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Shanghai Shares Rebound Nearly 4 Percent; China Says No Plans to Tax Capital Gains

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The Associated Press

SHANGHAI, China - Chinese stocks recovered Wednesday following their worst plunge in a decade as regulators shifted into damage control, denying rumors of plans for a 20 percent capital gains tax on stock investments.

The Shanghai Composite Index gained 3.9 percent to 2,881.07 after opening 1.3 percent lower. On Tuesday, it tumbled 8.8 percent, its largest decline since Feb. 18, 1997.

Bullish comments in the state-controlled media appeared to reassure jittery domestic investors, who account for virtually all trading.

China will focus on ensuring financial stability and security, the official Xinhua News Agency cited Premier Wen Jiabao as saying in an essay due to be published in Thursday's issue of the Communist Party magazine Qiushi.

Markets across Asia were still rattled, with many falling for a second day. Japan's benchmark Nikkei Index sank 2.85 percent, while stocks in the Philippines tumbled 7.9 percent. Malaysian shares fell 3.3 percent, while Hong Kong's market fell 2.5 percent.

On Tuesday, concerns about possible slowdowns in the Chinese and U.S. economies sparked Wall Street's worst drop since the Sept. 11, 2001, terror attacks. The Dow Jones industrial average lost 416 points, or 3.3 percent.

Analysts said they expected China's stock market to stabilize and keep climbing over time although further near-term declines were possible given concerns that prices may have risen too precipitously in recent months.

Tuesday's "sell-off does not reflect any fundamental change in the outlook for China's economy," Yiping Huang and other Citigroup economists said in a report released Wednesday. "A sharp contraction in excess liquidity that would reinforce damage in the stock market remains unlikely," it said.

China's big institutional investors are all state-controlled and would be unlikely to sell so heavily as to completely reverse gains that more than doubled share prices last year. With a key Communist Party congress due in the autumn, the authorities have a huge stake in keeping the markets on an even keel.

"They are acting now to nip a nascent bubble in the bud," says Stephen Green, senior economist at Standard Chartered Bank in Shanghai, adding that it's a challenge given generally bullish sentiment and the massive amount of funds available for investment.

"So they have to somehow calibrate the rhetoric and policy actions to keep a lid on this, while not triggering a collapse," Green says.

One option is a capital gains tax on stock investments. Rumors that such a tax may be enacted are thought to have been one factor behind Tuesday's sell-off.

But the Shanghai Securities News ran a front-page report denying those rumors. The newspaper, run by the official Xinhua News Agency and often used to convey official announcements, cited unnamed spokesmen for the Ministry of Finance and State Administration of Taxation.

China has refrained from imposing a tax on capital gains from stock investments, largely because until last year the markets were languishing near five-year lows. The Shanghai Securities News report cited officials saying that the government had little need to impose such a measure now, given that tax revenues soared by 22 percent last year.

The exact cause of Tuesday's decline in China was unclear, given the lack of any significant negative economic or corporate news.

Some analysts blamed profit taking following recent gains: the market had hit a fresh record high on Monday, with the Shanghai Composite Index closing above 3,000 for the first time.

Others pointed to comments by former Federal Reserve Chairman Alan Greenspan, who warned in remarks to a conference in Hong Kong that a recession in the U.S. was "possible" later this year.

Adding to those factors was a persisting expectation that China might impose further austerity measures, such as an interest rate hike, to cool torrid growth: China's economy grew 10.7 percent last year the fastest rise since 1995 and most forecasts put growth at between 9.5 percent and 10 percent this year.

China's markets took off after a successful round of shareholding reforms helped alleviate worries over a possible flood of state-held shares into the market. Efforts to clean up the brokerage industry and end market abuses also helped.

Their confidence renewed, millions of retail investors began shifting their bank savings into the markets in search of higher returns last year. Strong buying by state-controlled institutional investors and overseas funds also helped.

China still limits foreigners' purchases of the yuan-denominated stocks that make up the biggest share of the markets, though that is gradually changing as regulators allow increasing participation by so-called qualified foreign institutional investors.

Stocks have shown unusual volatility this year, with the Shanghai index notching one-day drops of 4.9 percent and 3.7 percent already this year before recovering to hit new records.

But there are limits to how far shares are allowed to drop in a single trading day: total single-day gains and losses are capped at 10 percent.