

Convergence of A-share and H-share Prices

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Summary

A-shares have been trading at premiums over H-shares². Among other factors, this is due to limited supply of A-shares and limited investment opportunities for Mainlanders. Such premiums have declined in recent years as a result of the possibility of the Mainland authorities offloading state shares as well as the possibility of relaxing restrictions on investments overseas in a controlled manner. In anticipation of price convergence, H-shares have advanced in recent years. Nevertheless, the narrowing of premiums has slowed down during 2004. This appears to be the result of macro-economic control in the Mainland and increasing fund-raising activities by H-shares.

Introduction

1. As of the end of December 2004, 30 H-share companies also issued A-shares. Of these, 28 A-shares were traded at premiums over their H-share counterparts (two H-shares were traded at the premiums of 0.1-8.9% over their A-share counterparts). The premiums ranged from 5.5% to 349%, with a weighted average of about 39% (Table 1)³.

Table 1 – Price Differences between A-shares and H-shares (Period end, number of stocks)	
Premium of A-shares over H-shares	December 2004
0 – 50%	10
50 – 100%	4
100 – 200%	9
200 – 300%	4
>300%	1
Sub-total	28
Premium of H-shares over A-shares	
0 – 25%	2
Sub-total	2
TOTAL	30
Source: SFC Research	

¹ This paper is for pure fact-finding and research purpose, and is not an attempt to comment on the developments of any markets/companies or interpret the policies concerned. The views expressed in this paper do not represent those of the SFC.

² H-share companies refer to companies incorporated in the PRC and approved by the CSRC for a listing in Hong Kong. The par value of the shares of these Chinese enterprises is denominated in RMB, and the shares are subscribed for and traded in HKD or other currencies.

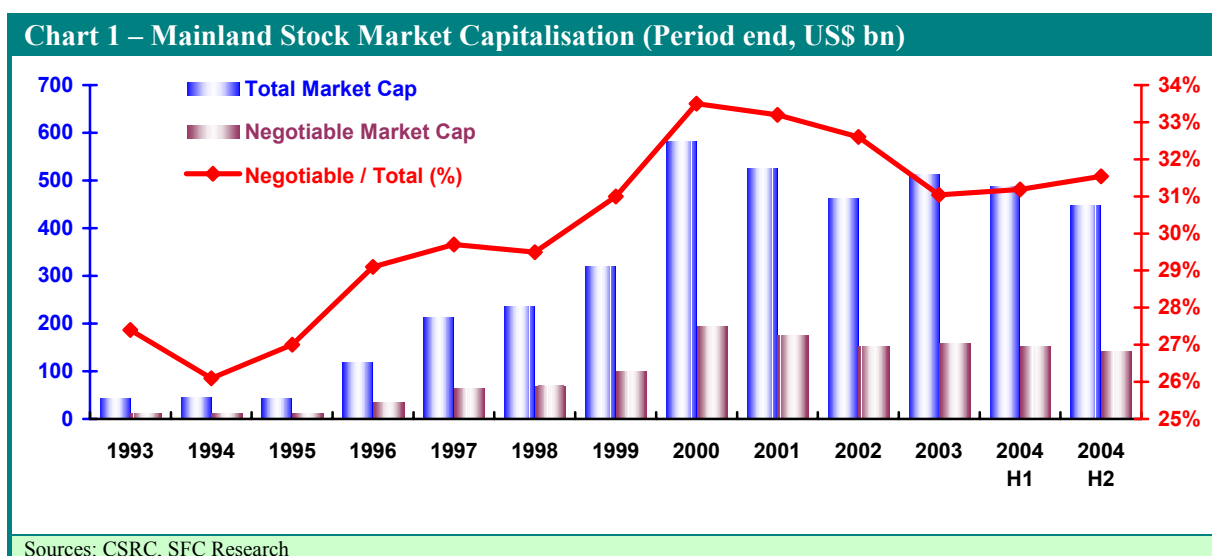
³ Premiums are weighted by market capitalisation.

Reasons for Price Differences

2. Among other factors, the premiums of prices of A-shares over H-shares were due to:
- limited supply of A-shares; and
 - limited investment opportunities for Mainlanders.

