Investment Event

27 July 2021

Regulatory fine-tuning in China

Regulatory fine-tuning is related to the government's priorities to ensure high-quality, inclusive and sustainable growth

The latest changes to education policy follow other revisions for internet and digital platforms

Uncertainty about the regulatory landscape is likely to linger for the remainder of the year

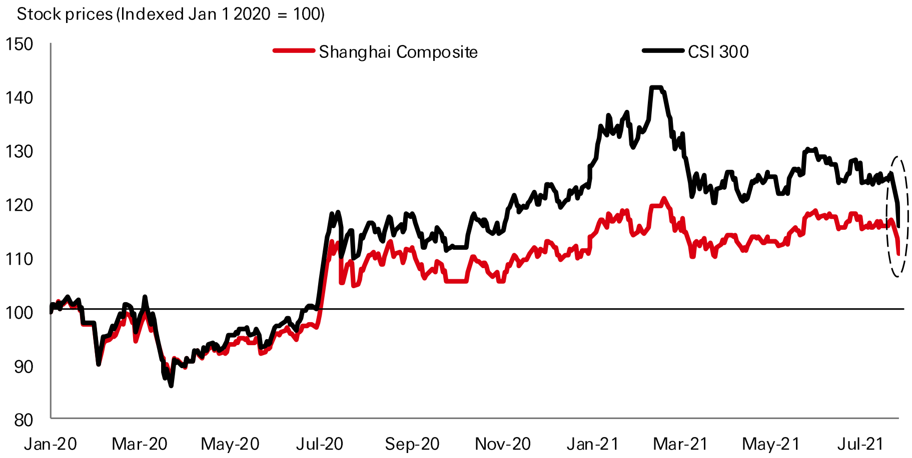
Our views

Regulatory uncertainty is a potential headwind to Chinese equity performance, although positives include contained Covid-19 risks, steady macroeconomic performance, and under-allocation from global investors

Regulatory uncertainty weighs on Chinese equities

Chinese equities have sold off (Figure 1) following the announcement of stricter-than-expected regulations in after-school tutoring institutions (ASTs). While the market reaction has been the most pronounced for education-related companies (<1% of key equity benchmarks), concerns about broader and tighter regulatory actions have hit performance in other sectors. In particular, internet platforms and tech companies (~40% of MSCI China) have recorded heavy losses.

Figure 1: Chinese equity market performance



Past performance is not a reliable indicator of future returns.

Source: Bloomberg; data as of 27 July 2021

The modification to private education policies follows recent regulatory changes to internet and digital platforms, including revisions to the Anti-Monopoly law, and regulation of overseas/foreign listings. Furthermore, in the past six months, there have been a series of regulatory changes in a number of other sectors/areas, such as housing, de-carbonisation, labour rights protection, healthcare, cybersecurity/data security and capital market developments.

Many of the regulatory changes are consistent with China's long-term development agenda. This includes:

- Supporting higher-quality, more inclusive and sustainable growth;
- Fostering a fairer business environment; and
- Helping to reduce systemic risks in the financial system and economy.

The changes also fit with an increasing focus on social welfare and equality, given housing, education and healthcare were identified as three major concerns for households.

Investment implications

Uncertainty regarding regulatory policy is likely to linger through the second half of the year, which could increase volatility in Chinese equities. Investors may need to await regulatory developments in other sectors, and details on regulations already announced, to assess the overall impact on earnings. Similar to other equity markets, the equity risk premium has narrowed since early 2020 reducing the margin-of-safety against downside risks.

Nonetheless, we should put this selloff in the context of strong equity market performance since the pandemic struck (Figure 1 again). Looking ahead, we believe Chinese equities are supported by contained Covid-19 risks, steady macroeconomic performance and structural growth opportunities. In addition, flexible macro policy that is responsive to changing macro and market conditions is also likely to support stability and prevent systemic risks. Finally, portfolio rebalancing by global investors, who are under-allocated in Chinese assets, and the ongoing internationalisation of local markets can also be positive drivers.

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