



Market Watch

Leaning against headwinds

Regulatory tightening puts pressure on Chinese equity markets

Summary

Chinese equities corrected sharply following new regulatory concerns. Regional markets were dragged lower as China regulatory tightening extended to the education sector.

Near-term technicals appear weak. Several equity indices breached key technical levels as recent policy changes caught markets off-guard.

We continue to view Chinese equities (offshore and onshore) as core holdings. Within MSCI China, we see limited spill-overs into the broader consumer and communication services sectors.

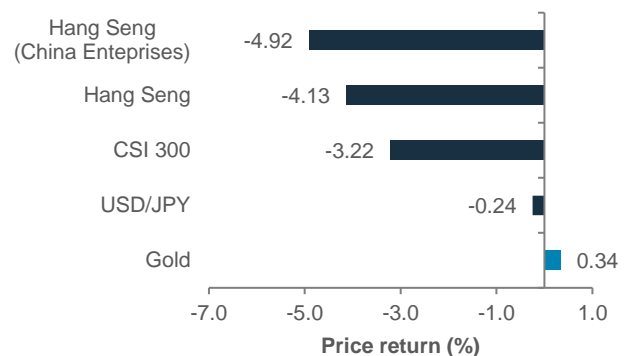
Background

China's regulatory changes hit Chinese equities. The most recent bout of weakness followed the Chinese government's decision to ban firms that teach school curriculums from making profits, raising foreign capital, or listing on equity markets. School tutoring in China will also be banned during the weekends and holidays. This follows continuing regulatory pressures on internet companies and the real estate sector. Market weakness extended into this week with Hang Seng and CSI 300 indices shedding -4.1% and -3.2% respectively today.

A subdued technical outlook. The MSCI China index is attempting to break below key support at the 2018 high of 102.30. A move below that level could pave the way towards the 200-week moving average (~89.50). Separately, the Hang Seng index's break below the 200-day moving average is also a warning sign. Immediate support is expected at 25,570.

The fallout from China's regulatory tightening continues

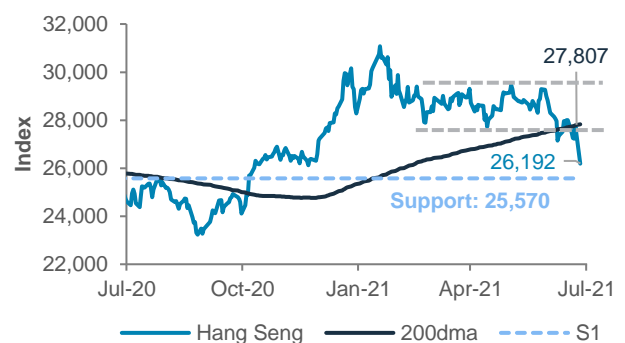
Performance of selected assets from 23 July 2021



Source: Bloomberg, Standard Chartered
As of 26 July 2021, approx. 6:40pm SG time

A break below the 200-day moving average points to further downside in the near-term

Hang Seng Index (daily)



Source: Bloomberg, Standard Chartered

DJ Cheong, CFA
Investment Strategist

Manish Jaradi
Senior Investment Strategist

What does this mean for investors?

The education sector faces significant regulatory headwinds. While the sector's business models will likely be impacted significantly by the intention to convert tutoring companies to non-profit entities and block them from issuing stock and obtaining foreign investment (via variable interest entities), this still raises many questions about the impact on existing holdings of foreign investors.

Recent crackdown follows regulatory tightening across other fast-growing sectors. The latest developments follow earlier regulatory tightening in the Chinese internet and real estate sectors.

Limited spill-overs to broader markets for now. Any direct impact on the broader MSCI China index and consumer discretionary sector will likely be limited as education services currently comprise less than 1% and 1-2% of these indices/sub-indices respectively. A spill-over into other sectors via advertising revenues has been partly anticipated. Although further regulatory changes are a risk, we believe a lot of negative news is already reflected in prices, which is why we retain Chinese equities as a core holding.

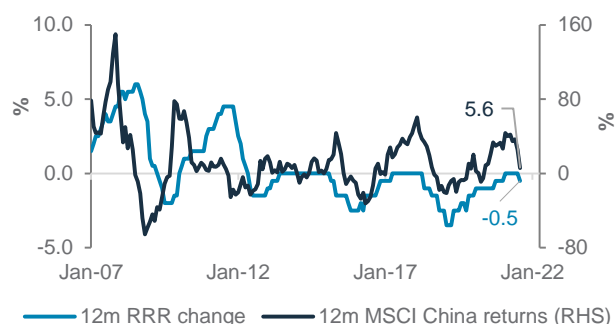
What's next?

Monetary policy may have turned, but regulatory tightening is still ongoing. While the People's Bank of China's (PBoC) decision to cut bank reserve requirements is a step in a positive direction, that alone is unlikely to ease pressure on equity markets in the short term. Regulatory pressure across sectors remains an ongoing headwind for Chinese equities, and reserve requirement cuts tend to have a positive impact on equities only after a lag.

Although earnings revision trends have regained some positive momentum, we would watch for signs of further policy easing, especially in regulatory policies, as well as renewed CNY appreciation before considering turning more constructive on Chinese equities. We would also look for an improvement in the technical outlook.

Monetary policy may have changed direction, but regulatory tightening ongoing; There is also a lag between RRR cuts and equity markets

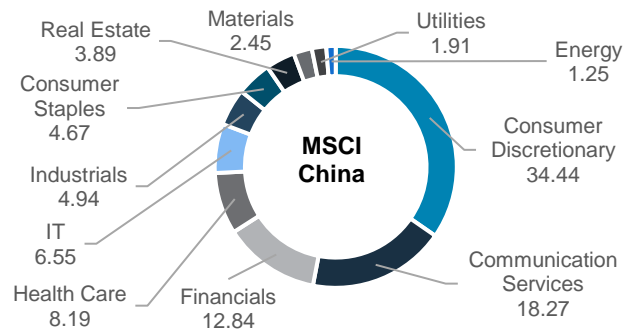
12-month net change in China's bank reserve requirements vs. 12-month rolling MSCI China returns



Source: Bloomberg, Standard Chartered

Education services comprise less than 1% of MSCI China and only 1-2% of the consumer discretionary sector; Impact on these sectors will likely be limited

Breakdown of MSCI China by sector (%)



Source: Bloomberg, Standard Chartered
 As of 30 June 2021

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