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Research Paper No. 73: Half-yearly Review of the Global and Local Securities Markets

11 August 2023

Executive Summary

1. Major overseas markets advanced during the first half of 2023. In the US, the Dow, Nasdaq and S&P rose 3.8%, 31.7% and 15.9% respectively. In Europe, the FTSE, DAX and CAC rose 1.1%, 16.0% and 14.3% respectively. Hopes for a pause in rate hikes lifted the markets at one point, but worries about inflation and possible further monetary tightening then reappeared. The banking sector turmoil in the US and Europe also weighed on market sentiment, though concerns eased somewhat after government authorities and financial institutions provided reassurance. Whilst the US government debt ceiling has been suspended, the outlook for the US credit rating remained uncertain. Worries about the global economic outlook also persisted. In Mainland China, both the SHCOMP and the SZCOMP rose 3.7%. The reopening of the economy, improved gross domestic product (GDP) growth in Q1 2023 and prospects for further growth-supportive policies lifted market sentiment. However, concerns persisted about the health of the Mainland's property sector.

2. In Hong Kong, the HSI, HSCEI and the Hang Seng TECH Index fell 4.4%, 4.2% and 5.3% respectively. The HSI rose to a 10-month high in January 2023, but then fluctuated downwards to a six-month low in June 2023. From November 2022 to January 2023, both the HSI and HSCEI recorded their largest three-month percentage increases (48.7% and 50.3% respectively) since 2009. Profit-taking seemed to pick up following substantial gains earlier on. Hong Kong's market performance was largely affected by external macro factors, including worries over interest rate hikes in the US, a slowing global economy and uncertainties about geopolitical tensions in Ukraine. Technology stocks paced losses on cautions about policy developments in the sector. Given their substantial market shares and heavy weighting in major benchmark indices, this dragged on the local market. Meanwhile, turmoil in the US and European banking sectors has had limited impact on the Hong Kong market. The Hong Kong markets were resilient during the period.

3. Stock market turnover declined during the first half of 2023, partly attributable to a price effect. The trading decline in the Hong Kong market spread over different types of securities and brokers with no concentration, and it was also largely in line with declines in major overseas markets during the same period. Nevertheless, trading in exchange-traded derivatives recorded an increase.

4. For Stock Connect, southbound (SB) trading recorded net buy for 18 consecutive months from December 2021 to May 2023. During the first half of 2023, the cumulative net buy amounted to RMB109.9 billion. In January 2023, northbound (NB) net buy hit a monthly record high of RMB141.3 billion, and the cumulative net buy during the first half of 2023 reached RMB183.3 billion. The Stock Connect scheme was enhanced in March 2023, when eligibility was expanded to include four Hong Kong-listed foreign stocks and about 1,000 A-shares (see Box 1 for details).

5. The launch of the renminbi (RMB) counters of 24 Hong Kong stocks on 19 June 2023 (see Box 2 for details) was a major initiative which helps promote the internationalisation of the RMB and its use as an investment currency. These RMB counters have contributed to the liquidity and trading volume of RMB-denominated securities in Hong Kong, consolidating Hong Kong's role as the prime offshore RMB centre.

6. Compared to 2022, short selling in Hong Kong decreased both in absolute terms and as a percentage of the total market turnover during the first half of 2023. Among others, it is worth noting that exchange-traded products (ETPs) have become a dominant component of the daily short selling turnover, and the majority of the short selling activities of ETPs were conducted by market makers (see Box 3 for details). During the

course of providing liquidity to the market, the market makers may need to short sell the relevant ETPs. The short selling of ETPs is unlikely to pose a significant systemic impact on the market, as the short positions of ETPs held by market makers are generally closed out within a short period of time.

