8 DECEMBER 2021

Strategy Flash

Delisting Fears, Moderate Easing and Domestic Shares Shine

Summary

- China offshore technology stocks were volatile due to delisting fears amidst a global market sell-off. However, broader domestic China indices were a relative haven and the Yuan hit a year-to-date high today.
- China economic surprises are picking up again combined with moderate monetary and fiscal easing. Another reserve rate cut this week.
- We maintain our positive view on China A-shares, in particular mid and small caps (CSI 500: +16.8% YTD) which benefit more directly from the selective policy easing. A-shares have a very low technology/ education sector overlap and low regulatory tightening risk with less than 1% exposure.
- **Portfolio Construction Tip**: Investors are not investing broadly in China by just focusing on one sector in offshore technology shares. We remain neutral technology globally as well.

Delisting Fears Overdone?

China Internet ADRs fell last Friday, before bouncing back this week on news of Didi's delisting, as well as unsubstantiated reports of Chinese regulators' plans to ban companies from going public on foreign stock markets through variable interest entities (VIEs). This also took place in a broader risk-off in technology globally as Omicron fears and a more hawkish Fed has led to a nearly a third of stocks in the Nasdaq trading down 50% from highs.

In our view, regulators could be examining forming regulations on VIE structured companies, and could tighten the regulatory process to list in overseas markets. For existing listed companies with VIE structure (i.e. the entire China internet space, listed overseas and in HK), there may be moves by regulators to strengthen operational regulations.

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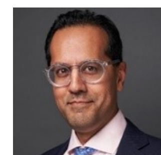


As for delisting of China ADRs, from US exchanges, under statutes adopted by the US Public Company Accounting Oversight Board companies they would face delisting if they do not allow audits in the next several years. Nevertheless, talks are ongoing between US and China officials. There would be time in this scenario, to seek a dual or relistings in China. On the other hand, China is also is sensitive to certain industries listing overseas for data protection issues. However, most of the larger names (unlike Didi), there should be minimal fundamental impact as they are dual listed in HK and the HK/US ADR shares are fully fungible.

On the liquidity front, short term selling pressure on a delisting scenario will likely be from retail investors/investors with a US-only mandate. In addition, the companies have several years to comply with the US regulations if not asked to delist by China authorities. In short, our equity team view is that the recent sell-off in response to the above newsflow looks overdone.

Property Slowdown Not Crash

While we are in the middle of a property market slowdown in China we also do not see a property crash in the market. (see note "***The Evergrande Crisis is Not China's "Lehman Moment"***).

This note forecasted that individual highly leveraged property companies could need to restructure. However, it would NOT cause contagion globally or lead to a collapse in the local banking system. In fact, the Yuan hit year-to-date highs today, China CDS has tightened modestly, and China investment grade credits have been a haven.

A slowdown is already forecasted in our GDP forecasts for China next year of +5.3% in 2022. Moreover, economic surprises are gradually picking up with better import/export data this week.

CHINESE ECONOMIC SURPRISE INDEX RISING

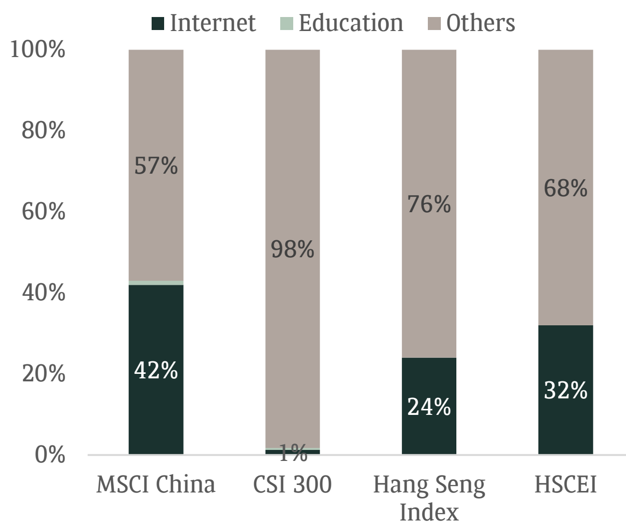
Source: Bloomberg, Citigroup, BNP Paribas (WM), 8 Dec 2021
Past performance is not indicative of current and future performance

Moderate Easing Underway

Over the past few months, the policymakers are beginning to focus on stabilising growth by shifting to a more moderate easing mode. On Monday, China cut its reserve ratio requirement by 0.5% (to 11.5% for major Chinese banks, effective from December 15), the second decrease this year. PBOC also stated "Prudent monetary policy direction has not changed".

At the same time, the Politburo stated China will continue to have a proactive fiscal policy in 2022 and that prudent monetary policy will be flexible and appropriate while maintaining ample liquidity. The word "stability" appeared 3x more frequently than in last year's statement and "housing" appeared 5 times versus just one time last year. While we do not expect loosening like 2015/16, other measures like local government bond issuance is also being accelerated.

CHINESE EQUITY INDICES' EXPOSURE TO INTERNET, FIN-TECH & EDUCATION SECTORS



Source: Bloomberg, BNP Paribas (WM), 28 July 2021
Past performance is not indicative of current and future performance

How to Position?

- We maintain (see note: *"Implication's of Beijing's Recent Regulatory Tightening"*) the positive view on China A-shares in particular mid- and small caps which would benefit more directly from the anticipated selective policy easing. A prime reason for recommending domestic shares is the **very low overlap with regulatory tightening with less than 1% exposure**. **In fact, CSI 500, domestic small cap (+16.8% YTD)** has largely outperformed CSI 300 domestic large cap (-3.8% YTD). Finally, this strategy has far outperformed the China offshore ADRs -45%.

- **Portfolio Construction Tip**: Investors are not investing in China by just focusing on one sector in offshore technology shares. We remain neutral technology globally as well.

- **Too late to Sell, too early to Buy?:** China's big tech stocks have heavily de-rated with valuations already reflecting a high risk premium. However, a sustained rally would need catalysts: more clarity on the details of regulations and additional easing. There will be a time to add to this.

- As mentioned in our previous note, the areas of government policy support, such as EV supply chains, semiconductor, renewable energy, high-end manufacturing as well as consumer and healthcare leaders continue to **outperform.**

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