

Trading of Hong Kong Stocks by US and Japanese Residents

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Summary

- *On a monthly basis, trading of Hong Kong stocks² by US residents has been accounting for about 11-35% of the market turnover since 2000. The corresponding figure for Japan has been less than 2%.*
- *There is no breakdown on the composition of stocks traded by US and Japanese investors. Nevertheless, HKEx's Cash Market Transaction Survey 2003/2004 shows that majority of the trading of overseas investors are institutional.³ Institutional investors tend to invest in large cap and high liquidity stocks, including Mainland stocks⁴ (i.e. H-shares and red chips) listed in Hong Kong. Of the 30 largest market cap stocks as of the end of June 2005, 11 were Mainland stocks. Of the 30 most actively traded stocks in June 2005, 16 were Mainland stocks. In addition, most of these Mainland stocks are constituents of benchmark indices.*
- *Trading of Hong Kong stocks by US residents seemed to be positively associated with Hong Kong's stock market capitalisation and market turnover. Among other factors, this is attributable to the fact that as overseas investors are mainly institutional with many being index-tracking funds, trading activities of these investors grow in line with the size of the market. Nevertheless, the share of the trading of Hong Kong stocks by US residents in total market turnover appeared to be negatively associated with market turnover. Among other factors, this could be attributable to the fact that local investors (in particular, local retail investors) are relatively more sensitive to market sentiment. During a bull market, trading of local investors becomes more active, which leads to a drop in the share of US residents. Therefore, trading of Hong Kong stocks by US residents help stabilize trading activities.*
- *Trading of Hong Kong stocks by Japanese residents also seemed to be somewhat positively associated with Hong Kong's stock market capitalisation and market turnover. The share of the trading of Hong Kong stocks by Japanese residents in total market turnover also looked positively associated with market turnover. Among other factors, this seems to suggest that the pattern of Japanese investors resembles to that of local investors which may be attributable to the fact that both Hong Kong and Japan belong to the same region and time zone. As Japanese investors appear to be sensitive to market sentiment, trading of Hong Kong stocks by Japanese residents do not help stabilize the market shares of trading activities.*

¹ This paper is for pure fact-finding and research purposes, 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 Trading of Hong Kong stocks by US and Japanese residents is the sum of gross purchases and gross sales of Hong Kong stocks by them, whilst buy and sell transactions have been counted in the market turnover of Hong Kong.

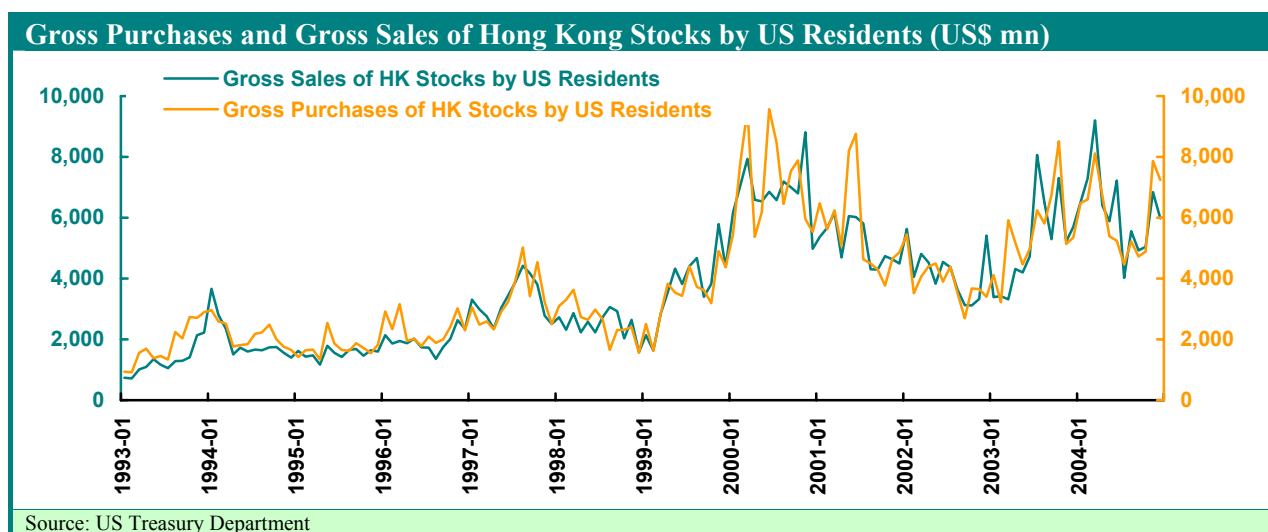
³ HKEx's Cash Market Transaction Survey 2003/2004 shows that the share of overseas institutional investors in total market turnover was 33% for the 12 months ending September 2004, whilst that for overseas retail investors was 3%.