Performance of stock markets

7. Globally, major stock markets rose but the Hong Kong market declined during the first half of 2023. The Hong Kong market saw a drop as investors remained cautious about the US interest rate outlook and technology stocks underperformed amid policy uncertainties. Worries about a slowing global economy and geopolitical tensions in Ukraine lingered. The turmoil in the US and European banking sector weighed on global investor sentiment, but has had a limited effect on the Hong Kong market thus far. Although the debt ceiling problem seemed resolved temporarily, there remained uncertainties about the outlook for the US credit rating. On the Mainland, the evolving economic situation and hopes for policy stimulus affected market sentiment.

Overseas markets

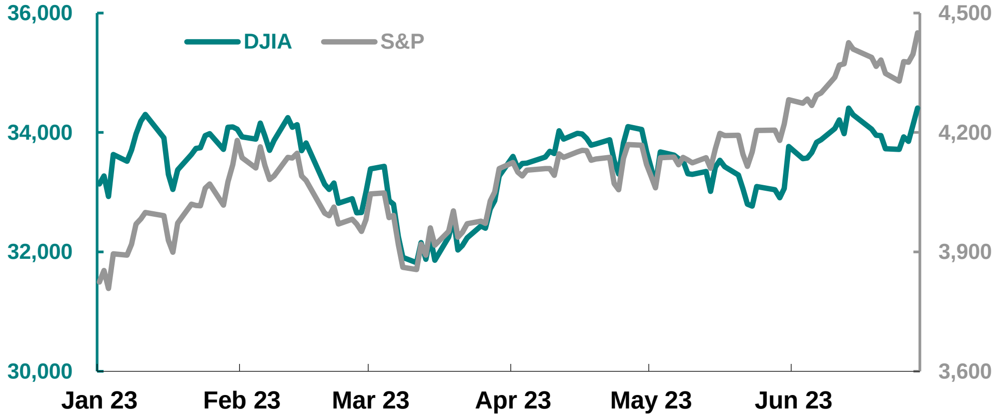
8. During the first half of 2023, the Dow, Nasdaq and S&P rose 3.8%, 31.7% and 15.9% respectively. For major European markets, the FTSE, DAX and CAC rose 1.1%, 16.0% and 14.3% respectively.

9. Against the backdrop of moderating inflationary pressure in the US and Eurozone in early 2023, major central banks slowed the pace of monetary tightening. As widely expected, the US Federal Reserve (Fed) raised interest rates three times by 75 basis points (bps) in total, whilst the European Central Bank (ECB) raised interest rates four times for a total of 150 bps. Hopes for a pause in rate hikes lifted investor sentiment at one point, but worries over the possibility of further monetary tightening revived later as both the Fed and the ECB remarked on the possibility of further rate hikes over the remainder of this year.

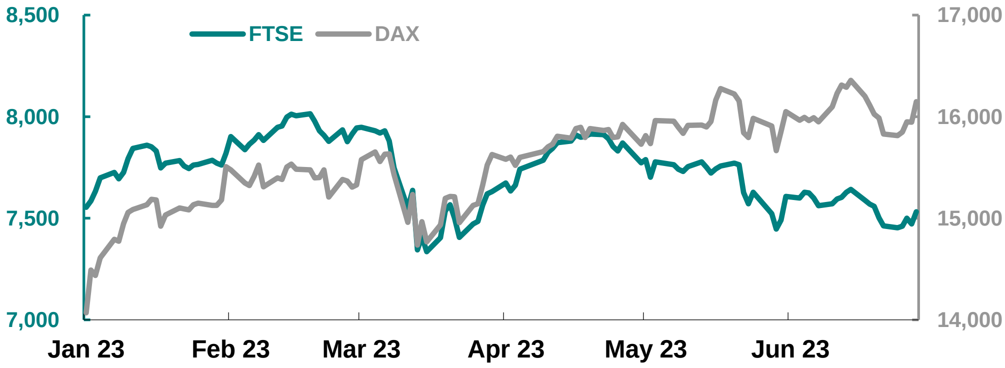
10. Tech stocks in the US outperformed, supported by solid corporate earnings and optimistic prospects for the growing artificial intelligence sector. Nevertheless, heightened worries about the financial health of the US and European banking sectors in March 2023 weighed on investor sentiment. Subsequently, liquidity concerns eased somewhat following reassurance and interventions by government authorities and financial institutions. Later, the debt ceiling impasse in the US also weighed on market sentiment. Whilst the US Congress approved a bill to suspend the US debt limit, uncertainties about the credit rating outlook lingered.

