Greece and China expose limits of 'whatever it takes'

REUTERS, London

FOR a world so confident that central banks can solve almost all economic ills, the dramas unfolding in Greece and China are sobering.

"Whatever it takes," Mario Draghi's 2012 assertion about what the ECB would do to save the euro, best captures the all-powerful, self-aware central bank activism that's cosseted world markets since the banking and credit collapse hit eight years ago.

From the United States to Europe and Asia, financial markets have been cowed, then calmed and are now coddled by the limitless power of central banks to print new money to ward off systemic shocks and deflation.

But even if you believe central banks will do whatever it takes - to save the euro, stop the recession, create jobs, boost inflation, prop up the stock market and so on - it doesn't necessarily mean it will always work.

Draghi himself merely pleaded for faith on that score three years ago when he added, "Believe me, it will be enough."

Critically, given the direction of events in Athens, his celebrated epigraph was preceded by "Within our mandate..."

And so the prospect of the European Central Bank potentially presiding over, some say precipitating, the first national exit from a supposedly unbreakable currency union will inspire a rethink of the limits of Draghi's phrase for all central banks.

Of course, the ECB does not want to push Greece out of the euro. But 'whatever it takes' may just not be enough to preserve the integrity of the 19-nation bloc if the ECB's mandate prevents it from endlessly funnelling emergency funding to insolvent Greek banks.

And as long as the Greek government is at loggerheads with its creditors, the central bank can't wave a magic wand of monetary support without breaking its own rules.

The ECB continues to insist it will do all in its power to prevent contagion to other euro zone markets and there's little doubt it will make good on that. But the problems stemming from a Greek exit are not of financial seepage but of political contagion to other euro electorates tiring of austerity. And that sort of contagion is beyond ECB control.

AFP

Greek Prime minister Alexis Tsipras, *left*, and German Chancellor Angela Merkel meet at the European Union headquarters in Brussels on Tuesday.

Switch across the planet and another test of central banking determination and effectiveness is playing out.

The once awesome ability of the People's Bank of China to micro-manage the world's second largest economy and one of the globe's biggest stock markets is being sorely challenged.

Having helped inflate a bubble-like doubling of Shanghai stocks with easy money over the past year, the PBOC, along with government regulators, is now desperately trying to control a sudden implosion that's wiped 30 percent and $3 trillion off equity values in just three weeks.

The worrying bit is that after cutting interest rates and bank reserve requirements in late June and then last weekend injecting liquidity into a state-backed margin finance company, the PBOC barely got any market response.

Given that 85 percent of share trading in China is conducted by small retail investors, the economic ripples on consumer sentiment could be sizeable for an economy slowing to below 7 percent for the first time since the financial crisis.

Economists at Schroders point out, for example, that booming brokerage business saw a near doubling of the financial sector contribution to GDP growth to 1.3 percent in the first quarter.

But the loss of PBOC control, however temporary, asks yet another question of the omnipotence of central banks.

"If the PBOC fails to support its equity markets, it will be the first major central bank to have failed trying to influence the targeted asset markets," said Stephen Jen at hedge fund SLJ Macro Partners. "Investors could wonder if central banks in general may be approaching an inflection point with diminishing returns on their operations."

The point is not lost on those tasked with monitoring the world's central banks.

Economists at the Bank for International Settlements warned on June 28 that a loss of control by central banks, now painfully short of new ammunition to deal with either a major market crash or a sudden world downturn, was one of the most worrying threats to the world financial system.

"Monetary policy has been overburdened for far too long," the BIS said in its 85th annual report, arguing deep-seated economic reforms must now be stepped up to take the pressure off over-easy monetary policy and highly indebted governments.

"The likelihood of turbulence will increase further if current extraordinary conditions are spun out. The more one stretches an elastic band, the more violently it snaps back."

US and UK central banks, fearing zero rates are not only causing investment distortions but also societal problems due to ballooning wealth inequality, have indeed been flagging the likelihood of interest rate rises over the coming months.

But their ability to do whatever it takes to achieve that may be more clipped than it was when they were easing.

If China or a Greece-less euro zone were to blow up into another financial shock that hit global economic confidence, the Federal Reserve and Bank of England could well find themselves trapped at zero, having never reset interest rates during one of the longest financial bull markets in history.

What happens at that point starts to look a bit scary.

India's push to curb steel imports could hit its small mills

REUTERS, Mumbai/London

Steps by India to protect its large steelmakers from a flood of cheap imports could end up closing scores of small, local firms that process the metal, industry analysts and executives said.

These processors currently buy imported steel at up to 20 percent below India's pricier, domestic steel, turning it into finished steel products for industrial use.

But after months of lobbying by its largest steelmakers such as JSW Steel Ltd and Tata Steel Ltd, India last month raised duties on some steel imports by up to 2.5 percentage points, with more increases expected.

India's steel imports had jumped around 70 percent to over 9 million tonnes in the year to end-March, with a surge of cheaper purchases from China accounting for about a third of the total. Imports soared 55 percent in April-May.

The duty hike, along with proposed steps to tighten quality controls on steel imports, should curb shipments into the country this year, industry experts said.

While that should help large steelmakers, it will pile more pressure on small steel processors, already grappling with faltering demand as the real estate sector slows. Often family-run, these firms account for almost 60 percent of the India's overall steel sector, according to one industry body.

"If imports get reduced, the integrated steel mills will start charging higher prices, irrespective of international price trends ... secondary steel producers will not be able to survive," said Mohan Gurnani, President of the Federation of Associations of Maharashtra, which represents over 750 small associations and traders.

