CHINESE STOCK MARKET

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Introduction

The Chinese stock market has become one of the largest and most influential financial markets in the world, largely due to China's economic prominence on the global stage. Originally established to support state-owned enterprises (SOEs) and facilitate economic liberalization, China's stock market reflects the complexities of operating in an authoritarian economy. While Western markets predominantly function under free-market principles, China's market is heavily influenced by government policies that prioritize political stability and control over market freedom.

China's journey toward economic modernization began with reforms initiated by Deng Xiaoping following Mao Zedong's regime, leading to the creation of the Shanghai and Shenzhen stock exchanges. These stock markets were designed to help SOEs raise capital and improve operational efficiency. However, despite the initial wave of liberalization, China's stock market has continued to operate under a high degree of state control, enabling rapid policy shifts but raising concerns over transparency and market stability.

As *The Diplomat* recently noted, "China's stock market is undergoing a resurgence of historic magnitude, driven by an unprecedented series of policy shifts... The critical question now is whether this rally is the beginning of a sustained recovery or simply a temporary surge driven by sentiment and liquidity" (September 2024). This highlights the tension between growth potential and the limitations imposed by China's unique economic system.

Despite its huge growth, China's stock market faces significant challenges. Institutional disadvantages—such as capital flow restrictions, authoritarian policies, and geopolitical tensions—pose unique risks for investors, especially when compared to more open and transparent markets. These challenges are compounded by economic issues tied to China's political regime, including slowing GDP growth, rising debt, and demographic shifts, all of which strain investor confidence.

This research paper aims to examine the current challenges and flaws within China's stock market by exploring how institutional disadvantages and government intervention within an authoritarian regime impact its development and limit the growth of the world's second-largest economy. Through case studies on regulatory crackdowns, the Common Prosperity policy, and the Zero-COVID policy, we analyze how China's approach to economic control shapes stock market performance, investor sentiment, and long-term sustainability. Ultimately, this paper seeks to determine whether the Chinese stock market is undervalued and assess its potential for growth in the long run, addressing whether it remains an attractive investment opportunity.

History of the Chinese Stock Market

From 1949 to 1976 the People's Republic of China, with Mao Zedong as its leader, established a communist regime at the political, social, and economic levels. The economic plan carried out by the party was known as "The Great Leap Forward".

During Mao Zedong's regime, there was a very significant drop in China's production and efficiency. Yet the population continued to grow. This had a devastating consequence in the relocation of resources by the state, causing food not to reach the rural areas. This increased the famine rate exponentially, with an estimated 25 million people starving to death. On the other hand, it also had a direct effect on companies. The collectivization of the resources and the implementation of high taxes created a lack of productivity and efficiency in these, as they were not keeping their profits. Taking into account that the agriculture sector was the most important in China, the creation of communes and the lack of investment in this sector, created a considerable decrease in the whole Chinese economy. Bearing all in mind, as it has been mentioned, China's economy was unable to grow during Mao's regime, this had also an effect on the creation of new companies, resulting in a period where the population could not develop new enterprises. The fact that new companies did not emerge and that the economy did not grow, happened in large part also because the government nationalized most private industries, erasing any possible competitiveness.

With the death of Mao Zedong, Deng Xiaoping became the leader of the Communist Party and started a process of Economic Development. It all started with the 11th Session of the Central Committee of the Chinese Communist Party in 1978. In this session, the Communist Party aimed to rebuild China's economy and society, which were devastated by the communist-driven strategies adopted by Mao Zedong. Taking this into account, Deng Xiaoping established several economic reforms. These reforms were gradually adopted and helped China to strengthen its agriculture and industrial sectors, achieving an increase in Chinese living conditions and in the competitiveness of China in global markets.

The most important reform taken by the party was the establishment of the "open-door Policy", deregulating the economy and opening a number of areas for foreign investment. These areas that were open to foreign investment are known as the economic zones, the technology development zones, the peninsula open zones… This produced the inflow of massive amounts of foreign investment. This reform came also with tax incentives or business growth incentives, which had the objective of promoting entrepreneurship. A clear example of this was the tax reduction for industrial manufacturers. This inflow of foreign capital and management know-how resulted in rapid economic growth in the first half of the 1980s. This growth was accompanied by a rise in per capita GDP, which was 14 times higher than in 1980. [1]

With this reform, China began to move toward a market economic system. In 1981, the Central Government, provincial and local governments, financial institutions, and enterprises started to issue bonds. In 1987 the first Over The Counter was held at the Shanghai market and in 1987 the Shenzhen Stock Market sold its first stock. By the end, in 1989, 3.8 billion yuan worth of shares were issued by shareholding companies, proving the effect that the open-door policy had in the Chinese Markets. [2]

Xiaoping also implemented a land reform based on the de-collectivization of all the communes, meaning that each household could retain the remaining profits, leading to an increase in productivity, efficiency, and the well-being of the Chinese - as it incentivized farmers to produce and make profits-. The government implemented a leasing method, meaning that the state owned the lands but gave the right of use to companies or individuals for a specific time. Also, he established a "Dual-Track pricing", under this scheme there were two prices, one fixed by the state and another based on the open market. The effects of this reform had a clear effect on wages, which increased from 560 Yuan per year in 1970 to 1750 Yuan per year in 1988. [3]

This increment in wages had also an effect on the markets. Since the government, local entities, and financial institutions were issuing bonds and people's wages increased considerably, investment in the markets was much stronger. This increased their capitalization and created a boom in the markets for the first time.

Another important reform was based on the SOEs (State-owned enterprises). The goal was to modernize the state-dominated economy. SOEs gave Deng Xiaoping the possibility to move from central planning to mixed economic planning, increasing the market involvement of private actors without losing the importance of the state. During Mao Zedong's regime, decisions regarding input and output levels of SOEs were taken by the central or local government and its budget relied totally on state budgetary or state bank loans. With the reform, the government allowed an enterprise to retain a part of its profits, and SOEs started to rely more on bank credit.[4]

As part of this reform, the Shanghai and Shenzhen stock exchanges were established. This allowed SOEs to increase their future equity through SEOs (Seasoned Equity Offerings). SOEs are listed via two stocks, non-tradable stocks held by the central or local governments and tradable stocks held by public investors. Today, 1047 SOEs are listed in both stocks, and they represent 52% of the market capitalization.

On the other hand, China desperately needed a financial gateway to attract foreign investors for additional capital. The other two stock markets were not sufficiently attractive to foreign capital due to a lack of transparency and numerous barriers to entry (currency control, quotas etc..). Hence, during the 1980s, Deng negotiated with the British government to finalize the Sino-

British Joint Declaration. This agreement, which took effect in 1997 with Hong Kong's return to China, guaranteed that Hong Kong would retain its capitalist system, legal autonomy, and independent stock exchange for at least 50 years. These assurances were crucial in maintaining investor confidence and allowed Hong Kong's stock exchange to flourish as a major global financial center after the handover.

Deng Xiaoping through his policies, helped solidify Hong Kong's role as a financial gateway, laying a foundation that enabled the Hong Kong Stock Exchange (HKEX) to grow as a bridge between China and global markets.

Reforms were then continued by Jiang Zemin, who also achieved the continuous growth of the economy in China.

China's stock markets

After 32 years of rapid development, the Shanghai Stock Exchange (SSE) has grown into a comprehensive, open, and service-oriented exchange. The Exchange has a complete market structure with a world-class trading system that ensures its stable and efficient operations. It has been the market on which major Chinese companies have been betting for a long time. Nowadays, it is one of the most important exchanges of the global capital markets. According to the Federation of Exchanges, in 2022, it was ranked 3rd in terms of market capitalisation.

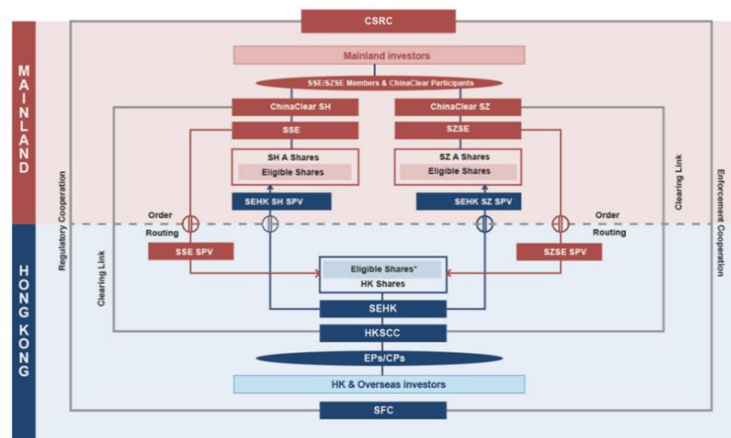
The Shenzhen market was founded in 1990 and started its operations in 1991. It is a platform for trading shares of state-owned enterprises and collectively owned enterprises. It has been the second most important index in China for a long time and its last innovation was the ChiNext Index opening in 2009. The ChiNext is an Index for Technological and Growth companies, emphasizing in SMEs. Just as the Shanghai Stock Exchange, its performance has increased over the years. Nowadays, it has a total of 2840 listed companies and 24600 billion RBM market capitalization.

As of today, the Hong Kong Stock Exchange (HKEX) is one of the largest stock exchanges in the world. [5]. As it has been said, the most important function of the HKEX is that it acts as a Financial Gateway linking Mainland China (traditional stock exchanges) to Global Markets. In January 2024, the HKEX had a capitalization of 4962.81 billion USD and there were a total of 2509 companies listed.