11. Recession fears persisted amidst mixed economic data and corporate earnings. The International Monetary Fund (IMF) downgraded its 2023 global GDP growth forecast from 2.9% to 2.8%. It expected global growth to remain around 3% over the next five years—the lowest medium-term forecast in 30 years. US GDP growth slowed from 2.6% in Q4 2022 to 2.0% in Q1 2023. The Eurozone's GDP growth also slowed from 1.8% in Q4 2022 to 1.0% in Q1 2023.

Performance of the Dow and S&P during the first half of 2023



Performance of FTSE and DAX during the first half of 2023



Performance of major stock markets

		Index level	% change 2023 H1	2022	2021
Hong Kong and the Mainland					
Hong Kong	-HSI	18,916.4	-4.4%	-15.5%	-14.1%
	-HSCEI	6,424.9	-4.2%	-18.6%	-23.3%
	-HS TECH	3,911.3	-5.3%	-27.2%	-32.7%
Mainland	-SHCOMP	3,202.1	+3.7%	-15.1%	+4.8%
	-SZCOMP	2,049.2	+3.7%	-21.9%	+8.6%
US					
US	-Dow	34,407.6	+3.8%	-8.8%	+18.7%
	-Nasdaq	13,787.9	+31.7%	-33.1%	+21.4%
	-S&P	4,450.4	+15.9%	-19.4%	+26.9%
Europe					
UK	-FTSE	7,531.5	+1.1%	+0.9%	+14.3%
Germany	-DAX	16,147.9	+16.0%	-12.3%	+15.8%
France	-CAC	7,400.1	+14.3%	-9.5%	+28.9%

Mainland China

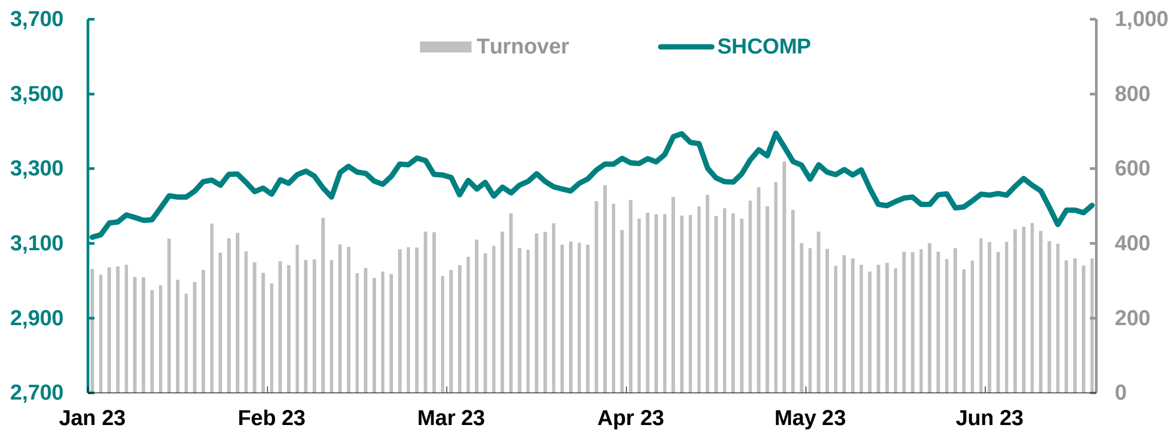
12. During the first half of 2023, both the SHCOMP and the SZCOMP rose 3.7%. Average daily trading on the Mainland market was RMB942 billion, 1.8% higher than the RMB925 billion in 2022.

13. The reopening of the Mainland economy supported market sentiment. GDP growth accelerated from 2.9% in Q4 2022 to 4.5% in Q1 2023, and the IMF upgraded its 2023 Mainland GDP forecast from 4.4% to 5.2%.