Limited supply of A-shares

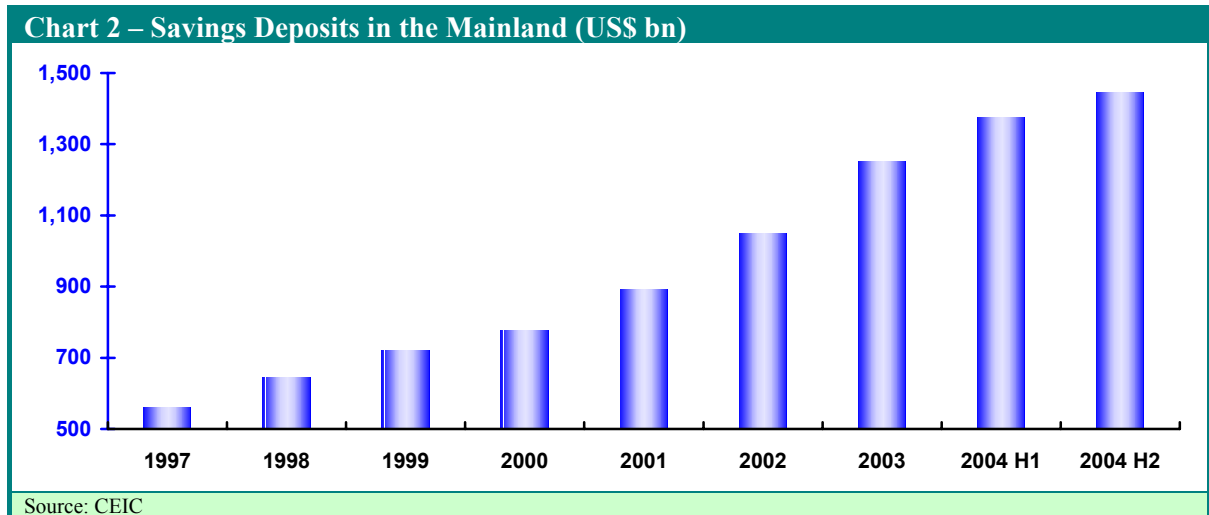
3. Only about one-third of the A-shares listed on the two Mainland exchanges are tradable (Chart 1). The remaining two-thirds of the shares are mainly state shares and legal person shares, and are non-tradable. Although the market capitalisation of Mainland stocks amounted to US\$447.7 bn as of the end of December 2004, the negotiable market capitalisation was only US\$141.2 bn (31.5% of the total).



Limited investment opportunities for Mainlanders

4. The economic growth of China has been maintained at an average rate of about 9% over the past 20 years. Latest figure for GDP per capita for China was US\$1,087.2 in 2003. Adjusted for purchasing power, GDP per capita has reached the level of a middle-income country, according to the World Bank⁴.
5. In the Mainland, financial investment in overseas markets is controlled, whilst local investment opportunities are still limited. Therefore, deposits have been growing. Savings deposits amounted to US\$1,444.4 bn as of the end of December 2004, roughly 3.2 times the total market capitalisation and 10.2 times the negotiable market capitalisation of the Mainland markets (Chart 2).

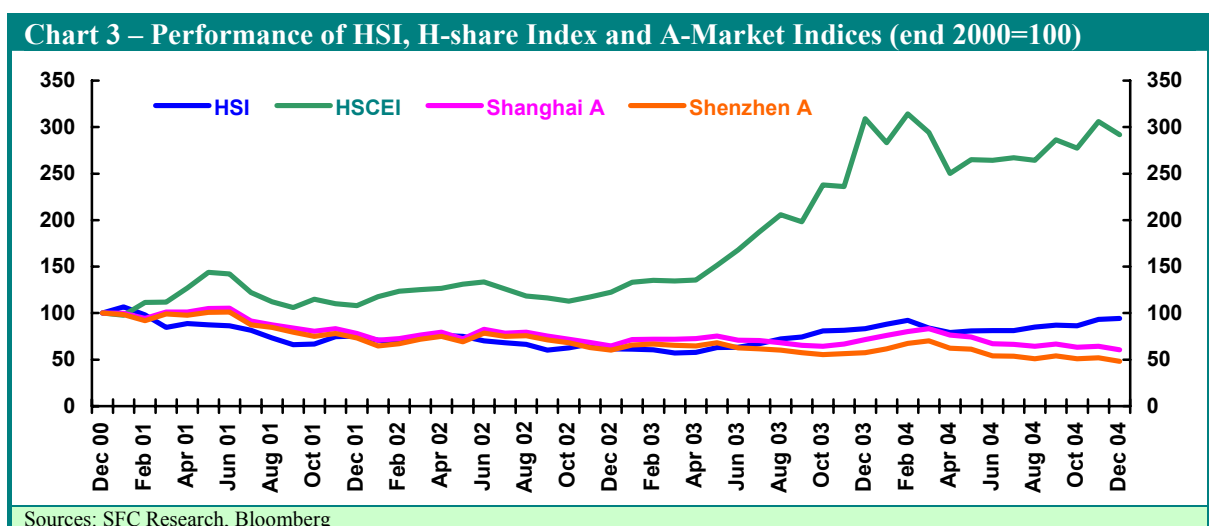
⁴ The World Bank (2003) "World Economic Indicators", downloadable from the website at http://econ.worldbank.org/files/30042_select.pdf.