Two main mechanisms have been designed by China to facilitate the connection of the three stock markets and improve liquidity and risk management: the Qualified Foreign Institutional Investment and the Stock Connect Scheme.

The Qualified Foreign Institutional Investment (QFII) program. This program allows specified licensed international investors to participate in mainland China's stock exchanges. The government utilizes this program to regulate the amount of capital that foreign investors can invest in China's capital markets. It should be added that the China Securities Regulatory Commission (CSRC) mandated that certain prerequisites had to be met by investors to be accepted into the QFII. These qualifications were based on the type of institutional investor.. From 2016, these institutional requisites have been simplified in order to attract more foreign investors.

The Stock Connect Scheme. As it can be seen in the image, the programme links HK & Overseas investors with Mainland Investors. The connection channel is the Eligible Securities, which as it can be seen are securities that can be traded on the HKEX but are listed on the mainland stocks. If it were not for this regulatory cooperation, the HKEX would be an independent stock and Hong Kong and overseas investors would not be able to access the mainland stocks.



[6]

Thus, it is visible that each exchange has its own particular focus and they complement each other. This is beneficial, both for enterprises and for investors. From the part of enterprises, it covers the needs of both large companies and SMEs. On the other hand, it is also beneficial for investors, as it allows them to diversify their portfolios within the Chinese market by being able to invest in companies from different industries and sizes.

Despite this beneficial approach to the Chinese Stock Markets, it should be noted that the state has a considerable influence on them. A clear example of this is the limitation of access to up-to-date information, creating a lack of transparency that directly affects foreign investment. In this way, the government's continued unstable regulation acts as a constraint on foreign investment and on the relationship of these markets to global markets.

Flaws of the Chinese Stock Market Because of its Institutional Disadvantage

Pegged Currency and Capital Flow Limitations

Following Deng Xiaoping's reforms, we saw that China's economic model has been built around a highly controlled financial system. While this approach aims to keep the economy stable, it creates barriers for foreign investors, making it harder for them to freely invest and move capital, which limits investment opportunities.

Pegged Currency

Usually, governments are presented with a trilemma. They can choose 2 of the 3 policies: free capital flows, fixed exchange rates, and monetary policy autonomy. Several countries, like the US, Japan, Brazil, and India, do not have a fixed exchange rate system but do have unrestricted capital flows and monetary policy autonomy. In order to establish a euro-to-euro peg and permit unrestricted money movement between these economies, the Eurozone nations gave up monetary authority, which was delegated to the European Central Bank (ECB).

Unlike the majority of developed economies, China does not have a floating exchange rate that is set by market forces. Rather, since 1997, China has maintained an unofficial pegged currency system (when a government fixes its currency's value to another, instead of letting it fluctuate freely) initially directly correlated with the U.S. dollar. [1]

Beginning in 1994, the value of the yuan was fixed at 8.28 to the dollar for almost 10 years. [2] This policy was put into place to guarantee currency rate stability, which is crucial for China's export-driven economy since it helped decrease uncertainty for both importers and exporters. Businesses were able to make long-term plans without worrying about abrupt currency movements because of the maintenance of a stable exchange rate. Additionally, by maintaining the yuan's low value, China was able to guarantee that its products would continue to be competitive in global markets, increasing its export competitiveness and maintaining economic expansion. [2] By reducing currency volatility and averting steep price rises in domestic markets, this method also assisted in containing inflation. Additionally, as investors were less concerned about currency swings reducing their returns, China was a desirable location for international investment due to its stable exchange rate. The People's Bank of China (POBC) could now purchase and sell foreign exchange reserves to maintain the appropriate exchange rate, which allowed the government to have more influence over monetary policies. [2] This system was further strengthened by capital restrictions, which kept significant quantities of money from leaving the nation and guaranteed economic stability. [4][5] China was able to build up

significant foreign reserves as a result, providing a financial cushion to shield the economy from downturns throughout the world. [1][2]

However, due to pressure from China's main trade partners, the yuan, also known as the renminbi, was only allowed to rise 2.1% versus the dollar in July 2005. [2] In fact, as we can see in the graph below, the PBOC only switched to a "managed float" system in 2005, meaning that the yuan's value was influenced by a basket of currencies and not only on the dollar. The yuan was permitted to increase by almost 21% during the following three years, reaching a level of 6.83 to the dollar. [3] As global demand for Chinese goods declined as a result of the global financial crisis, China stopped the yuan's appreciation in July 2008. China started steadily raising the value of the yuan again in June 2010, and by December 2013, the currency had increased by almost 12% to 6.11. [3] Regardless, the PBOC continued to heavily manage the exchange rate and continued stepping in to keep the yuan within small trading ranges (usually around 2%). [2] This led to controlling inflation, stabilizing export competitiveness, and managing the country's foreign exchange reserves. In fact, the PBOC aggressively bought and sold foreign exchange reserves, mostly US dollars, to influence the value of the yuan in order to accomplish these objectives. [1][3] The PBOC was able to maintain a favorable exchange rate that allowed Chinese exports to be priced competitively on international markets by doing this.

Chinese Yuan Renminbi to US Dollar Spot Exchange Rate, annually.

Chinese yuan renminbi to U.S. dollar spot exchange rate. (2024, October 7).
https://fred.stlouisfed.org/series/EXCHUS

Therefore, we can see that China has traditionally chosen a stable exchange rate with the US dollar (and later with several currencies) and monetary policy autonomy. The trilemma states that capital should not flow freely in and out of the nation, which, as our research article

previously demonstrated, was the case for Chinese businesses and consumers during the 2000s as a result of the nation's strict capital controls. [5]

However, because the yuan is not allowed to fluctuate freely, it can't naturally adapt to supply-demand dynamics and other influences affecting the world economy. As a result, it is difficult for foreign investors to accurately determine the true value of Chinese assets, which creates market inefficiencies. Long-term investment is discouraged by this uncertainty, and China finds it more difficult to completely open its economy to international markets. [6]

By placing strict restrictions on foreign investors, China's management of the currency, capital controls, and profit repatriation laws seriously hinder economic liberalization. These regulations restrict the free market forces that private businesses rely on to determine where and how to invest, particularly in cross-border commerce. The restricted capital flow and controlled exchange rate make it hard for foreign investors to evaluate asset values and repatriate earnings, which hinders their ability to participate in the Chinese stock market. One of the main reasons for this is that a lot of big Chinese businesses, like Alibaba and JD.com, have decided to list their shares on more open and liquid markets, like the New York Stock Exchange (NYSE), where they can reach a larger investor base and enjoy less limitations.

To this date, Foreign-Invested Enterprises (FIEs) have had to complete a number of requirements before they may withdraw their profits back home. These include paying their taxes, finishing audits, and setting aside 10% of their after-tax income in a reserve fund until it equals 50% of their registered capital. This process of several weeks creates financial and procedural barriers because it limits dividend repatriation to once per year and subjects these payments to a 10% withholding tax. Even other payment options, like intercompany payments, are subject to strict oversight and extra surcharges like local fees and VAT. In stark contrast to more open markets like the U.S. or the U.K., where money may move freely, these limitations diminish liquidity and discourage long-term investment.

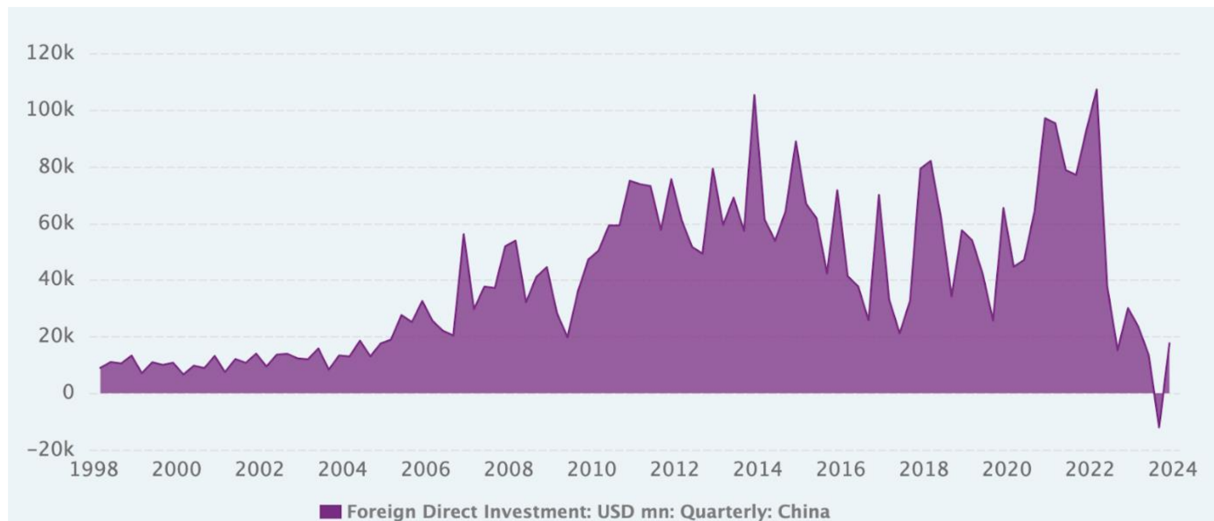
Capital Flow Limitations

As discussed previously, China's stock market is relatively closed to foreign investors. Alongside currency controls, access to the market is controlled through mechanisms like the Qualified Foreign Institutional Investor (QFII) program and the more recent Stock Connect scheme. Foreign investors are permitted to participate in China's domestic stock markets, Shenzhen and Shanghai, under the QFII program, but only after securing government clearance and quotas. While preserving the government's authority over the entrance and outflow of foreign cash, these two methods were intended to boost foreign involvement in China's financial markets.

