

Further Analysis of the Recent Rebound in Market Turnover

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Executive Summary

Trading activities of the Hong Kong stock market have recovered remarkably in recent months. In addition to the factors discussed in Research Paper No. 8, the recent rebound in market turnover was also due to the possible inflow of capital into the stock market, the relaxation of Mainland travel rules and the recovery of the world economy. The increase in trading activities benefits small and medium brokers.

The Recent Rebound in Market Turnover

- Trading activities of the Hong Kong stock market have recovered remarkably in recent months. Since the end of Apr 2003, the HSI has gained 29% and the total market cap has grown 35%.² The average daily turnover surged to a 3-year high of HK\$14.0 bn in Sep (Main Board and GEM combined), 92% higher than the Apr value of HK\$7.3 bn.
- In the previous issue of the Quarterly Bulletin (Issue No. 52) and Research Paper No. 8, factors contributing to the recent rebound in market turnover have been discussed. These included:
 - price effect;
 - an increase in trading activities of Mainland stocks³;
 - an increase in HSI Futures related transactions; and
 - an increase in trading activities of derivative warrants.
- In this supplementary note, other factors that might further explain the rebound in turnover will be examined. These are:
 - the possible inflow of capital into the stock market;
 - the relaxation of Mainland travel rules; and
 - the recovery of the global economy and strong corporate earnings.

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² Apr is chosen for the base period for comparison, as the HSI reached the year low on 25 Apr.

³ Mainland stocks include H-shares and red-chips. Following the definitions of HKEx,

- H-shares refer to shares issued by a PRC issuer under PRC law and listed on the SEHK, the par value of which is denominated in RMB, and which are subscribed for and traded in HKD.
- Red-Chips refer to companies which
 - have at least 35% shareholding held in aggregate directly by Mainland China entities, and/or through companies which are controlled by Mainland China entities, or
 - have below 35% but 20% or above shareholding held in aggregate directly by Mainland China entities, and/or through companies which are controlled by Mainland China entities and, there is a strong influential presence, on a judgmental basis, on the company's board of directors.

Mainland China entities include state-owned organisations, provincial or municipal authorities in Mainland China.

Possible Inflow of Capital into the Stock Market

- An inflow of capital is conjectured to be one of the factors supporting the recent rebound in turnover of most emerging economies in the region. The yield spreads (i.e. the yield of domestic bonds net of the yield of US Treasury bonds) in several emerging economies have been declining. This reflects a fall in the perceived risks of these economies, leading to an inflow of capital into their capital markets including the equity markets (Tables 1-2).

Table 1 – Yield Spreads in Selected Emerging Economies

	Average 5-Year Bond Yield Spread (in bps)				Average 10-Year Bond Yield Spread (in bps)			
	May 03	Aug 03	Yield Spread Change	% Change in Yield Spread	May 03	Aug 03	Yield Spread Change	% Change in Yield Spread
Hong Kong	22.42	9.31	-13.11	-58%	37.53	27.38	-10.16	-27%
South Korea	195.41	168.20	-27.21	-14%	115.21	89.54	-25.67	-22%
Thailand	-48.67	-136.45	-87.78	n.a.	-36.81	-158.73	-121.92	n.a.
Malaysia	57.61	49.06	-8.55	-15%	7.21	-34.16	-41.37	n.a.
Philippines	882.95	747.55	-135.40	-15%	866.03	741.90	-124.13	-14%
Japan*	-228.68	-284.67	-55.98	n.a.	-295.97	-325.66	-29.69	n.a.

* Japan is included for the sake of comparison.

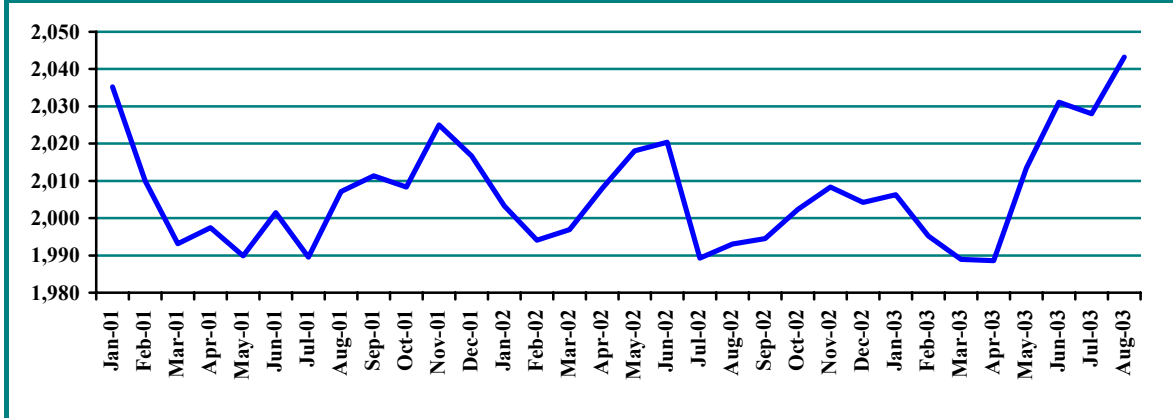
Table 2 – Performance of Stock Markets in Selected Emerging Economies