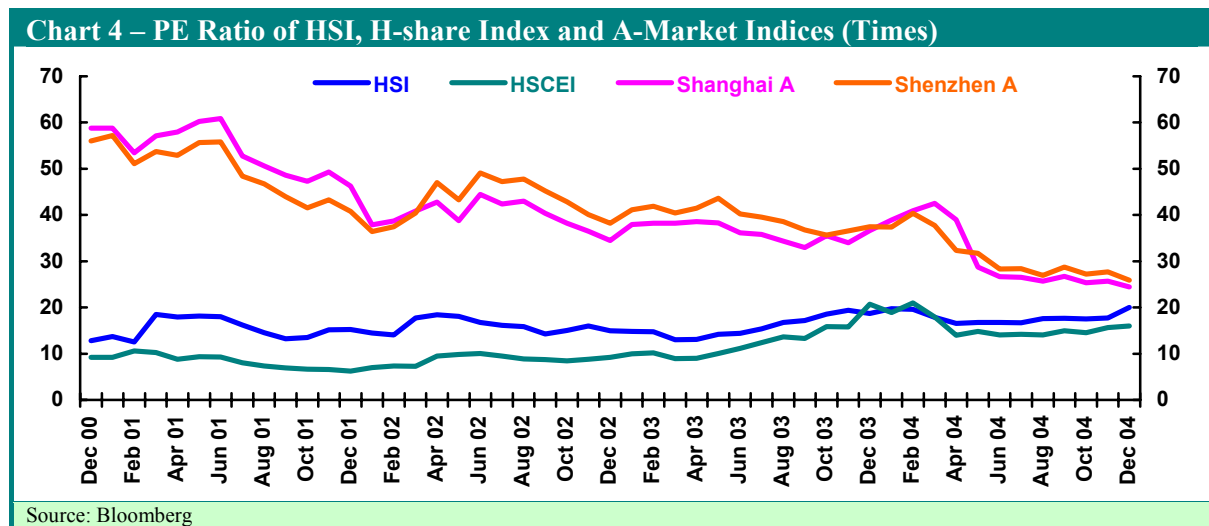
- Due to rapid growth of the economy and wealth accumulation but limited investment opportunities in the Mainland, funds might have been channelled to the local stock markets, possibly driving them to relatively high levels.

Narrowing of Premiums

- Nevertheless, the premiums of A-share prices over H-share prices narrowed from the weighted average of some 830% at the end of 2000 to 39% at the end of 2004. Between the end of 2000 and the end of 2004, the Shanghai A and Shenzhen A indices fell 39% and 52% respectively (Chart 3). In contrast, the H-share index gained 192%, despite the HSI dropping 5.7% over the period.



8. According to information vendors, the PE ratio for the Shanghai A- and Shenzhen A-markets receded from 59 times and 56 times respectively at the end of 2000 to 24 times and 26 times at the end of 2004 (Chart 4). In contrast, the PE ratio for H-shares advanced from 9 times to 16 times over the period, whilst that for the HSI increased from 13 times to 20 times.



9. Among other factors, the narrowing of premiums might be attributable to
- the possibility of Mainland authorities selling state shares and/or new share offering; and
 - the possibility of relaxing restrictions on investments overseas.

