Impact of Economic Fluctuation on Financial Market——Based on the Chinese Market

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Abstract: The operation and development of market economy itself has limitations, and there may be instability and volatility in the process of economic operation. Under the condition of the development of modern market economy, the financial market is an important part of the market economy, which can realize the function of adjusting the allocation of resources and widening the financing channels. With the implementation of the socialist market economy system in China, the Chinese government can carry out strong macro-control over the market economy. Under the macro-control of the government, the fluctuation caused by the defects of the market economy has a relatively small impact on the financial market. The government can take a series of economic measures to influence the market, so as to promote the sustained and stable development of the financial market. The government and investors should make a scientific understanding of the development characteristics of the market economy in China, and the government should regulate and manage the financial market and take the important role of ensuring the smooth operation of the economy. The investors should take into account the influence of the economic fluctuation on the market and make a scientific judgment on the development of the market when the investors are involved in the financial market transaction.

1. Introduction

Since the reform of the economic system in China in 1978, the Chinese economy has maintained a rapid growth since the introduction of the "reform and opening up" policy. The rapid growth of Chinese economy is accompanied by economic fluctuations, according to the National Bureau of Statistics. Chinese real GDP has an average annual growth rate of 9.59% since the reform and opening-up, but the magnitude of the economic fluctuation (standard deviation) is reach to 7.24%.With the rapid growth of Chinese economy, Chinese financial industry has also developed rapidly. By the end of 2018, the balance of broad money supply (m2) in China was 182.67 trillion yuan, the balance of deposits in local and foreign currencies of financial institutions was 182.52 trillion yuan at the end of 2018, and the balance of loans in local and foreign currencies was 141.75 trillion yuan. Although China's financial aggregate is expanding, the financial structure has not been optimized accordingly. Since China is a bank-led financial structure, the banking structure is dominated by large state-owned banks, resulting in a relatively large share of the credit market in China's financial market and a small share of the stock and bond markets. This not only affects the improvement of financial efficiency, but also restricts it. The function of financial functions. The judgment and prediction of economic fluctuations has always been a hot topic in academic research. For the Chinese market, the socialist market economy is special in the world. It is of great significance to study how China's economic fluctuations affect China's financial market and world financial market. From the perspective of economic fluctuations, it is important to seek structural optimization strategies and development strategies for financial markets.

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2. Theoretical Analysis

2.1. Financial instability theory

The hypothesis of financial instability is first proposed by Veblon, an American economist, but in the academic world it is generally believed that the systematic introduction of the intrinsic instability of the financial system is the Hyman. P. Minsky. Hyman. P. Minsky believes that the credit of the financial system is created by commercial banks, and commercial banks perform credit intermediary functions. Under the condition of modern market economy, instability is the characteristic of modern free financial system, and commercial banks, as enterprises, participate in market activities and have natural instability. If the economy is prosperous and the market environment is favorable to the development of enterprises, it will be easier for enterprises to apply for loans from banks. At this time, the loan amount of the first and second types of enterprises will increase, and once the enterprises have operational problems, they will gradually evolve into the third category of enterprises. If economic development is driven by debt, it will lead to inflation. When the economic prosperity reaches the peak, the financial market is unable to continue to provide the necessary funds for enterprises. Once the market is weak, the capital side of banks suddenly tightens, the ability of loan enterprises to finance from the market decreases, and the capital chain of the third type of enterprises is relatively easy to break, resulting in debt default and easy to break out of the financial crisis.

