How meaningful is the Beijing put for A-shares?

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Over the past week, we have continued to parse the readout, context, and implications of the Financial Stability and Development (FSDC) meeting that took place on March 16, and sent China markets soaring last Wednesday and Thursday.

As we continue to interpret the meeting itself, as well as follow-on statements and actions by a range of Chinese officials and regulators, the key question we are asking is this:

- How strong is the "FSDC put" going to be in supporting Chinese equity markets in the months ahead?

The flow of news articles and analyst reports we have seen over the past few days indicate that much of the sell side community has concluded that significant and ongoing support for Chinese equity markets is on the way, which will set up a sustained rally – but we aren't so sure.

We lay out our thinking on these dynamics below.

But before we get to that, another key question that we – and others – are asking in the wake of the FSDC meeting is what it means for the trajectory of the ongoing re-regulation of China's big tech companies.

- This question is, of course, related to the likely share-price trajectory for China's big tech names – in both the next few months, and further into the future.

Spoiler alert: We disagree with the consensus – i.e. that regulators are looking to back off big tech – on this second question, as well.

- In short, our strong view is that the ongoing policy push in the tech space has a long way to go.
- It ***might*** become better coordinated in the coming months, but there are big questions around whether financial, cyber, and anti-monopoly regulators can genuinely get on the same page.

The bottom line: We continue to be concerned about the outlook for Chinese equities – and think most analysts are overly optimistic about the trajectory over the next few months.

- That's because none of the very real, and intractable, risks to economic growth and company profitability have gone away over the past week – nor are they set to any time soon.
- **What's more, if regulators disappoint with their efforts to boost coordination, transparency, and support – the markets will punish them for it.**

State your purpose, Liu He

The readout from the FSDC meeting last Wednesday was wide-ranging, touching on a diverse set of issues, including:

- Sluggish macroeconomic performance and associated risks
- The macro-policy stance – including fiscal and monetary policy – and the need for better policy implementation
- Property market risks
- Global economic and geopolitical risks

- Regulators' desire to ensure stability in domestic capital markets
- US-listed Chinese companies, and the CSRC's auditing impasse with the SEC
- Policy coordination challenges – particularly regarding the re-regulation of the tech sector
- The overall timeline for the "rectification of the platform economy"

The sheer breadth of the discussion speaks to the mounting challenges that economic policymakers are facing.

And given this wide set of issues, the exact purpose of last week's meeting was initially unclear to us. Were officials looking to:

- Call for – or enact – more aggressive economic stimulus measures?
- Stabilize and support capital markets?
- Address the audit issue for US-listed companies?
- Signal a fundamental shift in the pace or direction of the tech sector rectification?

All of these initially seemed like plausible explanations for last week's meeting. Indeed, given the reverberations of the Russian invasion of Ukraine and the fast-worsening domestic outbreak of COVID-19 in China, policymakers' economic and financial concerns are clearly growing.

However, the more we considered various elements of the meeting – as well as follow-on statements and actions by other regulators – the more it became clear to us that officials' primary intention was simply to stabilize the slide in Chinese share prices that had been ongoing since the beginning of March.

Regulators were first looking to stabilize the market…

The key for us, when assessing policymakers' intentions at last week's FSDC meeting, was the fact that officials very clearly linked the accumulation of economic risks to capital market risks.

- Indeed, when discussing solutions to the current challenges officials face, the FSDC readout lumped defusing property market risks and ensuring credit growth right alongside resolving the auditing issue for US-listed Chinese companies, better coordinating the re-regulation of the tech sector, and encouraging long-term investors to boost their stakes in the equity market.

To us, this combination underscores that the emergency meeting was held not primarily to rejigger macro-economic policies, but to plainly offer verbal intervention for equity markets.

The idea that policymakers were primarily looking to stabilize the slide in domestic share prices is further supported by the fact that subsequent statements from various other financial regulators (CBIRC, CSRC, etc.) who were present at the meeting did not indicate that they plan to do anything genuinely new in terms of policy action.

- This lack of new concrete follow-up moves from various financial regulators indicates that officials were not looking to genuinely change policy course, but rather to boost short-term market confidence via enhanced communication.

Additionally, the fact that the meeting readout was released around 1:00pm China time on Wednesday – smack in the middle of the trading day – further supports the idea that the key goal was market intervention.

- Rarely do FSDC readouts – other potential market-moving policy and political statements – come out before the evening in China, well after domestic markets have closed.

Taking this altogether only further increases our confidence that officials are not set to significantly change policy course – whether macroeconomically or in terms of tech policy – and this point is critical for investors to understand, in order to game out the future impact of the FSDC meeting.

Indeed, this understanding of policymakers' motivation in holding this meeting now, raises a further key question:

- Was this only a one-time intervention to stop the recent equity market slide – or is Beijing signaling that it wants strong equity price growth from here, heading into the Party Congress?

...but will do they more?

Beijing's underlying policy stance, and accompanying statements, will be decisive in determining the trajectory of Chinese share prices from now till the Fall.

Because of all the growing headwinds to the economy – including COVID-19, the potential for secondary sanctions due to China's position on the Russian invasion, the drag from property, ongoing tech regulations, weak monetary policy transmission, upstream inflation, etc – we would normally be skeptical about how strong any rally for Chinese equities could possibly be from here.

- **But since Beijing's intention here seems to be primarily about supporting the equity market – with the FSDC readout explicitly saying that "long-term institutional investors are welcome to increase their shareholding ratios," which is often a sign that state players are expected to jump in to support the market – we are now watching closely to see if the financial agencies take concrete steps to boost the equity markets.**

Last Thursday, the first sign of such action occurred when the China Securities Depository and Clearing Co. (CSDC) – the state agency that provides settlement services to the Shenzhen and Shanghai stock exchanges – cut its minimum settlement provision ratio from 18% to 16%, effective April 1.

