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China's stock market jitters are hurting the middle class

At stake is investor confidence and the Chinese government's credibility.

Unfinished residential buildings developed by China Evergrande Group on the outskirts of Shijiazhuang in Hebei province on Feb 1. At the heart of China's economic spiral downwards is its real estate meltdown, which has had a ripple effect on the stock market and financial sector. The latest stock sell-off was triggered by the liquidation of Evergrande. PHOTO: REUTERS

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China posted an above-the-target GDP growth of 5.2 per cent in 2023, a figure revealed by Vice-Premier Li Qiang just weeks ago in a move to boost investor sentiment amid a flagging economy.

Yet its stock market, the world's second largest, continues to crumble. About US$1 trillion (S$1.3 trillion) of its value was wiped off in just two weeks in January. Some analysts have called Chinese equities "uninvestable".

The Shanghai index has never been a reliable gauge of the country's economic performance over the past three decades. Nevertheless, the unprecedented rout reflects the grim economic reality and loss of confidence among institutional and retail investors.

A STOCK MARKET CRATER

The Chinese bourse recovered in the last few days of trading before the Chinese New Year close. But hopes of a rebound seem premature. The government's piecemeal stimuli thus far, which include enhanced credit support for developers and cuts to banks' reserve requirement ratio, are unlikely to change the fortunes of the stock market unless fundamental problems plaguing the Chinese bourse are addressed.

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China has been here before, some say. The stock crash in 2015 saw a third of the value of A-shares on the Shanghai Stock Exchange wiped out within a month. A government rescue effort failed to immediately stabilise the market. Even after six months, the market continued to experience steep sell-offs. Trading was halted on two trading days in January after the Shanghai composite index fell 7 per cent.

But the situation today is far gloomier. Aversion to Chinese stocks among international investors has become more entrenched. Economic growth is anaemic, as the geopolitical uncertainty casts a pall over the Chinese economy, while the property sector, once a powerful growth engine, has become a debt-laden albatross. Fiscal support remains poor.

A SOURING MOOD

The Chinese government now faces the daunting task of rescuing its credibility while trying to explain away the gap between its rhetoric and the reality in the stock market. Despite officials' vow to rescue the embattled stock market in 2023, the Shanghai Composite Index shed 15 per cent while Hong Kong's Hang Seng Index plunged almost 24 per cent.

The recent slump will hurt the Chinese middle class most rather than foreign investors, who have limited access to mainland stocks. Most also fled in late 2023 after an expected rebound arising from China's relaxing of zero-Covid failed to materialise.

Defaults on everything from business loans to home mortgages are mushrooming. Defaulters on the authorities' blacklists have surged from 5.7 million in early 2020 to a record high of 8.5 million people – about 1 per cent of working-age Chinese adults.

The China Dream, where hundreds of millions followed the advice of officials in adhering to simple rules to get rich – work hard, buy Chinese stocks and properties – now seems like a nightmare.

Grievances are rife on social media about an estimated 30 per cent slump in household assets. In recent years, many have seen their entire life savings wiped out by the property bust, stock fraud or the peer-to-peer online lending crash.

Chinese officials know the national mood has soured. Not long ago, Chinese President Xi Jinping referred to the concept of the Tacitus Trap to highlight to officials the importance of preserving the government's credibility to safeguard its legitimacy and authority. In ancient Rome, the historian and politician Tacitus describes a situation where the government has lost all public confidence and credibility such that every word or action only earns it more public criticism and scorn, regardless of whether decisions proved correct.

A PROPERTY MARKET MELTDOWN

At the heart of this economic spiral downwards is China's real estate meltdown, which has had a ripple effect on the stock market and financial sector.

The latest stock sell-off was triggered by the liquidation of property giant Evergrande. Investors believe government support was too little too late and the same fate could befall a long list of developers facing similar woes.

The property meltdown spooked overseas investors who moved their money to other Asian markets. But the 200 million domestic investors were left holding the can. They saw much of their entire life savings wiped out in a few trading days.

Domestic investors have limited access to global markets due to China's stringent capital controls. Millions of households, dissatisfied with suppressed interest rates at home, had long invested in A-shares denominated in renminbi, expecting rich rewards from China's continued economic miracle.

But they have been left disappointed. The Chinese bourse has been in the doldrums. The Shanghai Composite Index peaked at 6,124 points in 2007, when the country's GDP was still behind Japan's.

The Chinese Securities Regulatory Commission has pledged to arrest rampant accounting fraud and market manipulation on the A-share market, but its failure has led to the swift removal of its chairman Yi Huiman.

There are limits to this scapegoating. Now regulators are threatening tougher penalties for financial crimes and speeding up the time it takes to prosecute wrongdoers, but many have dismissed this as hawkish bombast lacking substance.

Cracking down on "malicious" short-selling cannot halt widespread jitters in the stock market. Neither will removing top officials. On the contrary, slapping on more administrative curbs will only alarm investors both home and abroad, and fuel fears people could arbitrarily lose money while investing in stocks.

A large-scale fiscal and monetary stimulus by the government, long overdue, might do the trick to pump capital into the stock market.

But, in the long run, regulators need to overcome the Tacitus Trap and restore confidence in the Chinese bourse. For that to happen, corporate governance must be shored up so investors trust that prices reflect companies' true valuation and financial health. Chinese stocks must also show they can produce results for shareholders and return cash through dividends and buybacks, but most rarely do.

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