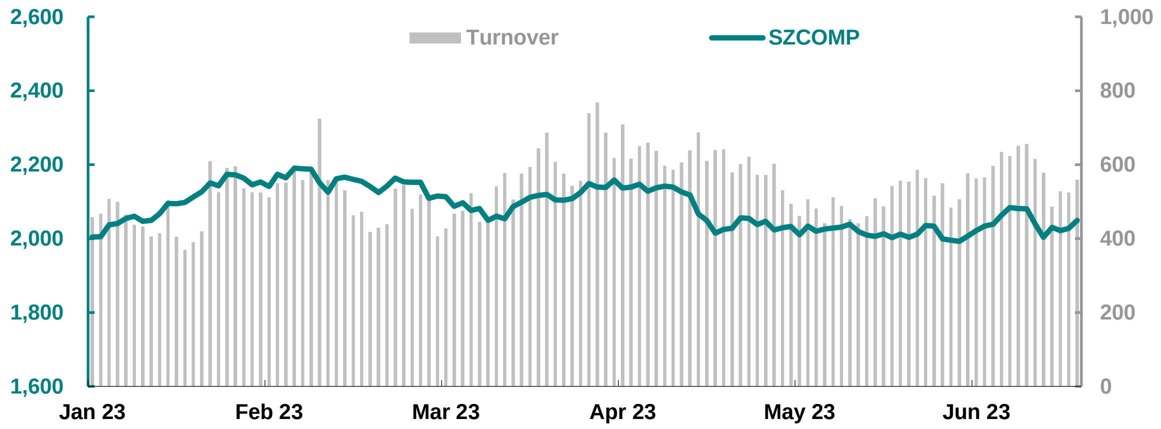
14. Hopes for further government policy stimulus to boost the economy paced gains. In March 2023, the People's Bank of China lowered the reserve requirement ratio by 25 bps. Investors also expected measures to support state-owned enterprises and the technology and property sectors.

15. Nevertheless, mixed data about credit growth, industrial profits and manufacturing, services and trade sectors weighed on the market. Uncertainties about the property sector's liquidity conditions lingered. Investor sentiment was affected by a weaker RMB, which depreciated 5% during the first half of 2023 and fell below the level of 7.25 against the US dollar at one point, hitting its lowest level since November 2022.

SHCOMP and market turnover (RMB billion) during the first half of 2023



SZCOMP and market turnover (RMB billion) during the first half of 2023



Hong Kong

Market performance

16. The Hong Kong market fell during the first half of 2023. The HSI, the HSCEI and the Hang Seng TECH index fell 4.4%, 4.2% and 5.3% respectively. The HSI hit a 10-month high in January 2023 but subsequently fluctuated downwards to a six-month low in June 2023.

17. Profit-taking seemed to pick up following substantial gains earlier on. From November 2022 to January 2023, both the HSI and HSCEI recorded their largest three-month percentage increases since 2009 and accumulated gains of 48.7% and 50.3% from their respective troughs in October 2022.

18. Local market performance seemed to be largely affected by external macro factors. There were concerns that a weaker RMB might affect the earnings of Mainland companies listed in Hong Kong. Uncertainties about the monetary policy stance of major central banks continued to weigh on the market. Worries over the risks of a global recession and lingering geopolitical tensions in Ukraine made investors more risk averse.

19. The market correction appeared to be mainly driven by the underperformance of some large-cap Mainland technology stocks. Given their significant market shares and high index weighting[1], their share-price corrections thus dragged on the Hong Kong market.

20. The developments in the US and European banking sectors have had limited impact on the Hong Kong market thus far. Changes in the share prices of most major bank stocks in Hong Kong have been relatively moderate. Nevertheless, optimism about further stimulus measures by the Mainland Government to support the economy trimmed some losses. The Hong Kong markets were resilient during the period.