	Stock Index Performance				Average Daily Turnover			
	31 Aug 03	30 Apr 03	% Change in Local Currency	% Change in US\$	May-Aug 2003 (US\$ bn)	Jan-Apr 2003 (US\$ bn)	% Change in Local Currency	% Change in US\$
Hong Kong	10,908.99	8,717.22	+25.1%	+25.1%	1307	841	+55.4%	+55.4%
South Korea	759.47	599.35	+26.7%	+30.7%	3161	2312	+36.7%	+32.6%
Thailand	537.71	374.63	+43.5%	+49.3%	389	148	+162.3%	+152.1%
Malaysia	743.30	630.37	+17.9%	+17.9%	200	93	+116.2%	+116.2%
Philippines	1,192.83	1,068.15	+11.7%	+6.7%	n.a.	n.a.	n.a.	n.a.
Japan	10,343.55	7,831.42	+32.1%	+34.3%	7350	4847	+51.6%	+49.1%

Sources: Bloomberg and websites of various exchanges.

- In addition, there have been indications of capital inflow into Hong Kong since May. One such indication is the rebound in HK\$M3. HK\$M3 has been on a downtrend for more than two years, but it rebounded from HK\$1,989 bn in Apr to HK\$2,043 in Aug (Chart 1).

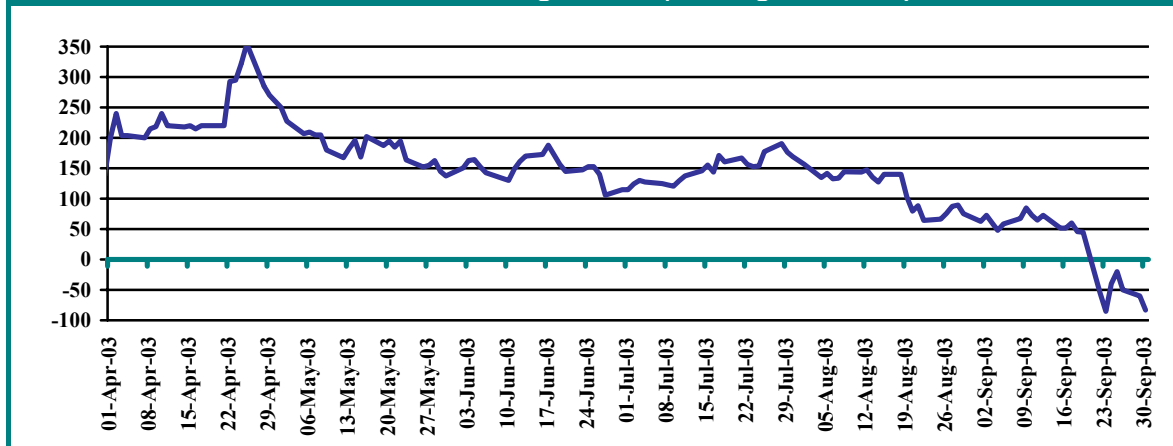
Chart 1 – HK\$M3 (HK\$ bn)



Source: HKMA.

- In the currency market, there seems to be strengthened support and enhanced confidence in the outlook of the Hong Kong dollar, and the HK\$ 1-year forward rate moved from a premium to a discount (Chart 2).

Chart 2 – HK\$ 1-Year Forward Exchange Rate* (HK\$ against US\$)



Source: HKMA.