Nevertheless, both systems have drawbacks that reduce the effectiveness of foreign investment in China, even with their advantages.

Although the QFII program allows licensed foreign investors to trade on mainland Chinese stock markets, it has a number of disadvantages. In the past, QFII imposed stringent restrictions on the amount of money that foreign institutional investors may spend on Chinese stocks and bonds. The program nevertheless places restrictions and regulatory examination on capital repatriation even after these ceilings were lifted in 2019, which deters long-term foreign investment. Even after China eliminated these caps in 2019, regulatory inspection and capital repatriation restrictions still apply to international investment. Furthermore, even after being streamlined in 2016, the strict screening procedure for QFII qualification continues to be a problem for smaller businesses because acceptance requires substantial asset requirements and documentation. As a result, even if QFII gives access to the Chinese market, the complex red tape and continuous limitations prevent China's financial system from being fully liberalized.

By connecting Hong Kong's stock market with mainland exchanges in Shanghai and Shenzhen, the Stock Connect Scheme tried to overcome some of these restrictions. Now, foreign investors can trade mainland Chinese equities using this plan without having to go through the drawn-out QFII procedure. However, investors are still unable to completely access the scope of the Chinese market because, despite Stock Connect's improvements in accessibility, it still restricts access to a small number of eligible stocks - roughly 2000 out of 4200 listed businesses (less than 50%). These factors keep China's stock market somewhat closed, in contrast to more open financial systems like the U.S., where investors face few limits on stock diversity. Furthermore, Stock Connect's settlement procedures are subject to Hong Kong's clearance systems, which makes things more complicated for international players. These systems limit the appeal of the Chinese market by making investment activities more difficult for foreign investors, even if their purpose is to lower cross-market risks.



China's Foreign Direct Investment from Mar 1998 to Jun 2024

CEICdata.com. (2018, June 1). China Foreign Direct Investment. *https://www.ceicdata.com/en/indicator/china/foreign-direct-investment*

The influence of China's strict capital flow restrictions and currency control is seen in the variations in its foreign direct investment (FDI) between 1998 and 2024. Even though China had significant FDI inflows, especially between 2010 and 2022, the graph's volatility shows that investor confidence is still impacted by regulatory problems. Stable and ongoing foreign investment is discouraged by China's strict capital restrictions and controlled currency system. Sharp declines, such as the drop in 2024, demonstrate how quickly money withdraws during uncertain times, while high peaks of FDI, reaching over $100 billion in many quarters, illustrate spikes in international interest. In contrast, FDI growth has been more consistent in other emerging countries, such as India which takes a more open market approach. In 2022, India brought in $84 billion in FDI without experiencing the same degree of volatility as China. Notably, this emphasizes that underlying prohibitions and market access limits have prevented such policies from entirely stabilizing or increasing FDI growth, even with expansions in programs such as the QFII.

On the other hand, because investors are confident in their capacity to transfer money freely in and out of the nation, the United States, with its free-floating dollar, enjoys more steady capital flows despite less direct government action. Businesses may now invest in the United States more easily without having to worry about the same bureaucratic obstacles that exist in China.

Inefficiencies in China's stock market are a result of institutional disadvantages such as capital flow restrictions, currency control, and the QFII program's restricted access for international investors. These fundamental problems handicap China's progress toward complete economic

reform and restrict the nation's capacity to draw in long-term foreign investment. Because of these restrictions on the Chinese stock market, a lot of Chinese businesses - especially those in the technology sector - look abroad for more advantageous prospects. The New York Stock Exchange (NYSE) has become the preferred exchange for large corporations such as Alibaba and JD.com over Hong Kong or mainland exchanges due to limited access through Stock Connect and bureaucratic obstacles in the local market. This change underscores the need for more transparent, liquid, and open markets that provide these businesses access to a larger pool of investors and increase their capacity to raise capital - a topic we'll go into more detail about.

Authoritarian Policies and Investor Concerns

In addition to capital flow limitations and currency control, authoritarian policies are another significant institutional disadvantage contributing to the flaws of the Chinese market. This market operates within an authoritarian, one-party system that enables rapid decision-making and policy implementation. However, this system also raises concerns over stability and transparency, which pose major threats to the health of the country's stock market. This section of the research paper will briefly explore four case studies - the 2015-2016 Chinese stock market turbulence, Common Prosperity Policy, the Zero-Covid policy, and Jack Ma’s disappearance and its effects on Alibaba - to illustrate the impact of authoritarian policies in a centrally planned economy on the Chinese stock market.

China’s one-party system exercises a high level of control over the economy, meaning that policies and regulatory decisions can be imposed without warning, which increases the perceived risk of investing in Chinese companies, particularly for foreign investors. The constant threat of regulatory crackdowns or state intervention in key industries leads to stock market instability. These sudden policy shifts, especially toward large private enterprises, frequently drive market volatility, causing significant fluctuations in stock prices and eroding trust in the consistency of Chinese market regulations.

In the graph below, we can observe how the S&P 500 Index, which reflects the stock performance of 500 of the largest companies listed on the U.S. stock exchange, shows a steady upward trend, indicating strong and stable growth in the U.S. market. In contrast, the Hangseng Index exhibits more volatility and relatively weaker growth. Notably, the Hangseng Index experienced sharp spikes in 2015; however, these gains were not sustained, leading to a prolonged period of stagnation. Meanwhile, the S&P 500 continues its upward trajectory, making it a much more appealing market for investors.

Graph. Hangsen Index vs. S&P 500

https://www.tradingview.com/

One example of how direct government intervention caused instability in the stock market is the Common Prosperity Policy, introduced by Xi Jinping in 2012. This authoritarian policy aimed to reduce wealth inequality by promoting more balanced economic growth and imposing stricter regulations on large corporations, especially in sectors like technology, education, and real estate.[1] While the initiative was meant to benefit the broader population, it led to significant government intervention in key industries, which reduced investor confidence and caused stock market underperformance, as shown in the graph. The widening gap between the S&P 500 and the Shanghai Stock Exchange from 2012 onward indicates a divergence in investor confidence between China's regulated market and the U.S. market, known for its stability and transparency. The implementation of the Common Prosperity policy introduced regulatory changes that contributed to uncertainty, particularly for foreign investors, leading to reduced investment and slower growth in the Chinese market.

Another example of how government intervention caused instability can be seen in the sharp rise and fall during the 2015-2016 Chinese stock market turbulence, which was largely driven by government actions during a stock market bubble. First, the Chinese government encouraged stock investment, promoting it as a way for ordinary citizens to grow their wealth. This led to a surge in buying, particularly from inexperienced retail investors, many of whom borrowed money to buy even more stocks. Consequently, stock prices rose far beyond the actual value of companies, raising concerns about a potential crash. To manage the instability - largely driven by excessive speculation and market manipulation in this centrally planned economy - the government further intervened to stabilize the market. They halted initial public offerings (IPOs),

and the China Securities Regulatory Commission (CSRC) imposed a six-month ban on stockholders owning more than 5% of a company's stock from selling. This move temporarily boosted the market by 6%.[1]

Overall, this period exemplifies how the government intervened and manipulated the market in various ways within a short time period. Such events clearly demonstrate the higher risks for investors due to the unpredictable nature of the Chinese government's authoritarian decision-making, leading to a volatile and unstable market.

Moreover, China's Zero-Covid policy is an example of how government decision making can indirectly influence economic conditions. China's Zero-Covid policy was imposed by the Chinese authorities in 2020 in response to the pandemic, and it was aimed at preventing and controlling Covid-19 outbreaks through early detection, quarantines, and lockdowns, with measures like regular PCR testing, isolation of suspected cases, and swift lockdowns of buildings or cities to cut off transmission chains. While this policy was effective in reducing virus transmission, to an extent it had severe consequences for the economy, particularly for businesses dependent on supply chains and consumer activity.

These restrictions led to a decrease in manufacturing output, disruptions in global supply chains, and a decline in domestic consumption since people could not leave their homes. Chinese companies, especially in sectors like manufacturing and technology, saw significant losses in stock value as their operations were slowed. Consequently, foreign investors, uncertain about the future direction of government policy, left the market, leading to a sharp decline in market indices. Since then, the Chinese economy has struggled to rebound from three punishing years of "Zero-Covid" policies during the pandemic, which prioritized health and security over economic growth.

Finally, one of the most recent examples of authoritarianism in China is the disappearance of Ma. In 2020, Jack Ma, the founder of Alibaba, which is a Chinese multinational technology company specializing in e-commerce, retail, and technology, publicly criticized China's financial regulatory system. Shortly after his words, the Chinese government suspended the Ant Group´s IPO, which was the largest planned IPO at the time. Following this, Jack Ma's disappearance from public view for several months raised concerns about the extent of government control over private businesses. The episode severely undermined confidence in the transparency and fairness of the Chinese stock market, leading to a sustained decline in Alibaba's share price, as shown in Graph XX below, following the prohibition of the Ant Group IPO. Foreign investors, in particular, grew more cautious about investing in Chinese tech firms, fearing they could face similar government interference.

Graph. Alibaba's Stock Market.

https://www.nytimes.com/2024/01/23/business/dealbook/jack-ma-alibaba-shares.html

The sharp and sustained drop in Alibaba's stock price demonstrates how government actions, particularly in an authoritarian regime, can undermine investor confidence and market stability. This case illustrates the risks posed by unpredictable political decisions and highlights broader concerns over the transparency and long-term viability of the Chinese stock market.

