# China’s “mad” stock market spiralling out of control

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China’s frenzied stock market passed another extraordinary benchmark last week. On May 9, it recorded a trading volume for that day which was bigger than all the other share markets in Asia combined, including in Japan, the world’s second largest economy.

According to the *Financial Times*, the value of shares traded daily on the Shanghai and Shenzhen markets was $5 billion six months ago. On March 30, it hit $16.4 billion. Last Wednesday, the figure reached $49 billion—nearly double that of Japan and triple the combined trading volume of Australia, Hong Kong, Thailand, Singapore, Malaysia, Korea, India, Taiwan, Indonesia, New Zealand and Vietnam.

While still less than half the $122 billion in shares that were traded in the US on May 8, the Chinese share market eclipsed the trading volume in Britain of $29.4 billion. At the same time, the total capitalisation of Shanghai and Shenzhen stock markets of $2.2 trillion is still well below that of Japan at $4.7 trillion and eight times less than the $16.5 trillion of the US.

The rapid rise of the Chinese share market is having an impact. In less than two months, the Shanghai Composite Index has passed the 3,000 and the 4,000 mark. As it rises to giddy new heights, fears grow of a sudden, sharp “correction” that will have profound consequences not just in China, but internationally.

In late February, a tumble of 9 percent in Shanghai triggered a chain reaction around the world, including on Wall Street, which experienced its largest one-day fall since the September 11 terrorist attacks. Two months on, a major collapse in China could produce a much bigger international shock wave.

Even though the current speculative bubble involves mainly the so-called “A” shares, which are restricted to domestic investors, almost every economist has pointed to the dangers to the entire Chinese economy. While China’s GDP grew by more than 10 percent last year, the main Shanghai share market grew by 130 percent. It has added another 50 percent so far this year.

The price-to-earning ratios for China’s stocks are now around 50, compared to an average 14-18 throughout the rest of Asia. In other words, the prices being paid for Chinese shares are completely out of line with the profits of associated companies. Despite repeated warnings by the central bank, regulatory officials and economists, share values have continued to climb.

Buyers in this investment frenzy include the emerging urban middle classes and layers of workers, with an estimated 300,000 to 500,000 stock accounts being opened every day. At the end of March, institutional investors such as banks accounted for just 23.3 percent of the total market capitalisation. The rest were small investors.

By May 10, the number of registered stock investors in China had passed 95 million. College students, housewives, taxi drivers and even Buddhist monks, not to mention businessmen and professionals, are all involved. The stock market is seen as the magic means for getting rich overnight. People are reportedly selling their homes, withdrawing pensions or loading up their credit cards with massive debts in order to gamble on shares.

An article posted on the Chinese version of the *Asia Times* web site on May 9, pointed out that almost 1 in 14 of the Chinese population is now a stock investor. A public servant in Guangzhou said 90 percent of his workmates were investing in stocks. “I also bought 20,000 yuan of shares. When it rises, I earn more in one day than my monthly pay,” he said.

Ma Chunhui, a media professor at Shenzhen

University, conducted a survey, which found that 10 percent of first-year students at his campus had become stock investors. In fourth year, the percentage was 80 percent. “Increasingly the first thing people do when they go to work is turn on the computer and look at the stock market,” he said.

A number of analysts have described small investors on the share market as “mad”. But their behaviour is the lawful expression of the economic contradictions that the misnamed Chinese Communist Party (CCP) leadership has unleashed with its unfettered market program. With low wages, rising prices and costly services such as education and health, many people have turned to the share market in the vain hope that it may provide them with a means of escape.

The stock exchange was abolished after the 1949 revolution and was only reinstated in the late 1980s as part of Beijing’s open embrace of capitalist relations. In the 1990s, however, even at the height of a speculative real estate bubble, the stock markets played a marginal economic role. The ups and downs of Chinese shares had no bearing at all on global financial markets.

The past few years have witnessed a dramatic reversal. To keep the yuan’s exchange rate low to assist exports, the Chinese central bank is now buying up to $500 billion in foreign currency a year, creating a huge money supply at home. In order to control excessive liquidity, the central bank has raised the reserve requirement on banks seven times and increased lending rates three times over the past year. But these measures have had little impact on the country’s investment bubble as the central authorities fear that a significant rise in interest rates will lead to business failures, higher unemployment and greater social unrest.

Real interest rates are very low—just 2.79 percent on one-year term bank deposits, less than this year’s inflation rate of more than 3 percent. The return on government bonds is also poor. Foreign investment is out of the question as the government maintains a tight control on foreign exchange and the outflow of domestic funds. As a result, large amounts of money have flooded into real estate and now into shares. Many working people see no avenue to increase their limited savings, other than by risking them on the share markets.

A *Financial Times* editorial in the warne market that goes up 200 percent in less than 18 months, and trades on a price-to-earnings ratio of about 50 is not necessarily a bubble. But if it looks like a crocodile and grins like a crocodile, it is probably best to treat it as a crocodile, just in case. China’s stock market has inflated to a worrying level, and because of Chinese policy and the state of the Chinese economy it could go higher before it falls.”

The last collapse of the Chinese stock market in 2001 affected a relatively small layer of better off investors. This time, however, the social consequences could be on a far bigger scale, as the number of investors is rapidly approaching 100 million. Many of them could lose everything—their homes, savings and pensions—in a vicious lesson in capitalist economics.

The social and political consequences may well be explosive.