21. During the first half of 2023, partly attributable to a price effect, average daily trading in the Hong Kong market fell to HK$115.5 billion, which was 7.5% lower than the HK$124.9 billion in 2022. The recent trading decline spread over different types of

[1] Altogether, they had aggregated weightings of 27% in the HSI.

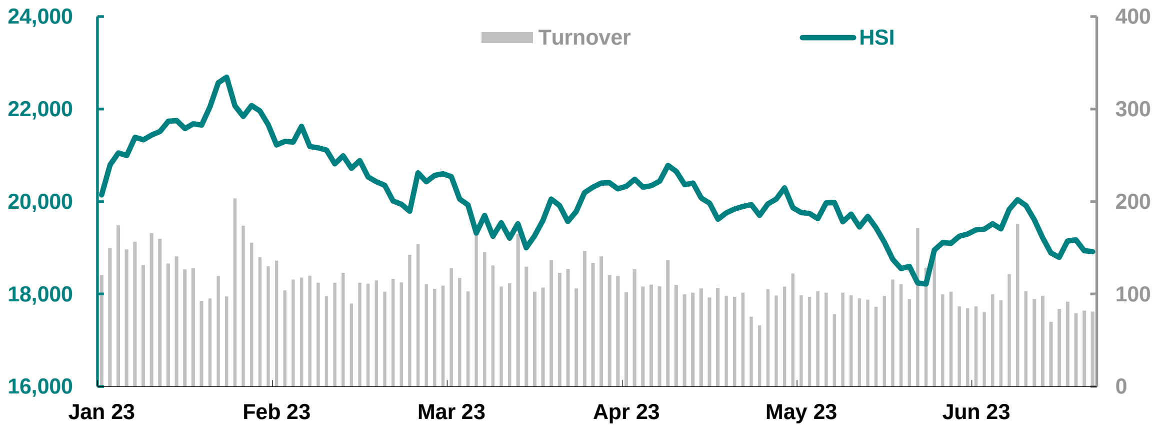
securities and brokers, and it was largely in line with declines in other major overseas markets, which fell between 1% and 16% in US dollar terms.

22. Mainland stocks (including H-shares, red chips and privately-owned enterprises) remained the most actively traded stocks, with a 67% share of total market turnover during the first half of 2023 (versus 67% in 2022).

Market outlook and risks

23. Looking ahead, the major risks facing the Hong Kong market will likely remain to be external macro factors. The monetary stance of major central banks will continue to affect global market performance. The financial health of the US and European banking sectors and geopolitical tensions in Ukraine may also weigh on the market. In Mainland China, investors are keeping a watch on the pace of economic recovery, the extent of policy stimulus and Sino-US relations.

HSI and market turnover (HK$ billion) during the first half of 2023



SFC 證監會

Activity in the Hong Kong securities market

Stock Connect

24. During the first half of 2023:
    - average daily NB trading (including buy and sell trades) was RMB109.3 billion, or 5.8% of trading in the Mainland market (RMB100.4 billion, or 5.4% of market trading in 2022); and
    - average daily SB trading (including buy and sell trades) was HK$33.8 billion, or 14.7% of trading in the Hong Kong market (HK$31.7 billion, or 12.7% of market trading in 2022).

25. During the first half of 2023, the net buy was:
    - RMB183.3 billion via NB trading (RMB90.0 billion in 2022); and
    - RMB109.9 billion via SB trading (RMB339.4 billion in 2022).

Box 1: Stock Connect expansion

A milestone expansion of Stock Connect was successfully introduced on 13 March 2023, deepening mutual market access between the Mainland and Hong Kong, offering more diverse investment choice for investors and bringing additional liquidity for both markets.

- For SB trading, four foreign companies primary-listed in Hong Kong were added and their SB trading accounted for about 10% of their total trading since their inclusion.
- For NB trading, some 1,000 A-shares[2] were added and their NB trading accounted for about 4% of their total trading since their inclusion.

After the expansion, over 2,500 A-shares and 500 Hong Kong stocks are eligible for Stock Connect, accounting for more than:

- 80% of the market capitalisation of each market; and
- 80% of equity trading in each market.