While centralized decision-making enables rapid policy implementation, it also introduces significant risks and challenges for the Chinese economic landscape by reducing investor trust. As seen in the previous examples, government actions frequently create market volatility and undermine investor confidence, as the unpredictability of policy shifts makes future developments uncertain. This lack of transparency makes it difficult for investors to plan long-term, particularly given the potential for sudden government intervention in private companies and broader market dynamics. As a result, concerns over stability and transparency pose major risks to the overall health of the Chinese stock market. For China to attract and retain global capital, it must address these concerns and balance its need for political control with the market's demand for transparency and predictability.

Listings Abroad

When considering the trading of Chinese companies in the U.S stock exchanges, it is important to talk about ADRs. ADRs are negotiable securities that represent securities of foreign companies. Thanks to these depositary receipts, US investors can buy securities of foreign companies in the domestic stock exchanges. This ADR program simplifies the process of exchanging foreign shares, taking into account that it's only the receipts that are traded, investors do not have to worry about exchange rates or opening abroad accounts. These receipts act as shares, as they entitle investors to receive dividends and capital gains.[1]

Although, ADRs give a possibility for investors to invest in foreign companies without the necessity of having to tackle the complexities of foreign exchanges. These receipts are subject to exchange rate risks, meaning that fluctuation in the foreign currency can affect returns for investors.

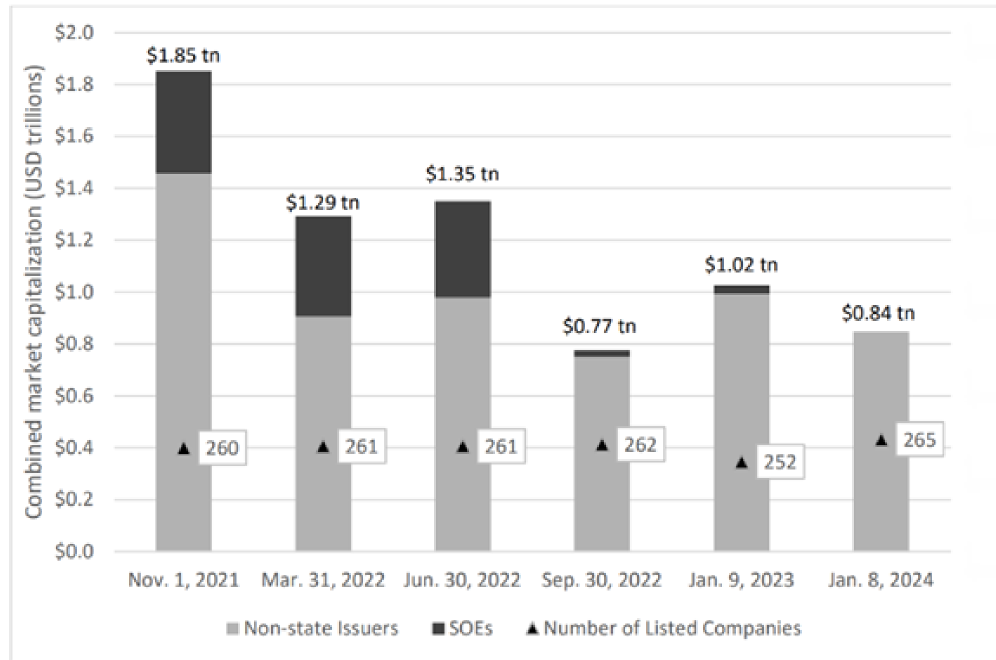
Relationship between the US Stock Markets and Chinese Companies.

Important Chinese companies, such as Pinduoduo or Alibaba have been trading in the US Stock market for the last two decades. Most of these companies have entered the market using Variable Interest Entities (VIEs) - a structure that many companies used to bypass the regulatory limitations for foreign investment -. In 2023, with the increase of the use of this corporate structure, China endured the restrictions of foreign investment in sectors such as tech.

On one hand, the China Securities Regulatory Commission (CSRC), implemented a new process. This process obliges all companies to register all their Initial Public Offerings (IPO) in foreign stocks with the CSRC. The aim of this is to guarantee compliance with national regulations and protect sensible sectors, in order to safeguard national security. This regulative standard enables China to ensure that companies raising foreign capital are aligned with its economic and political interests.

On the other hand, The Public Company Accounting Oversight Board (PCAOB) signed an agreement with the CSRC allowing it to carry out inspections and investigations of Chinese audit reports. These investigations resulted in the imposition of fines on audit firms such as PwC or KPMG Hong Kong for misstatements and inconsistencies in the reports. If Chinese auditors obstruct PCAOB reviews for two consecutive years, they will be banned from the US stock exchanges.

This agreement between the PCAOB and the CSRC has resulted in SOEs leaving the US stock exchanges. This has happened because of the high costs, and administrative burdens and to protect information about these companies, as they are directly related to the country. [2]



Although the government wants to have a lot of control over the listing abroad of its companies, it has contributed significantly to many companies going to foreign markets for capital. A clear example of this is that the government has allowed companies to issue medium- to long-term foreign debt. For instance, South China's Guangdong Province, grant incentives of up to 4 million yuan ($560,000) to enterprises that are listed in overseas markets.

With this in mind, Chinese enterprises, especially emerging ones, are listing abroad to achieve accelerated growth. Greater access to capital in stock markets such as the New York Stock Exchange offer more market capitalisation than the Chinese markets. [3]

For these reasons, we can find important Chinese companies, such as; Alibaba, Pinduoduo, NetEase, Baidu INC and Li Auto listed in the US exchanges. Alibaba is a clear example of the benefits of listing abroad. It completed an initial IPO of 25$ billion in the NYSE. In 2018, Alibaba performed a secondary listing in Honk Kong while maintaining New York as its primary listing venue. With this strategy, the company has managed to maintain the benefits of the US market, with more activity and stability. And, at the same time, it is able to show itself as a company committed to domestic markets and to gain the benefit of having direct access to Asian investors. [4]

	Symbol	Name	Market Cap (US$ mil)	IPO Month and Year	IPO Value (US$ mil)	Sector	Lead Underwriters
1	PDD	Pinduoduo Inc.	$196,033	July 2018	$1,626	Business Services	CICC, Credit Suisse, Goldman Sachs
2	BABA[+HK]	Alibaba Group Holding Limited	$183,174	September 2014	$21,767	Technology	Credit Suisse, Deutsche Bank, Goldman Sachs, JP Morgan Chase, Morgan Stanley, Citigroup
3	NTES[+HK]	NetEase, Inc.	$59,617	June 2000	n/a	Technology	Merrill Lynch, Deutsche Bank
4	JD[+HK]	JD.com, Inc.	$41,300	May 2014	$1,800	Consumer Services	Merrill Lynch, UBS
5	BIDU[+HK]	Baidu, Inc	$41,217	August 2005	$109	Technology	Goldman Sachs, Piper Jaffray, Credit Suisse
6	LI[+HK]	Li Auto	$34,463	July 2020	$1,000	Consumer Durables	Goldman Sachs, Morgan Stanley, UBS, CICC

[5]

Risk of investment in US-Listed Companies.

Although the PCAOB has signed an agreement with the CSRC to oversee audit reports of Chinese companies, there are some fears that China will once again restrict this access to accounts. This worrying comes because in the past, companies such as Luckin Coffee, that failed to comply with auditing standards and were therefore sanctioned by the PCAOB, caused huge losses to their investors and were even expelled from stocks such as the NASDAQ.

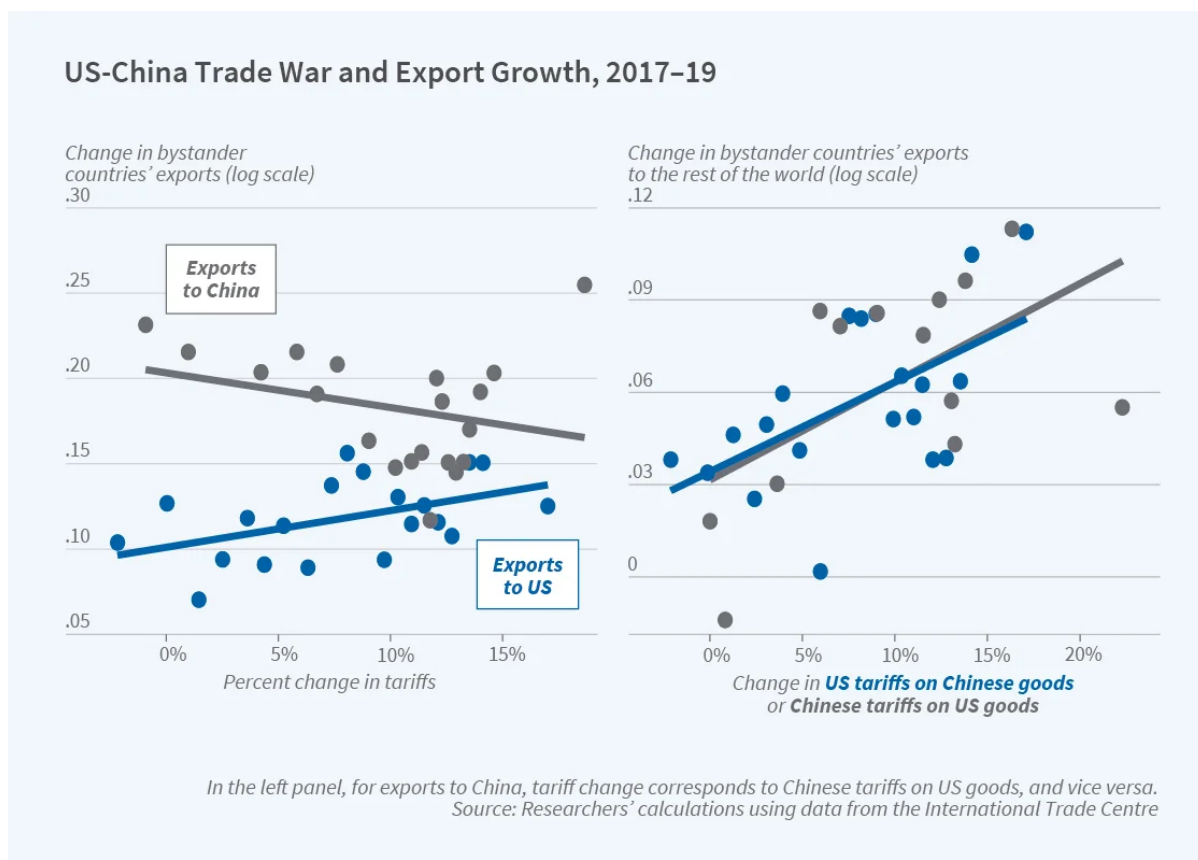
Because of the influence the Chinese government has on companies, even private ones, there are investors who are concerned about US national security.One example of this is the incorporation of companies that have subsequently been added to the list of Chinese military companies. The most obvious examples are Weibo Corporation, which collaborates with the Chinese government in censorship.

