ANDBANK
Private Bankers

Flash note
25/01/2024

Alex Fusté
@AlexfusteAlex
alex.fuste@andbank.com

Chinese authorities issue rescue package on slumping stock market. Our assement & Strategy

Greater China markets surged again on Wednesday in response to the recent stimulus measures orchestrated by the government aimed to reverse the pronounced long-term bearish trend in Chinese assets. Despite yesterday's surge, foreign investors were still net sellers of CNY539M in the session, meaning that only domestic investors gave support to companies like Alibaba (Jack Ma and Joe Tsai purchased more shares.

The regular reader is likely aware that our positioning in the group's discretionary management mandates entails zero exposure to the Chinese market—neither in equities, bonds, nor currency. The question I currently ponder is whether these stimulus measures can reverse the bearish trend in Chinese assets and, consequently, whether I should reconsider my strategy and begin acquiring some exposure to this market. To address this, let us first analyze precisely the measures announced and comprehend their potential impact:

The measures & my assessment.

- **PBOC:**
  - **Announcement of RRR cut by 50pb on 5-Feb in the last trading hour to inject CNY1T of liquidity into the market (US$136bn):** Not that it's a figure that impresses me. Additionally, given that the interest rate structure is already inherently lower than in the West, I presume there is not much more room to repeat this operation. I would view a stimulus operation more as a one-off measure.
  - **PBOC will lower rate for refinancing and rediscounting of loans by 25 bp from 25-Jan:** this measure will primarily support agriculture and small businesses. Not the large companies listed in the indices.
- **SOEs:**
  - **State Council officials noted that market value management will be a criterion in assessing performances of heads of the state-owned enterprises:** Will the CEOs of these companies be evaluated based on stock performance? Well, the measure is undoubtedly original. Not even in the most capitalist country would we see that. It suggests there is a sense of desperation to boost market prices. Typically, when there's desperation, it's because one doesn't see the end of the adjustment. Anyway, I suspect that linking the valuation of a CEO to the stock performance of that company might end up creating more imbalances than anything else. If only for the manifestation of the agency problem. You know, the executives' interests are not aligned with those of the ownership. I don't see a favorable long-term sense in this measure.
  - **Policymakers are seeking to mobilize about CNY2T ($278B), mainly from offshore accounts of state-owned enterprises, as part of a stabilization fund:** With this stabilization fund, the authorities intend to purchase shares of the index. Then, a reflection arises within me: The government takes money from a publicly traded state-owned company to put it into a fund, and in exchange, the company receive

participations of that fund. Ok. What will happen to the value of those fund participation if the strategy is merely to buy index shares without any market rationale? Most likely, this could temporarily lift the indices, but when the funds run out, it's probable that with such a strategy, the shares may be worth less in the future, and thus, the stock prices of the state-owned companies that contributed the capital could be negatively affected.

 - **CNY300B (some $40bn) of local funds to be earmarked to purchase onshore equities** through China Securities Finance Corp or Central Huijin Investment. Yes, an attempt to directly boost share prices, yet, the figure does not impress me, and the measure is fraught with the drawbacks mentioned earlier

- **Market restrictions:**
 - **China is expanding its net stock selling ban from major mutual funds to some insurers and Hed Funds:** Selling restrictions are included now as part of broader rescue efforts by authorities to stem market rout. I fail to comprehend why Chinese authorities persist in these measures to restrict market operations. The negative sentiment of recent months was precisely exacerbated after Beijing imposed selling restrictions on fund managers. Now, regulators issue the so-called "window guidance" (or restrictions in selling shares) to insurers and Hedge Funds. It is as if they believe their measures were not misguided in essence but only in intensity. That's why they now include more market agents in the package of restrictions on stock sales. Unfortunate, in my view.
 - **Draft rules on online gaming, which caused market havoc in December, were also removed from regulator's website.** This could be a sign that policymakers might moderate its stance on the sector.

In summary, authorities call for stronger stock market support, and to achieve this, it takes a battery of measures of diverse nature: monetary policy measures, channeling funds from state-owned enterprises, modifying incentives for SOE executives, and increasing restrictions on the sale of securities. In many of the measures, the specifics remain light. And for many of these measures, I do not see a promising future.

What Next?

It is quite possible that the market will experience an upward reaction for a while, perhaps days. After several attempts to boost the market, the government's only remaining option was to mobilize funds from state financial institutions, known as the 'national team,' to acquire shares on a large scale, as it did in previous episodes of market declines. However, I do not perceive in these measures the willingness to address the true root of the problem. As such, I suspect that the Chinese market will continue to be strongly influenced by adverse fundamentals, among which I would highlight attitudes towards private businesses and Beijing's stance on foreign policy, specifically towards Russia and also in relation to Taiwan. Reasons that would partly explain the country's poor economic performance after the pandemic and the sharp slowdown in the real capital inflow (IED) into the country. As much as the Chinese market may be cheap, none of these fundamental drivers is likely to change.

With regard to the persistent restrictions on market operations, especially in the sale of shares, I must say that there is no positive track record for this type of intervention in stock markets.

After these reflections and considering our better outlook in other emerging and developed markets, we will continue to maintain our strategy of zero exposure to the Chinese market, for the time being.