Reasons for Narrowing of Premiums

Possibility of Mainland authorities selling state shares and/or new share offering

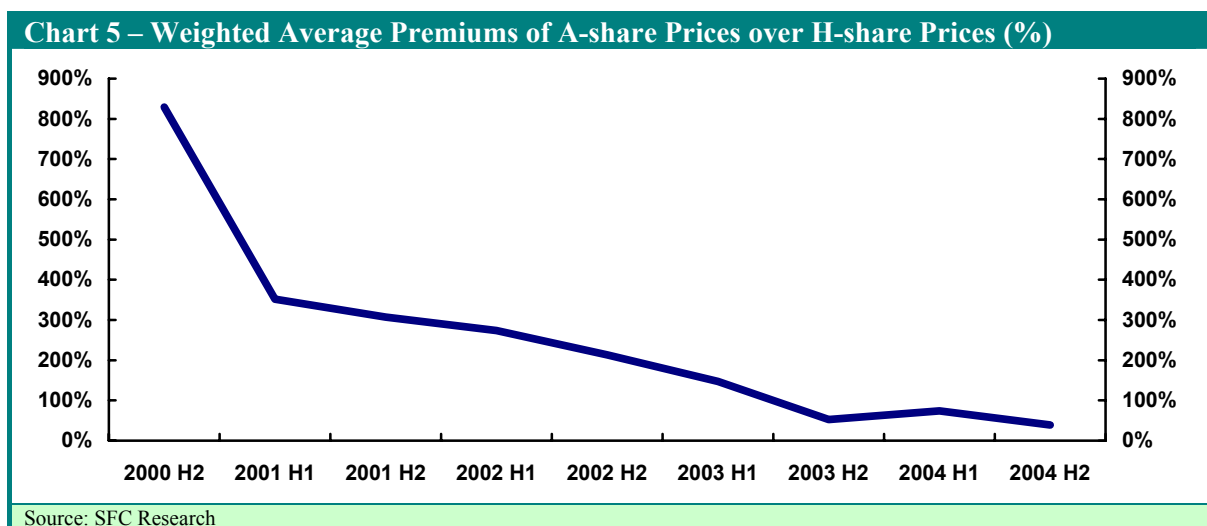
10. By selling state shares, it is hoped that management of listed companies will act according to market principles and for the best interest of shareholders. This may enhance investor confidence, which will in turn give support to share prices. However, selling state shares will increase the supply of shares and may create pressure on share prices. The resulting impact on share prices depends on the magnitude of these forces.
11. During the past few years, the stock market has not reacted positively to rumours of state share sales or even new share offerings. Quite often, when there were rumours of possible state share sales or of new share offerings, share prices declined. This might have contributed to the convergence of A-share prices with H-share prices.

Possibility of relaxing restrictions on investments overseas

12. Media reported that the Social Security Fund in the Mainland have got all necessary approvals to invest overseas, with the earliest possible implementation by early 2005. Fund assets amounted to RMB148.9 bn as of the end of September 2004. Analysts conjectured that about US\$0.5-1 bn would be invested overseas (including in Hong Kong). It is perceived that as more funds come to Hong Kong, the stock market will benefit, thus contributing to the narrowing of price differences between the two sides.
13. Although there has not been a concrete schedule regarding its implementation, the Qualified Domestic Institutional Investors (QDII) scheme is rumoured to be under consideration by relevant authorities in the Mainland. If implementation takes place, it would be a major step towards relaxing investments overseas in a controlled manner. Hong Kong would benefit when the relaxation takes place.

Slowdown in Narrowing of Premiums

14. Although the premiums of A-share prices over H-share prices have been declining, the decline has slowed down during 2004. For instance, the premium was 53% as of the end of 2003. It was 39% as of the end of 2004 (Chart 5 and Table 2). This compared to the decline of premium from 830% as of the end of 2000 to 307% as of the end of 2001, and further to 214% as of the end of 2002 and to 53% as of the end of 2003. The slowdown appears to be the result of:
 - macro-economic control in the Mainland; and
 - increasing fund-raising activities by H-shares.