After the scope of eligible securities is expanded, trading has remained smooth. This will also consolidate Hong Kong's position as the gateway to the Mainland market. Including foreign companies in SB trading is of particular strategic importance to Hong Kong and will strengthen its role as an initial public offering centre, as it helps attract more foreign companies to list in Hong Kong and expand their shareholder base to include more Mainland investors.

[2] The scope of NB eligible stocks has been adjusted to include constituents of the Shanghai Stock Exchange A Share Index and the Shenzhen Composite Index which meet related requirements (such as market capitalisation and turnover).

Box 2: HKD-RMB dual counter trading

On 19 June 2023, the RMB counters of 24 stocks were launched for trading in Hong Kong. Trading in the RMB counters has remained orderly and has contributed to the liquidity and trading volume of RMB-denominated securities in Hong Kong. During 19–30 June 2023:

- Average daily trading of the 24 RMB counters amounted to RMB193.9 million (HK$208.7 million). This was about 10 times the trading of other RMB-denominated products listed on Hong Kong Exchanges and Clearing Limited prior to 19 June 2023 (mainly exchange-traded funds (ETFs)).
- 101 brokers took part in the trading of the RMB counters.

The Dual Counter Market Makers mechanism has helped promote liquidity and minimise price differences between the RMB and Hong Kong dollar (HKD) counters.

- The RMB counters have closely tracked their corresponding HKD counters. The differences between the prices of the more liquid RMB counters and their HKD counters were small and within the ±0.3% range.
- The bid-ask spreads of the most liquid RMB counters were also tight, with spreads largely comparable to or slightly higher (1-2 ticks) than those of the HKD counters.

HKD-RMB dual counter trading helps promote the internationalisation of the RMB and its use as an investment currency, and also consolidates Hong Kong's role as the prime offshore RMB centre by offering more RMB-denominated securities for trading by Mainland and overseas investors. The SFC is liaising with Mainland authorities to include the RMB counters under Stock Connect.

Swap Connect

26. Swap Connect, the first Mainland-Hong Kong mutual market access programme for financial derivatives products, was launched on 15 May 2023 with the introduction of NB trading at the initial stage.
27. Swap Connect allows investors from Hong Kong and other jurisdictions to participate in the Mainland interbank interest rate swap market. It deepens connectivity between Mainland and overseas capital markets and bolsters Hong Kong's position as a risk management hub.
28. Swap Connect has operated smoothly since its launch. On the launch day, 27 overseas investors participated and interest rate swaps with a notional value of about RMB8.3 billion were executed. As of end-June 2023, a total of 540 Mainland interbank interest rate swap contracts were traded under Swap Connect, with the gross notional amount of about RMB129 billion or a daily average of about RMB3.9 billion.

Short-selling activities

29. During the first half of 2023, short selling in Hong Kong decreased both in absolute terms and as a percentage of the total market turnover compared to 2022. Average daily short selling amounted to HK$18.6 billion or 16.2% of the total market turnover (versus HK$21.7 billion or 17.4% in 2022).

30. Of the average daily short selling of HK$18.6 billion, exchange-traded products (ETPs), including ETFs and leveraged and inverse products, accounted for 29.0% or HK$5.4 billion. Excluding ETPs, average daily short selling turnover was HK$13.2 billion (or 13.1% of the total market trading), compared to HK$16.7 billion (or 14.9%) during 2022.

Box 3: ETPs as a dominant component of the daily short selling turnover

ETPs have become a dominant component of the daily short selling turnover, and the majority of the short selling activities of ETPs were conducted by market makers. During the course of providing liquidity to the market, market makers may need to short sell the relevant ETPs.

As a result of stamp duty exemptions for ETFs (effective 2015) and the launch of ETF Connect in July 2022, the SFC has observed that trading activities of ETPs are on the rise. High short selling ratios have also been seen on some trading days due in part to active SB net buy of major ETPs. ETP market makers may not always maintain sufficient ETP inventories to meet market demand. As such, amid the strong SB investor demand for ETPs, market makers will need to short sell the ETPs as part of their liquidity providing functions.