* HK\$ forward exchange rate refers to the premium/discount on the spot rate of HK\$ against US\$ in the interbank market

Relaxation of Mainland Travel Rules

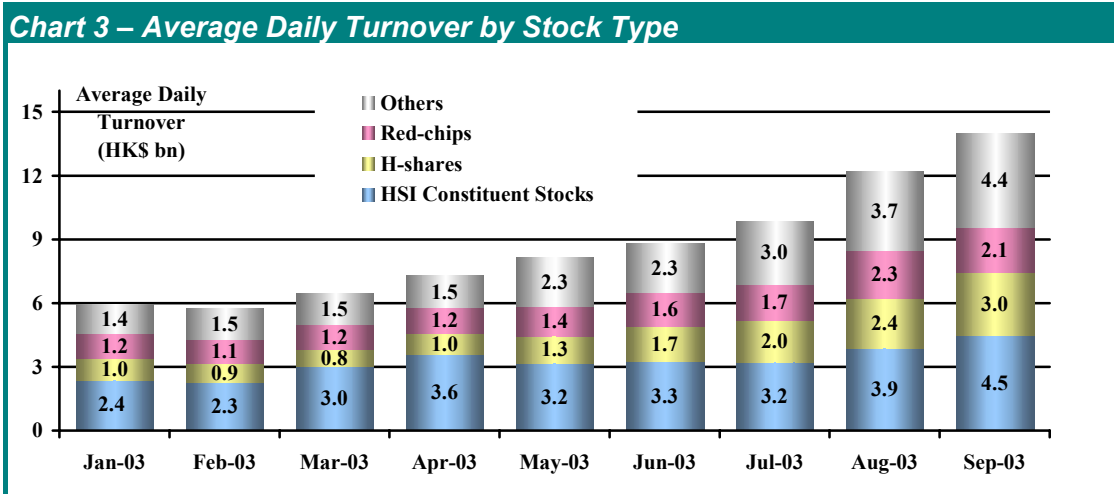
- The revival of trading activities on the Hong Kong stock markets was also due to the Mainland government’s supportive policies, including the CEPA agreement and the relaxation offered for Mainland tourists. These have helped restore confidence.
- In late Jul, the Chinese Government announced the scheme to allow residents from Beijing, Shanghai and several cities in Guangdong to travel individually to Hong Kong.
- Visitors from the Mainland have been important spenders in Hong Kong. The number of Mainland visitors totalled 3.2 mn during 2003 H1. This contributed 54% to the total and was 12% higher than 2002 H1, partly offsetting the drop in overseas visitors which fell 40% as a result of the SARS outbreak.
- Following the announcement of the relaxation, market sentiment in Hong Kong was boosted by the expected tourism rebound and economic turnaround. The HSI rallied to a 15-month high at 11,445 on 25 Sep.
- The retail and hotel industries are the prime beneficiary of the tourism boom. There are media reports that cash-rich Mainland tourists may also buy commodities from cosmetics to flats. Since late Jul, tourism-related stocks have out-performed the broad market with gains between 12%-214% (Table 3). The average daily turnover of tourism-related stocks also surged.

Table 3 – Stock Performance of Tourism-related Companies

		end Sep 03 Index / Price	% Change since 25 Jul 03	Average Daily Turnover during 28 Jul -end Sep 03 (HK\$ mn)	% Change from 2 Jan - 25 Jul 03 Daily Average
Hong Kong	-HSI	11,229.87	13.0%	12,598.41	72.2%
	-HSCEI	3,221.21	12.5%	2,092.96	71.0%
	-HSCCI	1,208.13	7.9%	2,432.38	85.0%
	-GEM	1,185.27	4.3%	191.31	49.4%
- Retail	Dickson Concepts	4.78	105.4%	10.06	3,382%
	Chow Sang Sang Holdings	2.65	81.5%	9.02	7,824%
	Luk Fook Holdings	1.39	56.2%	15.08	3,999%
	Hang Fung Gold Technology	1.59	93.9%	36.24	1,747%
	Crocodile Garments	0.32	75.8%	1.64	2,241%
	Sa Sa International	1.87	88.9%	15.75	966%
- Travel	Cathay Pacific	13.10	19.6%	115.64	0%
	China Eastern Airlines	1.15	11.7%	33.51	64%
	China Southern Airlines	2.63	15.4%	32.67	6%
	Guangshen Railway	1.95	26.6%	28.68	193%
	China Travel International	1.53	20.5%	41.15	153%
- Hotels	Hong Kong & Shanghai Hotels	4.68	29.9%	4.73	225%
	Shangri-la Asia Ltd	6.75	15.4%	11.82	59%
	Miramar Hotel Investment	7.25	22.9%	0.98	414%
	Regal Hotels International	0.18	214.3%	61.45	3,943%
- Restaurants	Hon Po Group (Lobster King) Ltd.	0.10	106.1%	0.44	644%
	Kamboat Group Co. Ltd.	0.63	46.5%	0.20	262%
	Tack Hsin Ltd	0.18	28.6%	0.35	50%

