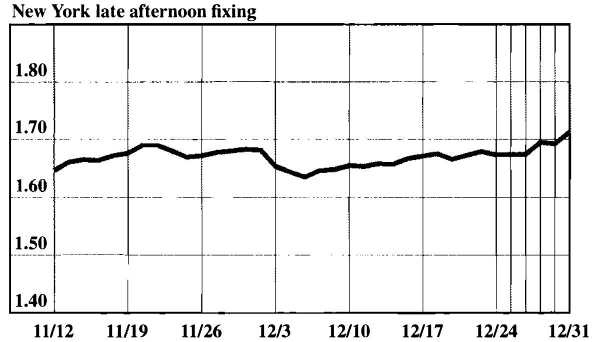
The dollar in deutschemarks
New York late afternoon fixing



The dollar in yen
New York late afternoon fixing



The British pound in dollars
New York late afternoon fixing



The dollar in Swiss francs
New York late afternoon fixing