Stocks Are Crashing in Shanghai

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The major U.S. stock indices gapped sharply lower at yesterdays opening, with the S&P 500 opening down 16 points in the first two minutes of trading amid increasing fears surrounding the steepening stock market crash in China and the lack of definitive progress in making much needed funding available to Greece in Europe. Strangely enough, the selloff in U.S. stocks coincided with European stock markets ending their Wednesday sessions materially higher.

In China, the Shanghai Composite plunged again on Wednesday even as regulators worked feverishly to contain a crisis that has now erased trillions of dollars in market capitalization from the country's stock markets. On Wednesday, the Shanghai Composite closed down 5.9%, off the session low of 8.1%, but with a large number of issues opening down the daily threshold of 10%.

In Hong Kong, the Hang Seng Index lost 5.8%, while the smaller Shenzhen Composite fell 2.5%.

The Shanghai Composite is now down 32% in just three weeks, with the Shenzhen Composite down 41%. By Tuesday's close, over 1,430 firms (51% of the market's 2,778 listed securities) had elected to halt trading in their shares where estimates of total losses now measure $3.25 trillion. With at least 1,331 companies halted on mainland exchanges, and another 747 plummeting by the 10% daily threshold, sellers were locked out of *72% of the Chinese market*.

Panicked investors and traders sought alternatives, ranging from government bonds, Hong Kong shares and commodity futures, to raise cash, sparking heavy losses in Hong Kong and sending China's one-year note yield up by the most on record.

In 12 straight days of decline, the unwinding of huge quantities of margin debt - which had soared five-fold in recent months - has been a big component underpinning the speed and persistency of the stock market collapse.

As illustrated in the chart above, the recent decline in Shanghai has followed a similar pattern to the Great Crash of 1929, which over took the NYSE earlier last century, huge quantities of margin debt were also a key driving force in the speed of that historic collapse.

To put the recent Shanghai losses in perspective, at $3.25 trillion, the losses in China's stock market are now bigger then the size of France's entire stock market and are nearly 60% of the market capitalization of the Japanese stock market, the second largest in the world. The decline in Chinese stocks is centered upon a growing awareness that Chinese economic growth is now the weakest since 2009, and that China could be moving into recession.

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