Steel ministry officials did not immediately respond to requests for comment.

Morgan Stanley estimates that the 2.5-percentage point duty hike could potentially boost Tata Steel earnings per share by 14 percent next year, Steel Authority of India's (SAIL) by 33 percent and JSW Steel by 30 percent.

"Import orders should reduce meaningfully from here as traders will become apprehensive of further increases in duties in some shape or the other," the bank said in a note.

India's largest steelmakers have been badly hit by high debt, interest costs and low appetite.

China stocks plunge as government efforts fail

AFP, Shanghai

China stocks took another plunge Wednesday, as the securities regulator warned the market was in the grip of "panic" selling after fresh government moves failed to arrest a rout that has now infected regional markets.

Confidence took a hit as trading halts expanded to cover more than 1,300 companies -- nearly half of mainland listings -- to prevent further sharp declines in their stock prices.

The benchmark Shanghai Composite Index closed down 5.90 percent, or 219.93 points, to 3,507.19. The Shenzhen Composite Index, which tracks China's second exchange, dropped 2.50 percent, or 48.38 points, to 1,884.45.

"There's really panic out there," Tony Chu, a Hong Kong-based money manager at RS Investment Management Co., told Bloomberg News. "I wouldn't suggest catching the falling knife."

The latest tumble came despite the government announcing new measures to support the market, including allowing insurance companies to invest more assets in stocks and a programme to buy the shares of smaller companies.

"Investors' panic and irrational sell-off caused a liquidity strain on the stock market," Deng Ge, a spokesman for the China Securities Regulatory Commission (CSRC) -- the market watchdog -- was quoted by state media as saying.

Asian bourses, already under pressure from the protracted Greek debt crisis, also posted sharp declines as contagion from the rout in China spread, with investors running for safe-haven assets such as the yen.

Hong Kong equities plunged 5.84 percent to their lowest close since early January, Tokyo dropped 3.14 percent and Sydney retreated 2.01 percent.

US-listed Chinese stocks were also marked down overnight despite gains across all three main indexes on Wall Street.

By the close on Wednesday, the Shanghai market was down 32 percent from its peak on June 12, when it had risen by more than 150 percent in 12 months, in a borrowing-fuelled frenzy powered by millions of new retail investors.

Analysts say the resulting deep correction has been mainly triggered by new restrictions on margin trading -- a practice that magnifies both profits and losses -- and accelerated by concern about overvaluations.

How the bubble bursts

AFP, Shanghai

TENS of millions of retail investors in China are learning a hard lesson as once high-flying stock prices plunge, sparking sadness and anger.

In Shanghai, China's financial capital and home to one of the mainland's two stock exchanges, the euphoria of the last year has vanished as investors grapple with uncertainty. Here are some reasons behind the plunge.

Why did the market surge?

China's stock market surge started in late 2014 despite the economy experiencing its slowest growth in 24 years.

The borrowing-fuelled rally began after the central bank cut interest rates on November 21 for the first time in more than two years, and the launch of a scheme linking trading between the Shanghai and Hong Kong stock exchanges.

The rally continued in 2015 with the benchmark Shanghai index climbing to the symbolic 5,000-point level in early June, driven higher by margin trading, through which investors only need to deposit a small proportion of the value of their trades, generating bigger profits but also potentially exposing them to bigger losses. When it peaked on June 12 it had risen more than 150 percent over the previous 12 months.

Why did it fall?

On the same day as the market reached its peak, China's securities regulator said it would tighten rules on margin trading for individual investors. The following day, the China Securities Regulatory Commission (CSRC) also banned trading with funds borrowed outside the margin trading system.

When markets reopened investors started to take profits on worries of over-valued stock prices and increasing market risk.

The de-leveraging process soon became uncontrollable, resulting in Shanghai plunging more than 30 percent since the peak. Market sentiment has worsened as investors who traded on margin were forced to liquidate their stock holdings to make payment.

What's being done to support the market?

The Shanghai index plunged 7.4 percent on June 26 and the next day China's central bank announced cuts in both interest rates and the reserve requirement ratio -- the amount of money banks must put aside.

The market regulator then announced a relaxation of margin trading rules and reduced stock transaction fees.

Soon after the government announced proposals to let social security pension funds enter the stock market. The CSRC cut back on the number of initial public offerings (IPOs), then went a step further by halting them for the near future.

On Wednesday, the government said Chinese insurance companies will be able to invest up to 10 percent of their assets in a single "blue chip" stock, up from the previous five percent.

Separately, the state-backed China Securities Finance Co. will "increase" stock purchases of small- and medium-sized companies, with liquidity support from the country's central bank.

As of Wednesday, the market regulator had suspended trading in more than 1,300 listed companies at their request to prevent further falls in stock prices.

What happens next?

No one really knows and the market remains wildly volatile. Investors forced to sell could drive prices lower, or bargain-hunters could see a buying opportunity and step in.

"With investors' confidence towards the market shattered, it's really hard to tell when it will start to stabilise and recover from recent falls," Haitong Securities analyst Zhang Qi told AFP.

What are the possible consequences?

Some analysts believe the stock market plunge may hurt the economy, the world's second largest, and could spark social unrest though the single-party state keeps a tight grip on dissent.

There are estimates that stock trading activity added more than half a percentage point to China's economic growth in the first quarter, and a slowdown in the financial sector could have a wider impact.

"The slumping Chinese stock market has raised concerns of systemic risks," ANZ Banking Group said, though it added the stock rout had yet to become a crisis.