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Trivium China

Markets Note

Backing the bull: Consumption, currency, and Beijing's efforts to buck up the stock market

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In recent weeks, regulators have unleashed a cascade of measures designed to stimulate sluggish demand for A-shares.

This isn't the first time officials have endeavored to boost share prices.

- Throughout the past 20 years, Beijing has intervened to manufacture bull markets – as in 2005 and 2015 – and at other times to halt price declines, as in 2018.

Less obvious this time round is what Beijing is trying to achieve.

- Do authorities simply want to put a floor under the market's current slide, or do they want to engineer a turnaround?

Our money's on the latter.

In past instances, Beijing only intervened once the market declined far more precipitously than it has this year.

- In 2015, the CSI 300 Index — a composite of the top 300 stocks on domestic exchanges — fell 45% over six months before Beijing rolled out support to halt the fall.
- In 2021-2022, intervention came after the index declined 30% over a year.
- This time, the CSI 300 fell only 12% from its January peak before Beijing stepped in.

Tellingly, in a commentary published August 3, the Economic Daily – the Party's official broadsheet on economic issues – said Beijing wants to achieve a "slow bull" market.

Why a slow bull market? China's had bad experiences with overly exuberant bull runs.

- Following intervention in 2005 and 2015, rapid price appreciation led to painful adjustments when the bubbles burst.

To state the obvious — regulators everywhere would like to preside over markets that exhibit slow, predictable price appreciation. So why is this imperative so important for China right now?

According to the Economic Daily commentary, a "slow bull" market would help revive consumption by boosting investment returns and household confidence.

Additionally, we believe other considerations are also at play. Specifically, rising share prices can:

- Make it easier for innovative companies to raise capital, a key part of Xi Jinping's vision of achieving technological self-sufficiency
- Attract inflows of foreign capital, helping lessen pressure on the RMB

So how far is Beijing willing to go to deliver higher prices? For now, it's too early to say.

- The CSI 300 appears to have stabilized since the authorities started rolling out support measures on August 18 – increasing by 1.7% in the two weeks following the initial push, before pulling back to end the past three-and-a-half weeks down 0.6%.

- If the markets remain stable, authorities will sit back and monitor before deciding if further intervention is needed.
- If prices start falling again, we expect regulators to roll out more measures akin to the ones they've recently trotted out, which we outline below.

The bottom line: Based on our assessment that improved equity prices are a key part of Beijing's plan to revive consumption, we expect authorities will continue to tinker in an effort to engineer a slow, sustainable appreciation of the equity markets.

And the kitchen sink

Before we explore Beijing's next moves, a quick recap of recent efforts is in order.

Since mid-August, regulators have rolled out a slate of measures to boost A-shares, mostly drawn straight from the old market-intervention playbook.

First came moves to lower the transaction costs of purchasing equities:

- On August 18, the Shenzhen, Shanghai, and Beijing stock exchanges reduced their fees for handling stock transactions by 30% to 50%.
- On August 27, the Ministry of Finance slashed stamp duty – a tax on stock trades – to 0.05% from 0.1%, the first cut since 2008.
- Also on August 27, the securities regulator (CSRC) cut margin requirements to 80% from 100%, increasing the amount investors can borrow against funds deposited with brokers.

Measures to reduce the cost of trading have been supplemented with efforts to curtail the supply of equities for sale. The CSRC has pledged to:

- Temporarily slow the pace of IPOs to prevent liquidity from exiting the secondary market and being diverted to new issues.
- Ban controlling shareholders from cutting their stakes under certain conditions, including if the stock price is lower than net assets per share or the firm hasn't paid enough dividends.

Regulators also want to manufacture new demand for shares.

- In an interview published on the CSRC website in late August, an unnamed official encouraged funds and listed companies to buy their own shares – and in the days following the pronouncement, at least 17 funds and 50 companies heeded the call.
- On August 28, Bloomberg reported that the Shanghai and Shenzhen stock exchanges had told some large mutual funds to buy more domestic equities than they sell.

