Eyes of IIMA Institute for International Monetary Affairs

2016.12.5

Shenzhen-Hong Kong Stock Connect and Future financial reforms in China

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The Shenzhen-Hong Kong Stock Connect plan was formally launched on December 5, mutually linking the two stock exchanges and giving the investors in Hong Kong and overseas a chance to trade Chinese stocks listed on the Shenzhen Stock Exchange (SZSE) more easily. The Shenzhen-Hong Kong Stock Connect is a Shenzhen version of Shanghai-Hong Kong Stock Connect, which was launched two years ago on November 17, 2014. As it is built on the experiences and knowhow developed in the Shanghai-HK Stock Connect, the Shenzhen-HK Stock Connect is expected to have a smooth start.

The greatest beneficiaries of the Shenzhen-HK Connect are the investors in Hong Kong and overseas who have interest in stocks listed on the SZSE. Of course there are many assessments on these stocks, say, the stock prices listed on the SZSE are already on an overvalued level in view of the Price Earnings Ratio (PER). Further, the reliability of disclosures of Chinese companies is low and there is a shortage of business analysists for them. With the uncertainties drifting around the Chinese stock market itself, it is not much expected that overseas funds will rush into the SZSE, but it of course is not a bad thing that new choices of investment become available.

China has now two stock markets in Shenzhen and Shanghai, both of which were established in around 1990. The characteristic of the SZSE is it is dominated by small and medium capitalization stocks like high-tech and venture stocks, in contrast with the Shanghai market where it mainly consists of large capital State owned enterprises' stocks. Currently the Chinese government emphasizes innovation as a new engine for growth and encourages private companies in China towards innovation. Especially Shenzhen City has served as an innovative model realizing development through creation and the Chinese government lays its high hopes on it. Many Chinese global companies including Tencent, Huawei, and DJI etc. have their head office there in Shenzhen, so it has been called a Silicon Valley in China in recent years, attracting talented people from all over China and abroad as well. Shenzhen has an advantage bordering on Hong Kong and having cities of Guangdong Province like Dongguan City and Huizhou City to be utilized as a hinterland, and is likely to nurture more listed companies that have potential. Shenzhen-HK Stock Connect may provide further vitality and dynamism to such emerging companies.

The Shenzhen-HK Connect, raising great expectations, was originally scheduled to start last year, in 2015. However, as the foreign exchange market and stock markets in China experienced an unexpected instability, the scheme suffered postponement by one year of its implementation.

In 2015, Chinese economy and the situation surrounding the Chinese yuan had undergone a big change. Until 2014 since the global financial crisis, China had steadily promoted measures oriented toward internationalization of the yuan and under the strategy of the Belt and Road Initiative, it had appealed for the “Great renaissance of the Chinese nation”. However, in the summer of 2015, the Chinese financial market went out of order and faced with an unprecedented instability. For more than ten years, the Chinese yuan had been a currency filled with anticipation of appreciation but since the devaluation implemented in August 2015, it turned to be a currency with anticipation of depreciation. There had been concerns over capital flights and together with decreasing foreign exchange reserves, a weakening Chinese economy became a globally shared concern.

Since around the end of the spring this year, the Chinese economy and financial market have regained the stability helped by the government public investment and measures for stimulating the property market. In the meanwhile, the government has strengthened the various control measures, which include oral regulations, of cross-border capital and foreign exchange transactions. The Shenzhen-HK Connect represents a move towards opening and liberalization of capital transactions but it was the measure decided upon more than two years ago. The present China has been deepening its inward-looking attitude with a strong fear over capital flights and depreciation of the yuan exchange rates.

In China, the annual Central Economic Work Conference will be held around the middle of December, and policy measures for the economic management in 2017 will be revealed there. It will be one of the attention points whether or not the measures will include foreign exchange reforms and liberalization of capital transactions.