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China makes A-shares accessible to the global market

Gabriela Tinti

China has been increasingly opening up to the global market. Last year the Renminbi was taken into the currency basket of the International Monetary Fund in October 2016. Now, another step towards liberalisation has followed. China has cleared A-shares for international trade via trading platforms.

What are A-shares?

A-shares are securities issued by Chinese companies that are listed in Chinese currency, the Renminbi, at the stock exchanges in Shanghai or Shenzhen. Previously only Chinese citizens were allowed to trade these shares. This was due to the restrictive economic policy pursued by China, which was supposed to protect the domestic economy from foreign investors and their influence. From 2002 onwards, the first foreign investors were permitted to invest within the framework of the “Qualified Foreign Institutional Investors” (QFII) System. The programme entailed a substantial amount of terms that could only be complied with by very large international investors. Many of the most successful Chinese companies are listed at the Hong Kong Stock exchange or in the USA and have been accessible to international investors for years.

In spite of the opening of China, its equity market regulations still contain sizeable barriers to entry. Different categories of shares are available on the stock exchange, depending on the respective group of investors (domestic vs. foreign). In contrast to A-shares, B-shares are listed in foreign currency (Hong Kong dollar and US dollar) and can also be traded by foreign investors. The implementation of the trading platforms Shanghai-Hong Kong Connect (2015) and Shenzhen-Hong Kong Connect (2016) were important steps towards a liberalised market access. A-shares are currently only available on these two platforms.

What is new?

The Chinese equity market now ranks as second-largest financial centre in the world. As far as liquidity is concerned, it has long surpassed the US stock exchanges. Every year since 2013, the admission of Chinese companies into the MSCI indices[1] has been discussed, given that the quickly growing capital market in China continues to become more and more relevant. This year, MSCI has decided to take 222 A-shares into the Emerging Markets index in two steps in May 2018 and August 2018. At the moment, China accounts for a weighting of 28.55% in the MSCI Emerging Market index (please refer to chart no.1) on the basis of its companies listed in Hong Kong and the USA. Thus, China is already the most heavily weighted country in the MSCI Emerging Market index. At first, the additional weighting of A-shares will only account for 0.73% for 2018. This equals only 5% of all shares in the Chinese overall market.

A symbolic step

Accepting the A-shares is imbued with significant symbolic meaning. In the long run though, the economic effects are enormous as well, because the full implementation of these A-shares would translate into a weighting of 18% in the MSCI Emerging Markets index (based on current data). As a result, the weighting of China would increase to more than 40% (please refer to chart no.2). So far, MSCI has not indicated any schedule for full inclusion beyond the aforementioned time line. For Korea and Taiwan, the path to full inclusion of all shares took between six and nine years.

Country weighting of the MSCI Emerging Markets index

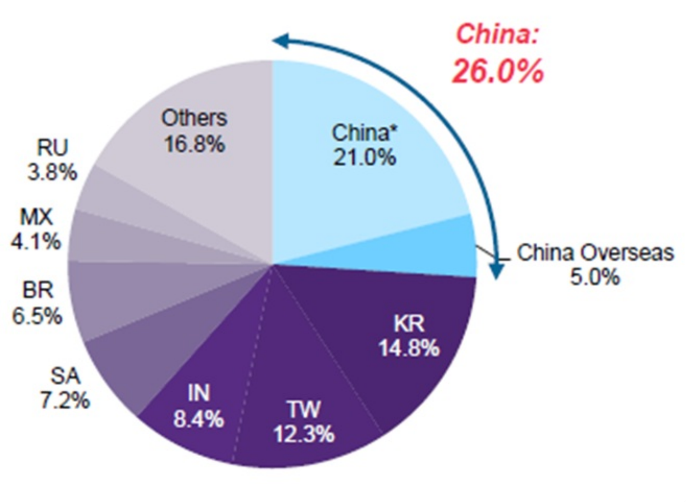

Chart 1: Status quo

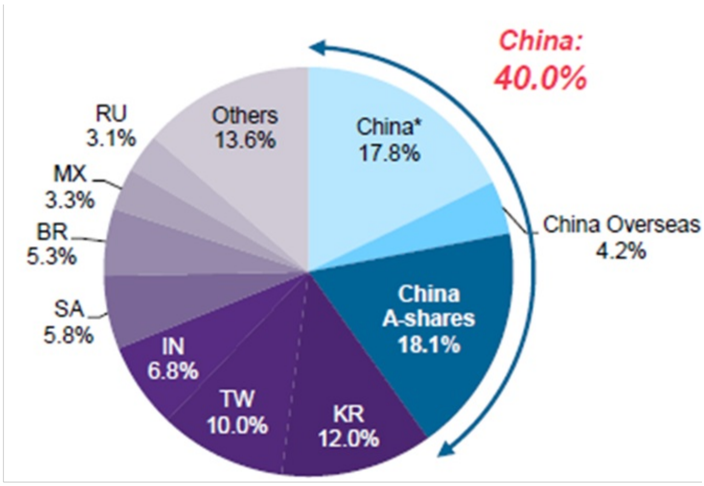

Chart 2: Potential after full inclusion of China

Source: MSCI, data as of 30th June 2016

Conclusion

The full inclusion of China will depend on how fast China is opening itself to the international capital market and is creating lower barriers to entry for all investors. In spite of the liberalisation of A-shares, the Chinese government has capped the purchase of A-shares by foreign investors at a total of 10%. This way, the Chinese government continues to limit the influence of foreign shareholders. That being said, the liberalisation of A-shares is very positive and could be a step towards a liberalisation of the entire country. China continues to harbour great growth potential. As a result of gradual liberalisation of the market and the inclusion of the Renminbi in the currency basket of the IMF, the relevance of China for the global economy has increased again.

[1]
MSCI Indices are equity indices that represent the development of equities in 23 developed and 23 emerging economies.

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Gabriela Tinti has been with the equity team of Erste Asset Management/ERSTE-SPARINVEST as senior fund manager since 2008. She focuses on companies from the global emerging markets and on property companies. Gabriela Tinti has worked in finance since 1988. At the beginning of her career, she was with a commercial bank, where she gained a wide range of experience in capital markets, retail and institutional banking, international finance, and corporate finance. In 2002 she moved to the asset management industry.