These concerns about government influence are linked to China's tightly controlled financial system, resulting in a structural disadvantage that directly impacts its markets. China's economic liberalization is still lacking.

Geopolitical Factors

China-U.S. Trade War

Investor confidence has been severely damaged by the ongoing trade war between the United States and China. When the Trump administration placed tariffs on Chinese imports in 2018, tensions increased and China responded with retaliatory tariffs. Technology, industry, and agriculture were among the industries impacted by this trade dispute, which had repercussions for the whole world economy. For example, as trade tensions escalated between 2018 and 2019, the Shanghai Stock Exchange Composite Index dropped by around 25%. [1]



US-China Trade War and Export Growth, 2017-2019

How the US-China Trade War Affected the Rest of the World. (n.d.). NBER.
https://www.nber.org/digest/202204/how-us-china-trade-war-affected-rest-world

The trade war raised doubts among investors about the long-term viability of Chinese businesses, especially those that depend on exporting to the United States. Investor confidence was also harmed by U.S. penalties on Chinese companies like Huawei, which limited their access to American technology. In 2021, Huawei's sales dropped by 29% to $99.5 billion, demonstrating the detrimental effects that sanctions may have on significant Chinese companies. [4]

In addition to tariffs and restrictions already in place on Chinese technology, the United States has increased its suppression on Chinese solar exports. Opportunities for nations like India to fill the void have been created by tariffs of up to 293% on Chinese solar imports. [3] To illustrate how geopolitical tensions may alter global supply chains, U.S. imports of Indian solar panels increased from $250 million to $1.8 billion in a single year. By taking advantage of the exclusion of Chinese enterprises, Indian companies like “ReNew” are establishing themselves as important suppliers to the United States. [2]

According to an expert interviewed, China lost that war. Although both parties experienced financial losses, China was especially susceptible to the U.S. tariffs because of its status as an export-driven economy. Industries that had long formed the pillar of China's economy saw important reductions as a result of the trade war. It forced several firms to reduce production, fire employees, and adapt to the lower demand. He also said that the trade conflict also showed how reliant China is on vital U.S. imports, especially in the technology sector. This hindered their ability to compete globally and postponed the nation's aspirations to lead high-tech industries like artificial intelligence, semiconductors, and 5G. Finally, in order to reduce the risks connected with tariffs and geopolitical concerns, we saw that some companies were forced to look for options outside of China, relocating their production operations to nations like Vietnam, India, and Mexico.

China has faced notable setbacks, evident in the adjustments to corporate strategies, a decline in investor confidence, and the reorientation of supply chains away from the country.

China and Russia's Political Alignment

Foreign investors are also concerned about China's close political ties to Russia, particularly in light of the international sanctions imposed on Russia as a result of the conflict in Ukraine. Although China has not provided direct military support to Russia, secondary penalties from the US or the EU may result from its diplomatic and commercial connections with Russia. For businesses in industries like energy, where China-Russia collaboration is significant, this may cause a danger.

After Russia was subjected to Western sanctions following its annexation of Crimea, China and Russia's economic ties became much stronger in 2014. [5] Russia sought deeper connections with China as a result of these sanctions, especially in the energy sector. That year, the two countries struck a $400 billion gas supply agreement, which was a watershed in their economic cooperation. Since then, their collaboration has grown, and their commerce has increased significantly, particularly in the areas of infrastructure, technology, and energy. For instance, when the two nations strengthened their economic connections back in 2023, their trades

increased by about 30%. Although this helps certain Chinese industries in the short run, it puts China at danger of international penalties, particularly as Western nations attempt to economically isolate Russia. Investors could worry that Western sanctions might target Chinese businesses that collaborate closely with Russia, so restricting their access to international markets. [6]

Subsidies for SOEs: Benefit or a Disadvantage?

As we previously said in our paper, China's economy heavily relies on SOEs, which are given extensive government support in the form of subsidies and advantageous regulations. For investors, this brings dangers as well as possibilities. On the one hand, government support for SOEs in industries like infrastructure and energy makes them more stable during difficult economic times. However, dependence on SOEs can result in inefficiencies and distort market competitiveness. [5]

The market for electric vehicles (EVs) is one sector where subsidies have generated a lot of controversy. Chinese EV manufacturers, like BYD, have dominated the local market thanks to billions of dollars in government subsidies. However, international trading partners have begun to examine these subsidies carefully. On October 25, 2024, EU tariffs on imports of Chinese electric vehicles officially came into force: a 45.3% tariff designed to ensure that Chinese EV manufacturers, unfairly subsidized by the government, are unable to undercut European prices. Major Chinese corporations that have been actively growing in Europe, like BYD and Geely, are anticipated to be greatly impacted. In 2023, Chinese EV shipments to Europe increased by 90%, and they now make up more than 7.5% of the EU's EV market.

Due to their disadvantages over domestic rivals, international businesses may be discouraged from investing in China as a result of this bias. Additionally, investor confidence may be lowered by the apparent absence of fair playing fields, particularly in industries like infrastructure, energy, and telecommunications where SOEs predominate. [5]

Implications of tariff policies and U.S. presidential election

The United States is expected to take a more assertive posture toward China since Donald Trump has been reelected the 6th november 2024, possibly extending penalties and tariffs.

Concerns about new taxes on Chinese imports are more probable than ever if Trump-era practices return, which may seriously disrupt China's export markets. As seen in the past when U.S.-China trade tensions resulted in stock market volatility and a depreciation of the yuan, the Chinese economy is heavily dependent on its export sector. Therefore, any increase in U.S. tariffs

would probably create significant changes in investor sentiment. More foreign investors may reconsider their holdings of Chinese equities if these tariffs are implemented, particularly in industries that are susceptible to international trade interdependence.

The stability of the stock market and investor confidence are continuously in danger due to China's currency control practices and the possibility of further U.S. tariffs. Although the PBOC's balancing effort attempts to protect the economy from outside shocks, volatility is nonetheless caused by the underlying political uncertainty in U.S.-China relations. [7]

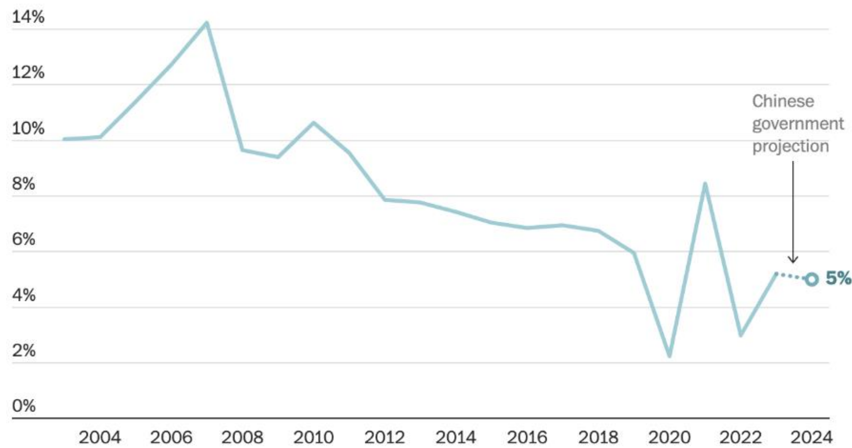
Economic Challenges related to its Political Regime

China's authoritarian regime and decision-making, has brought significant challenges to the economy. Challenges such as GDP growth, demographic shifts and rising debt, have profound implications for China's stock market performance and investor confidence.

Slowing GDP Growth

Over the past few decades, China has experienced slower GDP growth, largely attributed to endogenous factors, particularly its government's authoritarian policies and heavy market intervention. However, some of this slowdown can also be attributed to exogenous factors, which refer to external economic conditions beyond China's direct control.

Graph. GDP Growth China



https://www.washingtonpost.com/world/2024/09/20/chinese-economy-slowdown-real-estate-crisis/

One of the first notable periods of economic slowdown in China, attributable to exogenous factors, occurred during the Asian Financial Crisis of 1997-1999 and the Global Financial Crisis of 2008. For instance, the Asian Financial Crisis severely impacted many Asian economies, leading to a sharp decrease in FDI in China. This decline in FDI had a direct effect on China's export-driven economy, causing a significant drop in export growth.