- This move is directly supportive of the equity market as it will unlock about RMB 30 billion worth of funds held by investors, who now have discretion to plough it back into equities.
- And while that move, alone, is not enough evidence that

authorities are calling for a wider pump in the market, it is certainly notable.

Our thesis here is that while the macro environment is not conducive to a significant Chinese stock rally – ***if*** the Party really wants a rally in this important political year, then there very likely will be a significant surge in Chinese share prices.

- So does Xi Jinping and the senior Party apparatus want a big-time bull maker for political reasons?
- Even on this front, we think the answer is "no."

The upshot: Despite some rumblings of equity market support from policymakers, we still think the upside for Chinese stocks is capped.

Fool me once

The reason we continue to be skeptical about a looming pump up in Chinese equity prices is simple.

Officials – including Xi Jinping – have already learned their lesson on this front.

- The last time the Party-state signaled it wanted to engender a significant bull market in A-shares, things ended badly.
- This was in 2015, when positive state messaging around the stock market sent shares soaring – up over 50% in three months.
- Eventually, officials had to step in to tamp things down, and the market then fell by 30% in six weeks – and regulators then had to implement trading freezes, lock-ups, and capital controls.
- The episode ultimately led to the chairman of the securities regulator at the time, Xiao Gang, losing his job – and set off a wave of financial instability and capital outflow for the next twelve months.
- Finally, it all set the stage for the years-long financial de-risking campaign that began in earnest in 2017 and is still ongoing today.

The bottom line: When Party officials talk about the need for stability in this important political year, they obviously don't want a visible and aggressive stock market slide – like we saw in the first two weeks of March – but neither do they want a raging bull market, which could ultimately cause even greater risk and volatility.

So…is the tech crackdown coming to an end?

A secondary, but related area we will be watching closely to understand the trajectory of Chinese share prices will be the strength and effectiveness of any policy coordination on regulating the tech sector.

- At the FSDC meeting last week, Vice Premier Liu He called on regulators to ensure coordination with financial authorities when enacting policies that may affect the capital markets and/or share prices.
- A number of regulators – including the national market regulator (SAMR) – have since reiterated the call for better coordination, messaging, and predictability in policymaking.

- These moves could, indeed, be a signal that greater coordination and more predictability is coming – as Liu indicated that people and institutions will be "held accountable" – when necessary – for failing to take these dynamics into account when issuing new policies.
- If these dynamics lead to a more cautious regulatory environment in the short term, it could mean a temporary lull in new regulations – and a more predictable policy environment for tech companies at some stage in the future

Obviously, such a change would be a net positive for the share prices of China's big tech companies – and at a minimum would help to reduce the occasional jittery share sell-offs that a number of companies have seen over the past year, as the market has digested sudden policy moves and other official pronouncements.

That said, we have doubts about how well Liu He is placed to actually enact such policy coordination.

- The two key non-financial agencies regulating the tech sector have their own agendas, strength, and political backing – including generally having Xi Jinping's blessing to pursue their various mandates, as we outline below.

So on this score, we will be watching to see how and if any actual, functional coordination mechanism is established.

- That will be key to understanding if the policy environment can genuinely change for the better for big tech companies.

Coordinate this

To put a finer point on our contention that pursuing policy coordination for the tech will be an uphill battle, consider this: several regulatory campaigns have gained so much momentum that there's very little chance they can get put back in the box.

- The cyberspace regulator (CAC) is all geared up to strictly enforce the new data governance laws — namely the Data Security Law and the Personal Information Protection Law — that came into effect last year. Those rules are not going away.
- The CAC has also been screaming from the rooftops that it plans to further tighten control in other areas this year, from the way tech companies use algorithms and AI, to online content control.
- Meanwhile, SAMR spent the last half of the 2021 beefing up its anti-monopoly bureau, giving the bureau more authority, a new office, and more manpower.
- And Xi Jinping himself has called repeatedly for stronger anti-monopoly enforcement.

So it's quite likely that these agencies will not do what the FSDC is asking…

- **… and that's where things get politically interesting.**

Will the CAC bow to the FSDC?

The CAC's power, in particular, has grown by leaps and bounds over the past year.

- The agency started out as a little sub-bureau of the propaganda department.
- Now they're in charge of data security, algorithms and AI, online censorship, and other highly impactful regulatory areas.
- As of last year, the agency also gained some decision-making authority over whether or not a data-heavy company can list abroad.

Many have speculated that the CAC's new power originates from the fact that it sits in a special place in the Chinese Party-state org chart: it's a Party body – not a government organ – and reports directly to Xi Jinping.

- The implication is that the CAC has Xi's tacit approval to do whatever it wants…
- … and they may not like the idea that they have to clear new policies with Liu and the FSDC.

It's also clear that SAMR definitely has Xi's go-ahead to focus heavily on anti-monopoly regulation.

So, we've got the popcorn out to see whether these agencies shrug off Liu He's orders, and keep up the shock-and-awe intensity of the tech crackdown – or if they dial it down a notch.

The good news: While it remains to be seen if state agencies take the FSDC's message to heart, we think there's a good chance that they will.

- This would mean that, while tech regulation won't subside, it will hopefully be clearer to investors in advance where the policy winds are blowing.

The upshot: These announcements don't constitute an about-face on tech regulation. But depending on which way the political winds blow, they could contribute to a more measured approach.

Still, to us, the bottom line is this: It's far too early to pronounce the end of tech sector re-regulation, and we think policymakers will be cautious in how much overall support they're willing to provide directly to the equity markets more generally.

- **Add it all up, and Chinese stocks look set to bump along around their current valuations, rather than seeing significant and sustainable increases, over the coming six months.**