Source: Bloomberg

- On 29 Aug 2003, the Chinese Government announced it would raise the limit of foreign currency that Mainland residents can take abroad for travelling from US\$2,000 to US\$5,000. It is perceived that as more capital comes to Hong Kong, the stock market will benefit.
- The recent rebound in market turnover was across the board, with all stock types gaining turnover. For instance, the average daily turnover of HSI stocks increased 25% from HK\$3.6 bn in Apr to HK\$4.5 bn in Sep, whilst that of the Mainland stocks has gained 132% from HK\$2.2 bn to HK\$5.1 bn (Chart 3). The turnover of other stocks also advanced 193% from HK\$1.5 bn to HK\$4.4 bn over the period.



Source: HKEx.

Note: HSI constituent stocks here do not include those which also belong to the category of Mainland enterprises (i.e. H-shares and red-chips).

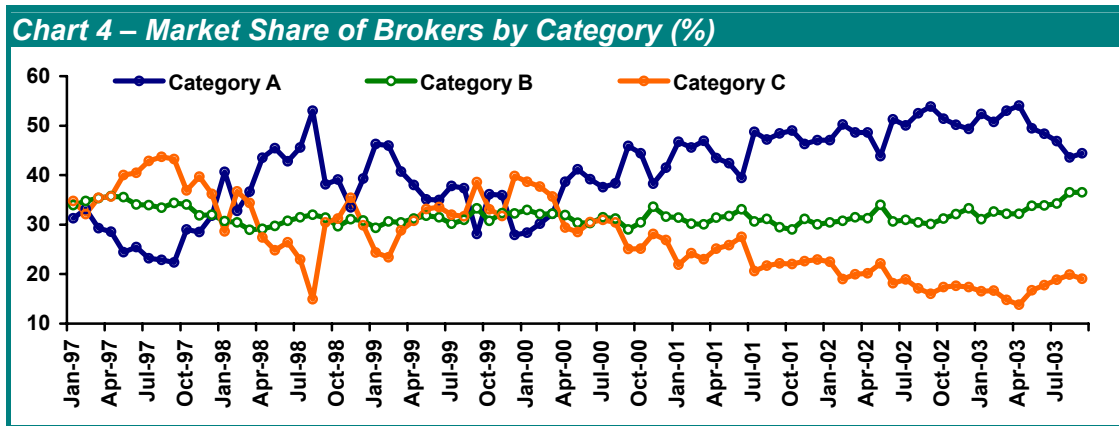
- Notice that since the launch of the individual visit scheme and the relaxation of the limit on foreign currency to be brought by Mainland residents coincided with the CEPA agreement, the possible inflow of capital into the stock market, the improved sentiment of major markets and other rumours such as the introduction of QDII later, these impacts on the stock market could not be isolated.

Recovery of Global Economy and Improving Investor Confidence

- The expected global recovery led by the US also supported the stock market. Bolstered by optimism that the US economy is picking up and the Fed's indication to keep the benchmark interest rate unchanged at a 45-year low for some time, major markets in the US and Europe all recorded gains. Both the Dow and the Nikkei rose to 15-month highs in active trade. The buoyant external environment might have helped support investor confidence in Hong Kong.
- With promising external markets which give strength to merchandise exports and the positive spill-over from the surge in inbound tourists, a post-SARS economic recovery is taking place in Hong Kong. The Hong Kong Government also revised its GDP forecast for 2003 in Aug from 1.5% to 2%. The improvement in economic conditions has therefore been reflected in the equity market in both prices and turnover.

Impact of Increase in Trading Activities on Brokers

- The increase in trading activities benefits small and medium brokers. The share of Category C brokers rebounded steadily from the lowest level of 13.8% in Apr to 19.1% in Sep, whilst that of Category B brokers climbed from 32.2% in Apr to 36.5% (Chart 4). In contrast, the market share of Category A brokers dropped from 54.0% to 44.4% during the period.



Source: HKEx.