On the other hand, a critical endogenous factor contributing to China's economic slowdown is the housing market crisis. The property and housing market, which until recently accounted for almost one-quarter of the economy and was a key driver of middle-class wealth, is now at the center of China's economic challenges. Following government restrictions on property developers' borrowing abilities in 2020, a string of defaults triggered a ripple effect across the economy. Real estate investments in China fell by 10.2% in the first seven months of this year compared to the same period last year.

Declining real estate prices have drained family savings and constrained local governments' ability to raise funds through land sales - one of their primary revenue sources. The collapse of major property developers, such as Evergrande, exposes the vulnerabilities in China's real estate market, which has been a key driver of growth for years.

Another endogenous factor that significantly contributed to the slowing of China's GDP growth occurred during the Covid-19 pandemic. The Chinese government's strict "Zero-Covid" policies, including extended lockdowns and severe restrictions, significantly disrupted both domestic and global supply chains. These interventions led to sharp declines in industrial output, consumer

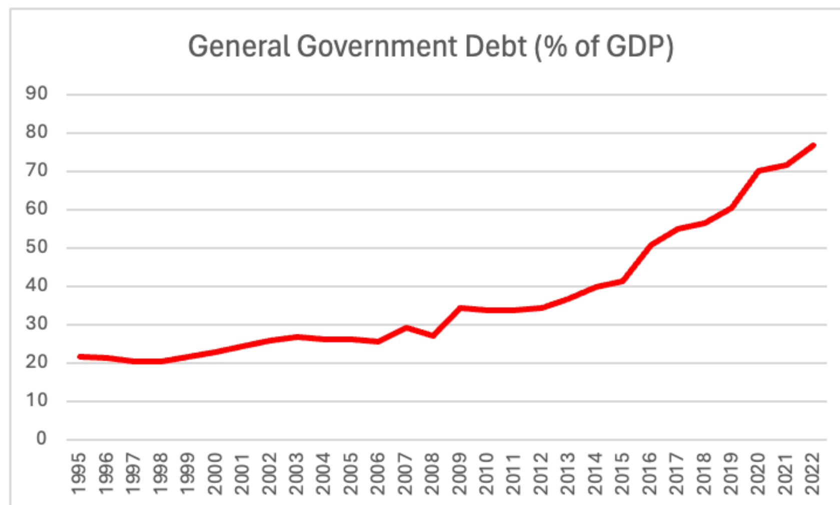
spending, and trade, pushing GDP growth to just 2.5% in 2020, as shown in the graph of Chinese GDP growth.When looking at the past 20 years, the economic growth of China has been slowing and is slowing faster than expected, with analysts predicting that China will miss its relatively modest 5 percent growth target for 2024. Market instability due to the uncertainty of authoritarian decision-making, reduced foreign investment as trust declined, and ultimately leading to slower GDP growth

Overall, unpredictable decision-making and a high level of control, have increasingly disrupted economic activity, reducing foreign investor confidence and leading to a decline in foreign direct investment (FDI). This internal approach to governance and economic management has been a primary cause of China's slower growth.

Rising Debt

Tied to slowing GDP growth is the issue of rising debt. China's government debt has grown significantly since the country opened up economically in 1978 under Deng Xiaoping's Open Door Policy. However, more recent increases in debt can largely be attributed to the country's slowing GDP growth. To fight economic slowdowns, China has employed expansionary fiscal policies, which involve increased government spending to stimulate the economy, therefore increasing government debt.

Graph. China's general government* debt *as a percentage of GDP 1995-2022



https://www.imf.org/en/Publications/SPROLLs/world-economic-outlook-databases#sort=%40imfdate%20descending

As shown in the graph of debt as a percentage of GDP, government debt was initially low, ranging from 20.6% to 29.17% in the late 1990s and early 2000s. The 2008 Financial Crisis marked a turning point, with the government significantly increasing spending to counter the recession. This spending led to a steady rise in the debt-to-GDP ratio from 2008 onward.

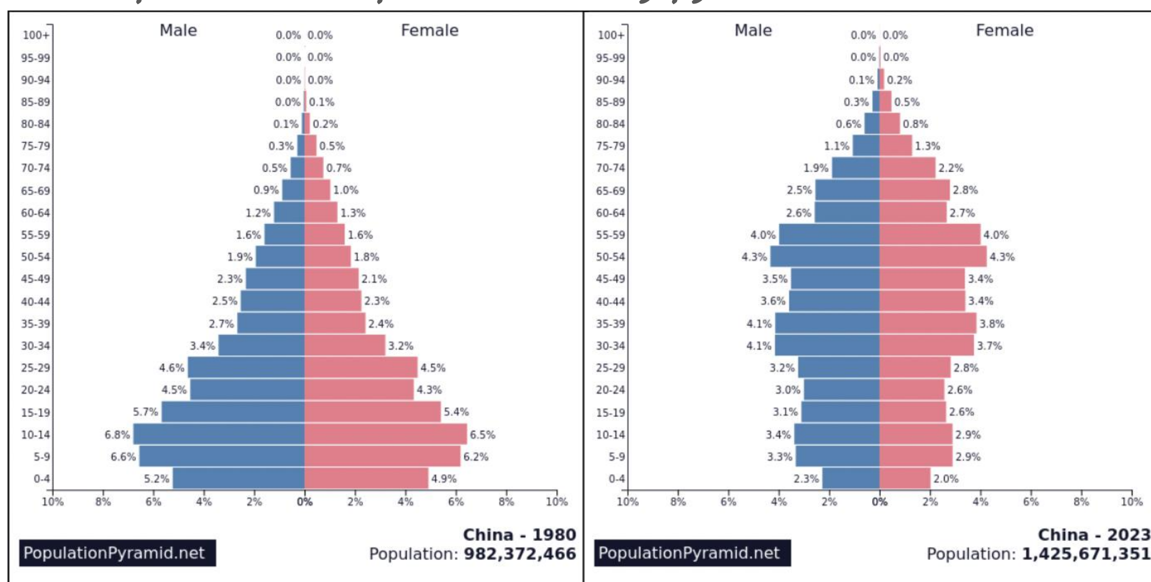
The most significant spike in debt occurred in 2020 during the Covid-19 pandemic, when factory closures, lockdowns, and massive public health expenditures caused a 10% increase in the debt-to-GDP ratio, reaching 70.1%. While economic growth could help manage this debt, the government's ability to reduce spending and improve solvency in the future remains uncertain.

Demographics Changes

In addition to slowing GDP growth and debt, demographics are not helping China's economic conditions either. Confronting an aging population and declining birth rate, the Chinese government in September 2024 announced that it would raise the retirement age by three years to 63 for men, and by five years to 55 for women in blue-collar jobs, as it attempts to tackle the shrinking workforce.

The shrinking workforce and aging population all links back to the One-Child Policy, a demographic intervention initiated in China in 1979 that restricted most couples to having only one child. It was implemented to facilitate economic growth under a planned economy that faced severe shortages of capital, natural resources, and consumer goods. By reducing fertility rates and slowing down population growth, the policy aimed to establish conditions favorable for economic development,.However, this policy resulted in a demographic shift towards an aging population and a shrinking workforce, so the initial intent of the policy, which was to bring favorable economic conditions, ended up in an aging population that puts even more pressure.

Graph. China's Population Density pyramids 1980 and 2023



www.populationpyramid.net/

The graph above depicts this transformation, portraying two population density pyramids representing the age-sex composition of China's population.

An aging population, tends to contribute less to the workforce because a greater proportion of individuals are either retiring or facing reduced productivity due to age-related factors, such as health issues and decreased physical capabilities. This shift in the demographic structure has led to a declining labor force participation rate, potentially impacting overall economic productivity and placing an increased burden on the economy which is also facing slowing GDP growth and rising debt.

Youth Unemployment

China's youth unemployment rate for 16 to 24-year-olds reached 21.3% in June 2023, as shown in the graph below, driven by several interconnected factors. The Zero-Covid policy significantly disrupted the economy, forcing many businesses to cut costs and thus layoff workers and limiting job opportunities for young workers. Additionally, the housing market crisis further dampened economic activity, as the collapse of major developers like Evergrande reduced demand in industries reliant on real estate and construction, sectors that often provide entry-level employment opportunities.

Graph. China's youth (16 to 24) Unemployment rate 2021-2024

Monthly surveyed urban unemployment rate of people aged 16 to 24 in China from June 2021 to March 2024

China: monthly surveyed youth unemployment rate 2024 | Statista. (2024, April 22). Statista. https://www.statista.com/statistics/1244339/surveyed-monthly-youth-unemployment-rate-in-china/

Moreover, the ongoing economic slowdown has affected the issue, creating a mismatch between the jobs available and the qualifications of young graduates. As companies struggle to recover from the effects of the pandemic and a slowing economy, they are more selective in hiring, often requiring higher qualifications and demand higher skills that many young people do not yet know. Government interventions, the real estate crisis, and an economy recovering from external shocks are causing young workers to face limited employment opportunities.

Overall, the economic challenges facing China from slowing GDP growth and rising debt to demographic shifts and a housing market crisis are closely tied to the country's political regime. These issues not only create economic stability for the country but also reduce investor confidence,.China's population,, has opted to save rather than invest, further reducing capital inflows that could stimulate growth. As China grapples with these internal struggles, substantial reforms are needed to restore market confidence and drive sustainable growth.

Stock Market Valuation: Undervalued or Misunderstood?

