Market Watch

The perfect storm

Summary

Chinese stocks have come under pressure over the past four days. US-listed Chinese stocks are down 23% and the Hang Seng Index broke below the psychological 20,000 level.

A confluence of factors is likely to drive Chinese equities in the short term, including concerns of potential ADR de-listings, worries about potential sanctions on China, the extent of Covid-19 lockdowns and the domestic policy response.

Key events to watch include (i) how quickly the Omicron outbreak is controlled, (ii) any resolutions on the US account audit disclosure issue, and (iii) index technicals, especially if the Hang Seng index is able to hold the critical 18,279 level.

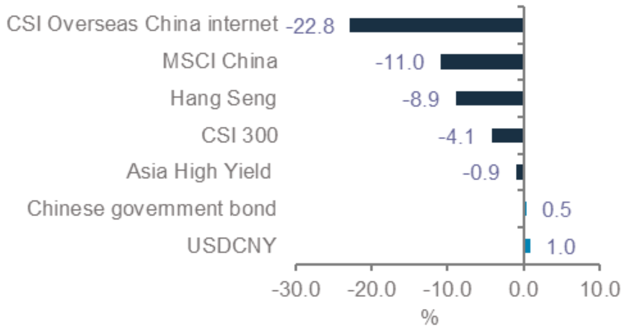
Background

A sharp correction in Chinese equities started last week after the US Securities and Exchange Commission (SEC) identified five US-listed ADRs of Chinese companies for failing to adhere to the Holding Foreign Companies Accountable Act (HFCAA). The Act, which was passed in 2020, permits the SEC banning companies from trading on, and to be delisted from, US exchanges if US regulators are not able to review company audits for three consecutive years.

Chinese ADRs (as measured by the CSI Overseas China index) have fallen by about 23% over the last three sessions while Hong Kong's Hang Seng Index has fallen 9% over the same period amid investor doubts of whether Chinese companies will be able to comply with the request. These concerns were exacerbated by worries that the US could consider imposing sanctions on China based on media reports of Russian requests for China's limitary assistance in Ukraine. In addition, China has imposed varying degrees of lockdowns on major cities following an Omicron outbreak. This includes Shenzhen (a city with the 3rd highest contribution to national GDP, as well as Shanghai.

Chinese equities have sold off sharply over the last few days

Asset class price return (%) since March 8 close



Source: Bloomberg, Standard Chartered

Hang Seng index has broken below the 20,000 key psychological level. The 2016 low at 18,279 will be a multi-year support

Hang Seng index price chart

Source: Bloomberg, Standard Chartered

What does this mean for investors?

The path of COVID cases and policy is one signpost to watch. One major concern for markets has been the potential negative impact on economic and earnings growth from COVID-based restrictions on major cities. The path of COVID cases, and the length and intensity of restrictions, is likely to offer one guide to how markets react. Recent experiences of other countries suggest any easing of restrictions may not be imminent.

The policy reaction is a second signpost to watch. Both monetary (central bank) and fiscal (government spending) policy signals have been supportive in recent months as the policy goal shifted towards greater growth stabilisation around a 5.5% GDP growth target. The recent restrictions make it likely that more policy support will be forthcoming, but markets are likely to be sensitive to the magnitude of any such measures.

Geopolitics is a third signpost to watch. The fall in oil prices is a positive, given high prices can impose a drag on global economic growth. However, markets are likely to closely watch whether recent US public statements urging China to avoid tacitly supporting Russia remain contained to media reports alone, or if there is a risk of an escalation resulting in worsening relations between the two countries.

Equity market technical are a fourth signpost to watch. As the chart illustrates, the Hang Seng has broken below the key psychological level at 20,000. We see key technical support at the 2016 low of 18,279. Deeply oversold conditions raise the odds of a rebound in the near-term. However, for the downward pressure to ease meaningfully, the index needs to break above key resistance at 21,115.

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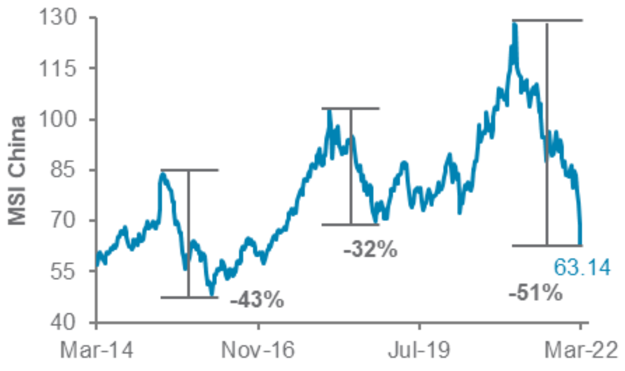
The MSCI China index's decline since 2021 peak is already larger than previous major pullbacks of the past decade, making it overdue for a rebound

MSCI China index (since March 2014)



Source: MSCI, Bloomberg, Standard Chartered

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