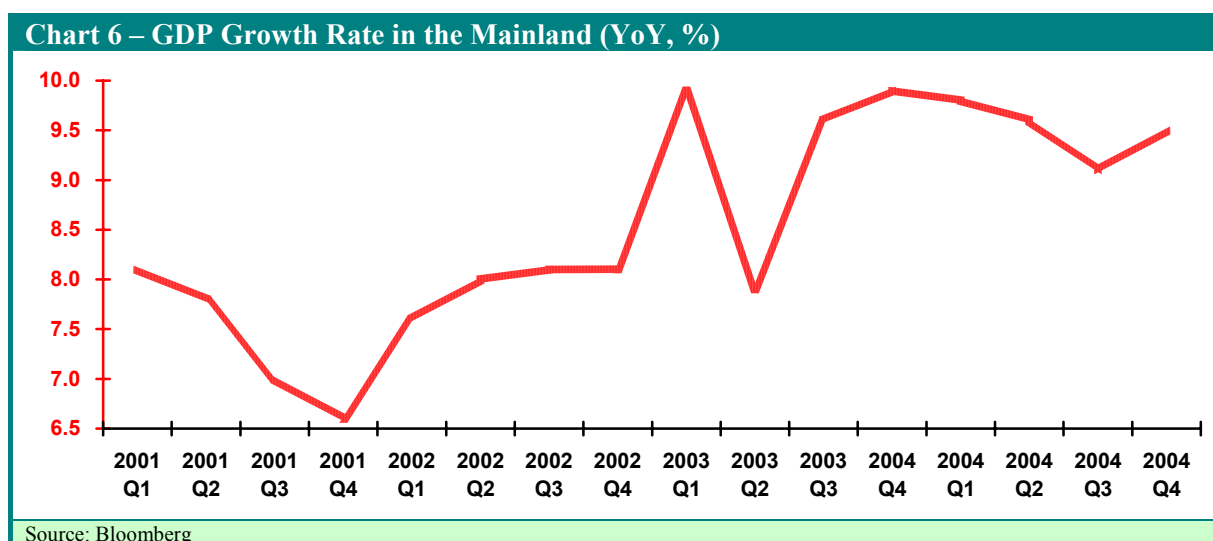


Premiums of A-shares over H-shares	2000	2001	2002	2003	2004 H1	2004 H2
0 – 100%	0	0	2	12	12	14
100 – 200%	0	1	6	10	7	9
200 – 300%	0	6	1	6	6	4
300 – 500%	6	12	11	0	4	1
>500%	13	5	7	0	0	0
Sub-total	19	24	27	28	29	28
Premiums of H-shares over A-shares						
0 – 25%	0	0	0	1	0	2
Sub-total	0	0	0	1	0	2
TOTAL	19	24	27	29	29	30

Source: SFC Research

Macro-economic control in the Mainland

15. The macro-economic control in the Mainland, which came into effect in the latter half of 2003, has cooled off the bullish sentiment over H-shares and contributed to the slowdown in the price convergence of A-shares and H-shares.
- During the SARS period, economic growth in the Mainland retreated somewhat but remained firm. GDP growth was 7.9% in 2003 Q2. It quickly rebounded to 9.6% in 2003 Q3 and has remained resilient since then (Chart 6).
 - The People's Bank of China (PBoC) raised the banking reserve requirement from 6% to 7% in 2003 Q3.
 - However, certain sectors continued to expand rapidly. For instance, investment in the real estate sector grew 50.2% during the first two months of 2004. Certain administrative measures such as tightening of bank credits were adopted. The PBoC further raised the banking reserve requirement from 7% to 7.5% in 2004 Q2. However, the inflation rate rose to 5%+ during the third quarter. Further macro-economic measures seemed imminent.
 - The PBoC raised the interest rates on 29 October 2004, the first interest rate hike in nine years.



16. Consequently, H-shares consolidated, with the HSCEI dropping 20% from the peak of 5,102 as of the end of February 2004 to the year-low of 4,061 as of the end of April 2004. The Shanghai A- and Shenzhen A-markets fell 4.7% and 7.6% respectively over the same period. Among other factors, the larger decline in H-share prices accounted for the slowdown in the price convergence of A-shares and H-shares.

Increasing fund-raising activities by H-shares

17. The amount of funds raised by H-shares has been increasing in recent years whilst by A-shares has been decreasing.
- In 2001, the total amount of funds raised by H-shares was US\$0.9 bn (8.6%). This compared to US\$9.1 bn (91.4%) raised by the A-shares (Chart 7).
 - In 2002, the total amount of funds raised by H-shares rose to US\$2.2 bn (21.1%), but by A-shares fell to US\$8.2 bn (78.9%).
 - In 2003, the total amount of funds raised by H-shares rose further to US\$6.5 bn (48.6%), but by A-shares fell further to US\$6.8 bn (51.4%).
 - In 2004, the total amount of funds raised by H-shares was US\$7.8 bn (55.4%). This compared to US\$6.3 bn (44.6%) raised by the A-shares.
18. On one hand, this strengthens Hong Kong's role as a fund-raising centre for Mainland enterprises. On the other hand, it alters the demand-supply situation of both A-shares and H-shares, which affects the price convergence of A- and H-shares.