2.2. Business cycle theory

The economic cycle, also known as the business cycle, is a cyclical change in the expansion and contraction of overall economic activity. The duration of the economic cycle is a minimum of several months, and the maximum can reach more than ten years. The economic cycle usually begins with prosperity, and it has experienced economic boom, economic recession, economic depression, and economic recovery. In the economic boom, the economic activity is very active and in the state of continuous growth. At this time, the economic resources in the society are reasonable, the investment recovery rate is high, the total economic amount is increasing, the market participants are optimistic about the expected market, the total demand reaches the highest level, The unemployment rate is at a lower level. During the economic recession, as the total supply is greater than the total demand, sales in the market become difficult, commodity prices fall, and investment also declines. At this time, credit contraction, unemployment rate rises, and enterprises face bankruptcy crisis. During the economic recession, market participants lost confidence in the market and held a pessimistic attitude, demand continued to decline, economic activity was the lowest, investment was reduced, and most companies faced a crisis of bankruptcy. During the economic recovery period, production gradually recovered, credit supply gradually increased, business operations resumed, the market continued to be active, and economic activities gradually returned to their original levels. Changes in the economic cycle are regular, and different stages are maintained for some time. Although the length of time is not fixed, it can be predicted scientifically.

2.3. Macroeconomic policy theory

In order to reduce the violent fluctuations caused by financial instability, promote the steady growth of national output levels and price levels, increase market employment rate, reduce market unemployment rate, and achieve domestic and international balance of payments, the government needs to macro-control the market economy. For the Chinese government, fiscal and monetary policies are usually used for regulation. Fiscal policy is to regulate the economy by regulating the government's income and expenditure. Government expenditures are generally used to purchase goods and services. In addition, poverty relief and subsidies are included. The government's income sources are mainly taxes and debts to the public. The monetary policy is a form in which the People's Bank of China adopts policy instruments based on the rediscount rate, the statutory reserve ratio, and the open market business to control the money supply to achieve the role of regulating the economy. The government usually implements a tightening fiscal policy when the economy is booming, that is, increasing taxes, reducing government spending, etc.; implementing expansionary fiscal policies in the event of economic decline, that is, reducing taxes and increasing government spending. In order to adjust the economy, the government can also use macroeconomic policies together, such as expansionary fiscal and monetary policies, or tight fiscal and expansionary monetary policies to increase national income in times of economic depression, and tight fiscal and monetary policies, or loose fiscal policies and tight monetary policies to control inflation.

3. The Way to Influence Financial Market by Economic Fluctuation

3.1. Financial accelerator effect

Under the conditions of modern market economy, the financial system is flawed, which will inevitably lead to different effects of economic fluctuations on different financing structures. According to information theory, due to information asymmetry, traders are not completely rational, and there are transactions in financial markets. Cost, under the influence of these factors, will produce financial friction, which will inevitably lead to different effects of economic development on different financing structures. In the indirect financing market, the loan-to-deposit relationship between enterprises and banks will have a financial accelerator effect, which will cause macroeconomic fluctuations to play a non-negligible role in financial markets. When the economy develops and prospers, under the guidance of favorable information, investors will buy the company's securities, thereby promoting the price of securities. When economic development is at a low level, under the influence of non-profit information, investors will sell securities and thus reduce the price of securities. It is based on such a mechanism that financial markets have become a distribution center for economic development information. Through the changes in the prices of products in the financial market, economic fluctuations are quickly and effectively reflected.

3.2. Dispersion effect of risk

Economic entities in the market economy face various risks in the production and operation process. Financial markets can provide participants with opportunities to spread risk and reduce risk. Investors can use portfolio investment to diversify the non-systematic risks of investing in a single financial asset. When the economic development is in a low period, when the direct financing of enterprises is insufficient, the financing structure of the enterprise will become relatively simple, and it is difficult to optimize the capital structure, and enterprises will face greater financial risks. When most of the corporate liabilities are expressed as loans to banks, if the economic environment changes, it will lead to business difficulties, and banks will form a large number of non-performing assets, which will have a serious impact on the security of the financial system. Financial markets can disperse the risks of economic fluctuations, but only if investors can adopt a scientific investment strategy to improve the level of investment risks management. Through bond financing and stock financing, enterprises can improve the capital structure and reduce the financial risks of enterprises. By diversifying risks, the impact of macroeconomic fluctuations on individual markets in the market is reduced, thereby effectively alleviating and decentralizing the impact of adverse shocks and slowing down the impact of economic fluctuations on financial markets.