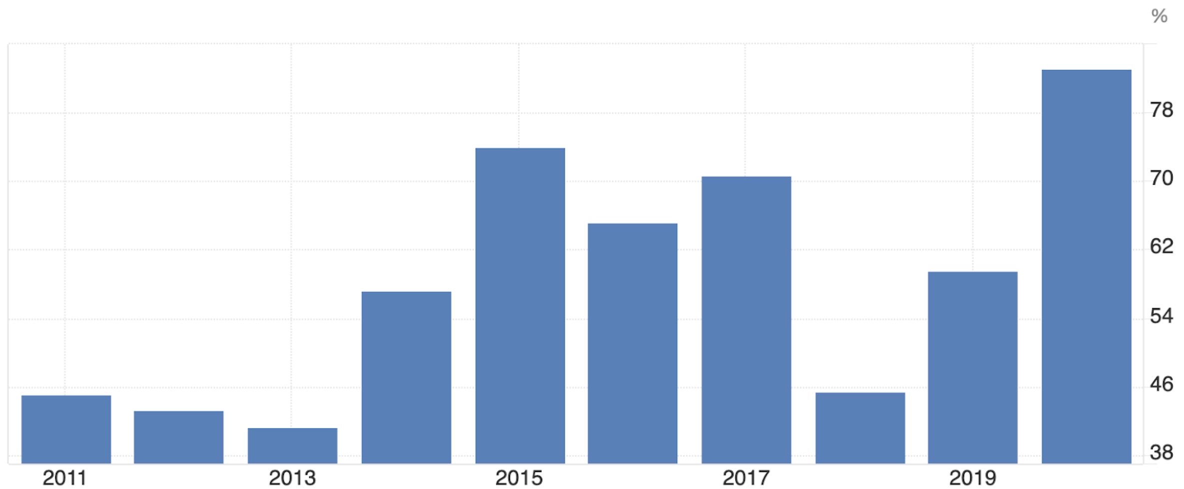
Current Valuation

The Chinese stock market has historically been perceived as undervalued by global standards, because of its lower price-to-earnings (P/E) ratios than Western markets like the U.S. The P/E ratio for the Shanghai Stock Exchange was 14,03 as of October 25, 2024. [1] By contrast, the P/E ratio of the U.S. S&P 500 is around 29,7 [3]. Chinese stocks are priced at far lower multiples than the U.S. stocks, showing that there is a big difference between the two markets. This disparity questions us about whether systemic risks are taken into account when determining market values or if the market is indeed undervalued.

However, market performance has changed historically as a result of recent changes in China's monetary and fiscal policies. The Chinese government implemented substantial fiscal stimulus measures together, which represents 6% of GDP and is anticipated to reach approximately ¥7.5 trillion (US$1.07 trillion) as of October 2024. [2] Massive mortgage debt reductions, new stock market facilities, and bond issuances are some of the measures. As a result, several firms' market capitalizations have increased quickly, with some enjoying increases of over 100%, while the Hang Seng Index (HIS), which is sometimes seen as China's version of the S&P 500, has increased by 30%. [2]

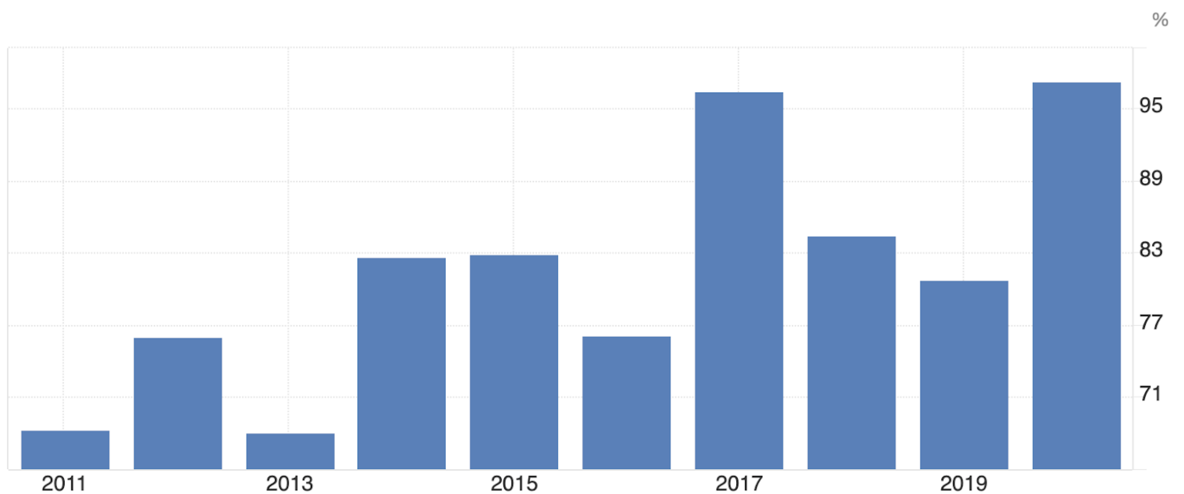
The debt-to-equity ratio is a crucial indicator that backs up the undervaluation concept. Because of government policies that encourage cash flows and reduced leverage, many Chinese businesses maintain low debt levels. For example, leading tech companies like Tencent and Alibaba disclose debt-to-equity ratios of about 20–30%, which is low when compared to their international equivalents (around 52%, according to EQVISTA). [8] Theoretically, these healthy balance sheets should indicate a stronger valuation.

However, this is not always reflected in the stock market. In contrast to other developing economies like India, where stock growth more closely reflects GDP growth, the discrepancy between China's GDP growth - which has averaged 6% over the last decade - and stock market performance also points to an undervaluation. As seen in the two figures below, China's stock market capitalization to GDP (%) was 83.16% in 2020, while India's stock market capitalization to GDP (%) was 97.29 % in 2020, according to the World Bank. [9]



China - Stock Market Capitalization To GDP

TRADING ECONOMICS. (n.d.). China - Stock Market Capitalization to GDP - 2024 Data 2025 forecast 1992-2020 historical. *https://tradingeconomics.com/china/stock-market-capitalization-to-gdp-percent-wb-data.html*

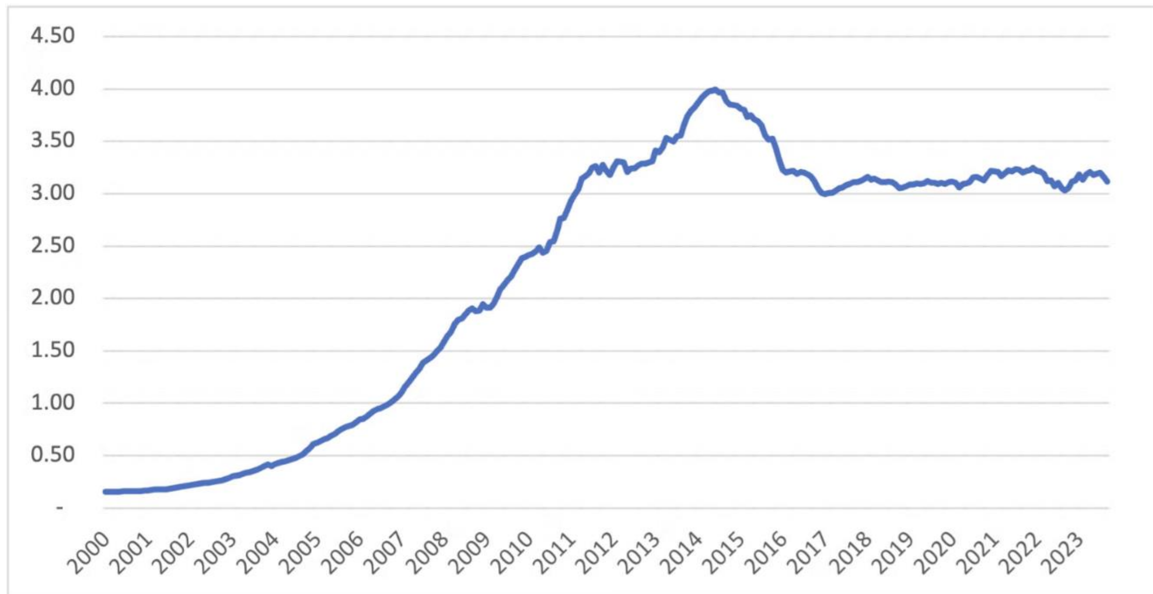


India - Stock Market Capitalization To GDP

TRADING ECONOMICS. (n.d.-b). India - Stock Market Capitalization to GDP - 2024 Data 2025 forecast 1989-2020 historical. *https://tradingeconomics.com/india/stock-market-capitalization-to-gdp-percent-wb-data.html*

As we previously talked about in our section on "Pegged Currency and Capital Flow Limitations" China kept its currency pegged to the US dollar and devalued the yuan artificially in order to increase exports. [10] Due to the PBOC's extensive purchases of foreign currencies,

mostly US dollars, the Chinese yuan continued to be undervalued in relation to its true market value. As seen in the picture below, China's foreign reserves increased dramatically, reaching about $4 trillion in June 2014. [11]



China Foreign Exchange Reserves (USD trillion)

International Monetary Fund (n.d.). https://data.imf.org/?sk=E6A5F467-C14B-4AA8-9F6D-5A09EC4E62A4

Additionally, we can see that Chinese foreign reserves increased from $2 trillion to $4 trillion in the first 5 years following the great financial crisis. However, the Belt and Road Initiative started by the Chinese government in 2013, created a significant demand for the yuan while rapidly devaluing US dollars. The BRI-backed projects, which included power plants and highways, received loans totaling over $120 billion. [13] With an abundance of foreign investment, China thought that the yuan would replace the US dollar as the world's preferred currency. [14]

As a consequence of this high demand for the yuan, Chinese authorities wanted to internationalize the yuan and have free capital markets, therefore ignoring the trilemma - free capital flows, fixed exchange rates, and monetary policy autonomy. [16] China thought that limitless reserves of U.S. dollars would prevent speculative attacks, which frequently lead to the downfall of governments that try to maintain open capital accounts, monetary policy autonomy, and fixed exchange rate regimes.