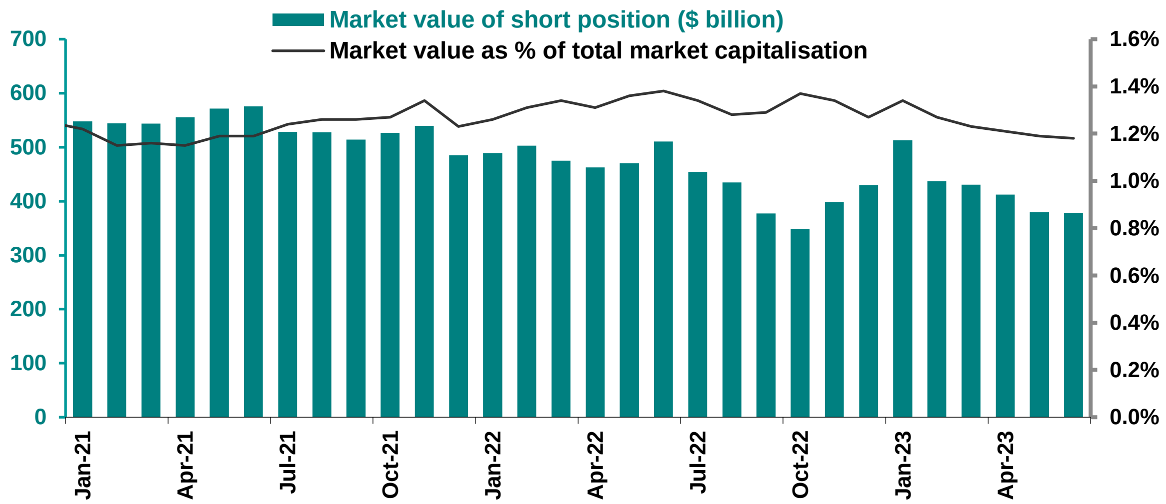
For example, on 5 June 2023:

- The short selling ratio of 23.4% was the second highest on record at that time.
- Of the short selling turnover of HK$23.4 billion on that day, major ETPs accounted for 56% or HK$13.1 billion.
- Excluding ETPs, the short selling turnover was HK$10.3 billion (12.9% of the total market trading), which remained at a normal level.
- SB net buy of major ETPs amounted to HK$10.3 billion, also a record high on that day.

The short selling of ETPs is unlikely to pose a significant systemic impact on the market, as the short positions of ETPs held by market makers are generally closed out within a short period of time.

31. For the market as a whole, the market value of reportable short positions fell both in absolute terms and as a percentage of market capitalisation. Based on the data submitted to the SFC, aggregated short positions declined to HK$378.7 billion as of end-June 2023 (versus HK$429.8 billion as of end-2022). Short positions accounted for 1.18% of market capitalisation, compared to 1.27% as of end-2022.

Short positions in the Hong Kong stock market



Exchange-traded derivatives

32. During the first half of 2023, average daily trading of exchange-traded derivatives was 5% higher than in the first half of 2022. The large open positions data showed no concentration or build-up of short positions in the exchange-traded derivatives market. There appeared to be no major systemic concerns.

- Trading of futures products fell 0.4%.
  - HSI futures and HSCEI futures were the most actively traded contracts, accounting for 24.2% and 32.7% of total futures trading. Compared to the first half of 2022, trading in HSI futures decreased 8.3% whilst that in HSCEI futures increased 7.4%.
  - Trading in Hang Seng TECH Index futures increased 59.4% compared to the first half of 2022, with an average daily turnover amounting to 103,509 contracts. This was partly attributable to investors' growing demand to manage exposures to technology stocks in light of their increased volatility.
- Trading in options products rose 8.7%. Stock options remained the most active, accounting for 81.0% of total options product trading. Trading in stock options increased 4.7% compared to the first half of 2022.