3.3. Irrational expectations of investors

The products circulated in the financial market are different from other markets. The pricing of financial products is not the same as the pricing of ordinary commodities. It depends to a large extent on investors' expectations of future economic trends. Due to the complexity of the economic system, people cannot make accurate expectations about the direction of the market economy. If people's expectations of the market are not realized, it may bring confusion or even collapse of the financial system. The violent fluctuations in the price of financial assets will be accompanied by a sudden change in the flow of large amounts of funds. The macroeconomic fluctuations of the economic system will have a bad impact on the sustainable production capacity of the real economy. Changes in the real economy will be reflected in the financial market and may bring The irrational expectations of investors, which in turn lead to violent fluctuations in the prices of financial assets.

When an investor judges the probability of an event, it usually zooms in or out in the direction of self-judgment. When the economy fluctuates, it mainly shows that the investor overestimates the risk of the asset when assessing the risk of the asset. Excessively overestimate your risk tolerance and trust your judgement about the future.

4. Coping Strategies for Financial Market Participants

4.1. The government should clarify the boundaries of administrative management

The Chinese government can exert strong macroeconomic regulation and control on the economy, but it also needs to clarify the boundaries of macroeconomic regulation and control to prevent the market economy from becoming a planned economy. China's financial resources are unevenly distributed among regions. The number of financial intermediaries in central and western China is relatively small, and the financial service system is not well developed. A large amount of funds flow into the eastern region through bank credit, stock market and insurance market. The backward infrastructure construction and investment environment in the western region has led to the outflow of financial resources, further expanding the imbalance in the distribution of regional financial resources. Therefore, in the western region of China, measures should be taken to reduce the outflow of financial resources. At the same time, optimize the scale of financial markets in other regions, focus on improving the financial service system in the region, promote the diversified development of financial intermediaries, and build local financial service industries based on local advantages. In the eastern region, financial market access conditions should be lowered and financial market competition should be fully introduced.

4.2. The government should optimize the financial structure

In the three dimensions of financial development, the improvement of financial structure is most conducive to reducing the negative impact of sustained economic fluctuations on R&D intensity. In contrast, the role of financial scale expansion is limited. Therefore, China should control finance at this stage. Scale, in order to prevent excessive expansion of financial scale, and at the same time, should pay more attention to financial restructuring when promoting financial development. On the one hand, adjust the term structure of loans, increase the proportion of medium and long-term loans in total loans, and strengthen the evaluation and supervision of medium and long-term loans, and maximize the improvement of R&D intensity by financial structure adjustment under the premise of controlling credit risk effect. On the other hand, in order to meet the financing needs of different enterprises and make the market more responsive when the economy fluctuates, it is necessary to improve the financial intermediation structure, promote the development of large banks that provide large financing for large enterprises. The government should encourage financing for SMEs services for the development of small financial institutions and private financial institutions.

4.3. Investors should make scientific judgments

Investors are the connection point between the macroeconomic situation and the development of financial markets. The irregular fluctuations in financial markets are largely due to the fact that investors have not made accurate judgments on the economic situation. The price changes in financial markets will be affected by speculative activities, supply and demand, and political factors. From the perspective of behavioural finance, investors have irrational psychological characteristics such as overconfidence and risk appetite, and spread through the “herd effect”. It will cause large fluctuations in asset prices. Investors should improve their own quality and make more scientific judgments on economic development, so that even if the economy fluctuates, investors can minimize the risk according to their own judgments, and at the same time reduce the impact of economic fluctuations on financial markets to the minimum.

4.4. Investors should be more rational

Due to factors such as information asymmetry and agency costs, when the macro economy is hit, the impact on the financial market will be amplified by the role of the credit market. Driven by the interests of investors, in order to obtain excess profits, the motivation to search for relevant information of enterprises and make judgments will be even greater. At this time, investors should be more rational and minimize the impact of economic fluctuations on financial markets. For every country in the world, the economy is gradually developing in stability and is the optimal target for the operation of the market economy. From the perspective of the international market, if the main players in the financial market can become more rational, then the economic development will become more and more stable, and the country’s ability to cope with economic fluctuations and unexpected phenomena will be stronger, thus driving the country's overall economic development and market prosperity.

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