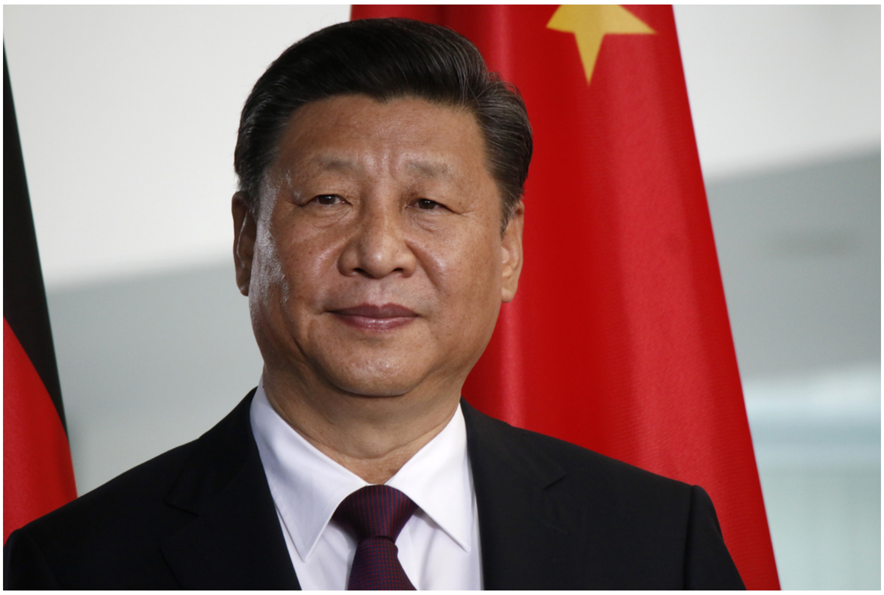
Will the optimism last?

Chinese authorities have stopped the rot in stocks with confidence-boosting comments and supporting policies...will it last?



Source: Shutterstock

Can this be sustained? Probably

Equity markets are driven by confidence. Sure, at the margin, valuations, momentum and investment themes can all matter. But sap the underlying support of confidence, and that all comes crashing down.

Yesterday, a combination of supportive comments from everyone that mattered, from President Xi's "unwavering support", to Vice Premier Liu He, to the head of the central bank, the banking watchdog and head of securities regulation, all came out in support of the stock market. Backing up the comments were policy changes, an income tax cut worth perhaps 1% of GDP, business tax cuts and additional funding for local governments to finance infrastructure and lend to smaller firms in the private sector. on the day, this was enough to deliver the biggest gain in the Shanghai composite index for around three years.

Now the question is, can it last, and will it go further?

Needs must

Having pledged support for the private sector from the highest levels, I don't believe that this is just hot air. If more money needs to be spent, it will be. If more funds need to be pledged to the SME sector, they will be. If financial sector regulation needs to be loosened, this will happen.

And this needs to be the case because default rates in China have been picking up. Many firms use their own equity as collateral pledged to obtain loans. At the sorts of level the Shanghai composite was reaching before the support was offered, many of these loans would have been callable, and not all of them would have been fully met, so this had to happen. And more may need to be done.

But China is not the entire world

However, recent events remind us that there is a lot more to what happens to the Chinese stock market than domestic policies and support. The recent jitters in the US stock market show that global investor sentiment remains shaky. Geopolitical concerns are rising high at the moment, with US President Trump threatening to pull out of nuclear arms agreements with Russia, and the aftermath of the Khashoggi murder lingering over energy markets. The trade war is far from over and could get worse. It seems miles away from China, but the European standoff with Italy over the Italian budget and ongoing stalemate over Brexit could also tinge general market sentiment in a way that could spill over into renewed EM anxiety requiring more support.

In short, while I do not doubt the Chinese authorities intentions and actions to stem the rot in local stocks, I am concerned about the extent of their firepower against any global turn in confidence.

Day ahead - more supportive commentary would be helpful

With little on the economic calendar to get too excited about in Asia (Bank Indonesia - not expected to hike, and Singapore September CPI) or the G-7 (practically nothing), today would be a good day for the Chinese authorities to come out and supplement weekend and yesterday's comments with further reassurance, actions and even further policy announcements. If yesterday's move turns into a one-day wonder, then much of the latest effort will have been wasted. And with US stocks weaker overnight, the authorities still need to maintain their pressure against the tide of market sentiment. Stocks, as we said at the beginning, are essentially confidence driven beasts. That confidence, though improved, is still vulnerable to any adverse news, and will need supporting for some time. This is not over.

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