Our take: This mix of approaches has previously worked, generating sufficient upward pressure on share prices to reverse a market slump. Given the muted market response to the measures this time round, markets will likely need more adjustments before investors feel confident that the tide has turned.

Does the road to a consumption revival necessarily pass through A-shares?

By now you might be asking: Where did this equity support push come from, and who is behind it?

- The answer, as is often the case in China, is that senior political figures set this train in motion weeks before the first policies emerged.

Indeed, the Politburo flagged its intention to boost stock prices in the readout of its July 24 meeting, saying it wanted to:

> *"Enliven capital markets and increase investor confidence."*

That said, it wasn't until the Economic Daily's August 3 commentary that we – and many domestic investors – understood the true intent of that statement.

According to the commentary, rising A-share prices can play a unique role in reviving domestic demand. Per the Economic Daily:

> *"To make the consumption pie bigger, we need to...find ways to increase residents' income from...stocks, funds, and other [financial assets]...thereby [giving households] the ability to consume."*

> *"The wealth effect brought about by a rise in the stock market can directly increase investors' income and boost income growth expectations, thereby translating into actual consumption…In short, the capital market can stimulate consumption, expand domestic demand, and drive economic growth."*

> *"How can capital markets...play a more positive role in promoting consumption and expanding domestic demand? It is necessary to take measures to increase market activity, and push stocks toward a 'slow bull' market."*

Interesting stuff.

And this is especially pertinent given home prices – the main financial asset for most households – are in the doldrums.

That said, we also think other considerations are at play. In particular, we suspect Beijing is concerned that weak capital markets are putting the RMB under additional pressure.

- Foreign investors net sold nearly RMB 90 billion in mainland equities via the Stock Connect in August – a staggering outflow for this capital channel.
- What's more, widening interest rate differentials between the US and China, combined with China's weak domestic economy, have pushed the CNY to its lowest level against the dollar in 16 years.
- Rising A-share prices could attract foreign capital inflows, lessening the scope for the currency to weaken further.

Additionally, as we wrote in our August 4 note, "Tech-Industry-Finance: the incipient remaking of China's financial system," Xi Jinping wants capital markets to play a greater role in funding innovative firms, thereby delivering technological self-sufficiency.

- Rising A-share prices will make it far easier for such firms to launch IPOs.

Putting it all together: An equity market turnaround ticks multiple boxes for Beijing.

- And that makes it likely that any further market drop will be met with additional policy support measures.

What's left after the kitchen sink?

What else can Beijing do to help deliver a "slow bull" market in the months ahead?

Here's where history may offer some lessons. In 2015, for example, after the equity bubble popped, officials moved to:

- Prohibit short selling
- Place a moratorium on new IPOs
- Ban large shareholders from selling their shares

Officials also promised "unlimited" liquidity support for state securities firms from the central bank and the CSRC – including an injection of RMB 76 billion into China Securities Finance Corporation, the only entity in China permitted to extend margin financing.

Conceivably, policymakers could use the same tricks again this time – but what's still unclear is just how committed Beijing is to achieving a "slow bull" market.

- We're not optimistic about Beijing's ability to deliver a bull market – slow or otherwise – until the economy picks up.
- In lieu of an economic recovery, the stock market will likely need authorities to continue making ongoing – and potentially more aggressive – technical tweaks to generate demand for shares.

Another wildcard here is the Chinese retail investor.

- If small players expect that more and larger-scale government support is coming, they may plow back into A-shares to get ahead of the curve.
- If so, that could generate enough momentum to keep prices rising without requiring significant intervention.
- Importantly, that's exactly how the bull markets of 2005 and 2015 worked.

The key question, then, is whether China's securities regulators still have enough of the old magic left to convince retail investors that now is the time to jump back into the markets – and to strong-arm more large, institutional players to get on board as well.

Given policymakers' striking lack of available tools to otherwise boost business and household confidence – and thereby jolt consumer spending back to life – we expect they'll give it a serious go over the coming weeks.

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