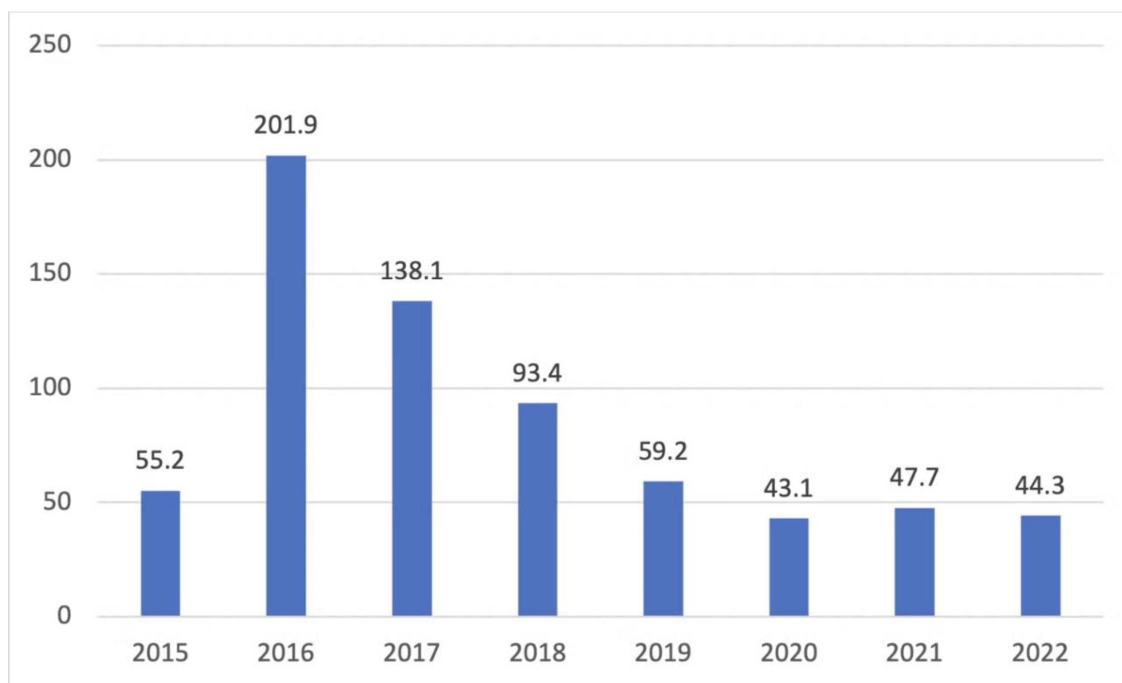
However, in 2015 and for the first time since 2008, the Federal Reserve increased US interest rates. [6] [15] A lot of experts were convinced that the Chinese economy would take a severe hit. [4] The reality was that investors began selling yuan assets and capital began to flow out of China quickly, causing a speculative attack on the currency. [7] In fact, a stronger U.S. dollar and the devaluation of currencies like the yuan resulted from investors finding American assets more appealing due to the prospect of higher profits brought about by higher U.S. interest rates. [5] In search of greater returns in the U.S. market, many investors therefore started liquidating their Chinese assets in favor of USD investments. [6] Therefore, the yuan was under pressure from this capital flight from China, which caused a dramatic rise in capital outflows. [7] The Chinese economy lost about $1 trillion in 2016. [5] [12]

Shanghai Stock Exchange Composite Index 2014-2015

Lee, T. B. (2015, August 26). China's stock market crash, explained in charts. Vox.
https://www.vox.com/2015/7/8/8911519/china-stock-market-charts

We can see that on June 12, the Shanghai Stock Exchange Composite Index peaked at 5166 (this means that the index's value increased to 5166 points as a result of the aggregate market performance of the businesses listed on the SSE), up around 150% from June 2014 to June 2015. After that, the market collapsed. It dropped to 3507 in less than a month, a 32% decrease.

With capital outflow restrictions removed and local banks offering generous credit, state-owned enterprises acquired international corporations in transactions worth $200 billion. 2016 saw nearly 4 times as many outbound mergers and acquisitions (M&A) from China as the year before, shown by the graph below. [14] By purchasing international enterprises, Chinese companies were essentially betting on the devaluation of the yuan. Thus, China's initial plans for a universal yuan were dismantled by a speculative attack.



Outbound M&A deal value by companies from China between 2015 and 2022 (in billions USD)

Statista. (2024, July 22). Announced outbound M&A deal value in China 2015-2023. https://www.statista.com/statistics/1120348/china-announced-outbound-merger-and-acquisition-deals-value/

Nonetheless, one interesting thing on this graph is the dramatic fall from 2016 to 2023, which can be explained by the fact that in August 2016, the PBOC allowed the yuan to devalue (intentional reduction of a nation's currency to make its exports more affordable and competitive in global markets) by over 3% daily for 2 consecutive days. [11] At the same time tightened capital controls for private and public companies (actions taken to stabilize the economy by limiting the flow of foreign capital into and out of the country). Investor behavior was greatly affected by this change in policy. Fearing more devaluation, investors withdrew their money from China as the yuan declined in value, which put downward pressure on the stock market as

liquidity shrank. At the same time, Chinese businesses found it challenging to get the money required for foreign acquisitions because of these stricter restrictions on capital outflows. As a result, the value of outbound M&A fell by 90% between 2016 and 2023, as Chinese corporations had restricted access to loans to fund the acquisition of Western enterprises.

Today, as we saw in our part "Pegged Currency and Capital Flow Limitations", the yuan is much closer to a free-floating currency (currency that is not established by a central authority but rather by market factors) [10]. Before 2016, the yuan fluctuated little, providing a stable environment for business and stock market investments. However, now it varies according to the business cycle (economic growth's natural increase and decrease throughout time). Instead of stepping in to keep the yuan under certain levels, the PBOC has allowed it to appreciate and depreciate according to the relative amounts of foreign currency entering or leaving China. This adjustment has increased the stock market's sensitivity to currency fluctuations since shifts in the value of the yuan have a direct impact on the return on investment for foreign investors in Chinese markets as well as the cost of doing business for Chinese companies operating outside.

Investment Opportunities

As it has been seen, China's economy is defined as an unstable economy due to regulatory uncertainty, governmental influence, and authoritarian policies... This has a clear direct effect on the price of Chinese companies. However, as Warren Buffet said, it is important not to confuse the price of a company with its value. Several companies stand out due to their solid performance, showing remarkable growth potential and, most importantly, possessing strong cash flows.Taking this into account, it can be argued that these indicators show that many Chinese companies have very strong profitability and financial health.real value. This gives investors reason for optimism that they can expect an increase in the value of the stock prices of many Chinese companies.

Taking this into account, it could be argued that Chinese stocks show great opportunities for investors. However, it is important to differentiate between short-term and long-term. Those investors who are risk-averse and have a long-term view may find a compelling opportunity in the Chinese markets. But those with short-term intentions may be clearly influenced by the uncertainties surrounding China's market. Today, the Chinese market is facing a real estate bubble and a lack of transparency that makes it much safer to invest in a stock exchange such as the S&P 500.

According to an expert whose name cannot be given, China is ‘One of the biggest undervalued sectors, amazing companies that are extremely cheap like JD, should be 3 times more expensive’ and therefore assures that ‘I am convinced that in the future, China's stock market is going to take off when the sky will be clearer’.

Apart from this, it is important to mention the geopolitical factors that also affect investment opportunities. According to the expert ‘The day the US will be able to produce their microchips on their ground, they will not care about Taiwan and China will invade Taiwan and that's it, no doubts’, in addition, with the possible arrival of Trump to the government an increase in China's export tariffs could be seen. This could affect the value of many Chinese companies whose main revenue comes from exports. In addition, China's alignment with Russia and the recent exposure of investors in Russia makes investors more reluctant to invest in China and take similar risks. In addition, China's situation with Taiwan can be likened in some ways to that between Russia and Ukraine before the war, and this is a deterrent to many investors. These geopolitical factors can clearly weaken the Chinese market, causing the price of many companies to fall and even the value of these companies to decline due to a possible decrease in their performance.

The Chinese market presents very good investment opportunities for those risk-averse and long-term investors. However, it may not be an opportunity for those who look for short term investments, as fundamental flaws and geopolitical factors may directly affect the market, creating a drop in the value and price of Chinese companies' stocks.

Conclusion

In conclusion, the Chinese stock market is an important but complex part of the global financial system. China's attempts to participate in international markets while retaining strategic control are demonstrated by the market's transition from its initial, extremely limited state to one that is more open but still regulated. Although there are still obstacles because of strict capital restrictions and a controlled currency, reforms like the QFII and Stock Connect programs have improved international investment. Despite their intention to preserve economic stability, these laws restrict foreign investors' freedom to evaluate asset prices and repatriate revenues, increasing market uncertainty and inefficiency.

For long-term investors who are prepared to manage the risks, the Chinese market presents attractive potential in spite of these obstacles. A lot of Chinese businesses have solid financial results and room for expansion, which raises the possibility that certain stocks are undervalued

when compared to their international equivalents. However, domestic policy changes like the Common Prosperity Policy and geopolitical factors like the U.S.-China relations add layers of uncertainty that can alter market dynamics. The future of China's stock market will rely on how well it can create a more stable and open investment environment as it continues to strike a balance between its political goals and its economic aspirations.

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