⁴ Mainland stocks in this paper refer to H-shares and red chips. The definitions of H-shares and red chips are adopted from HKEx, and are found in Table B2 of the Statistics section of the SFC Quarterly Bulletin.

Background

1. There are no official statistics on capital flow to the stock market of Hong Kong. To analyse capital flow to the stock market of Hong Kong, we have to rely on statistics provided by overseas authorities. At present, the US Treasury Department provides data on gross purchases and gross sales of Hong Kong stocks by US residents on a monthly basis, whilst the Ministry of Finance of Japan provides data on gross purchases and gross sales of Hong Kong stocks by Japanese residents also on a monthly basis. This paper is to analyse trading activities of the US and Japan in relation to the stock market of Hong Kong, based on the statistics obtained from these sources. Whilst data from the US Treasury is available since 1987, data from Ministry of Finance of Japan is only available since 1997. Data on trading of Hong Kong stocks from overseas investors of other countries are not available.
2. There is no further breakdown on the composition of Hong Kong stocks traded by US and Japanese investors. Nevertheless, HKEx's Cash Market Transaction Survey 2003/2004 shows that majority of the trading from overseas investors are institutional. Institutional investors tend to invest in large cap and high liquidity stocks, including Mainland stocks (i.e. H-shares and red chips) listed in Hong Kong. Of the 30 largest market cap stocks as of the end of June 2005, 11 were Mainland stocks. Of the 30 most actively traded stocks in June 2005, 16 were Mainland stocks. In addition, most of these Mainland stocks are constituents of benchmark indices.

Trading of Hong Kong Stocks by US Residents



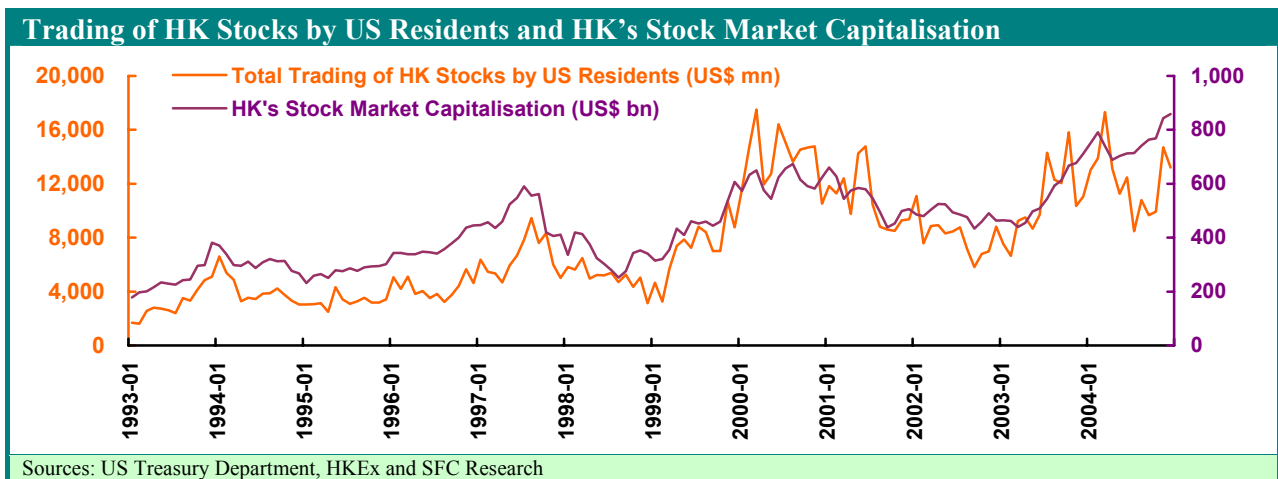
3. On a monthly basis, gross purchases of Hong Kong stocks by US residents have been moving closely in line with monthly gross sales of Hong Kong stocks by US residents. Total trading of Hong Kong stocks by US residents has therefore been US\$5,800-17,500 mn since 2000 (11-35% as percentage of market turnover).

Trading of Hong Kong Stocks by US Residents (US\$ mn)				
Year	Gross Purchases of HK Stocks by US Residents	Gross Sales of HK Stocks by US Residents	Total Trading of HK Stocks by US Residents	Total Trading of HK Stocks by US Residents / HK Market Turnover (%)
1993	21,871	15,482	37,353	11.9%
1994	25,796	23,392	49,188	16.9%
1995	20,683	18,504	39,187	18.5%
1996	27,858	23,406	51,264	14.2%
1997	39,275	39,443	78,718	8.1%
1998	31,302	29,917	61,219	14.0%
1999	41,996	44,773	86,769	17.6%
2000	85,721	82,467	168,188	20.9%
2001	67,052	62,229	129,281	25.3%
2002	47,185	50,371	97,556	23.2%
2003	65,667	61,444	127,111	19.2%
2004	72,934	74,895	147,829	14.5%

Sources: US Treasury Department, HKEx and SFC Research

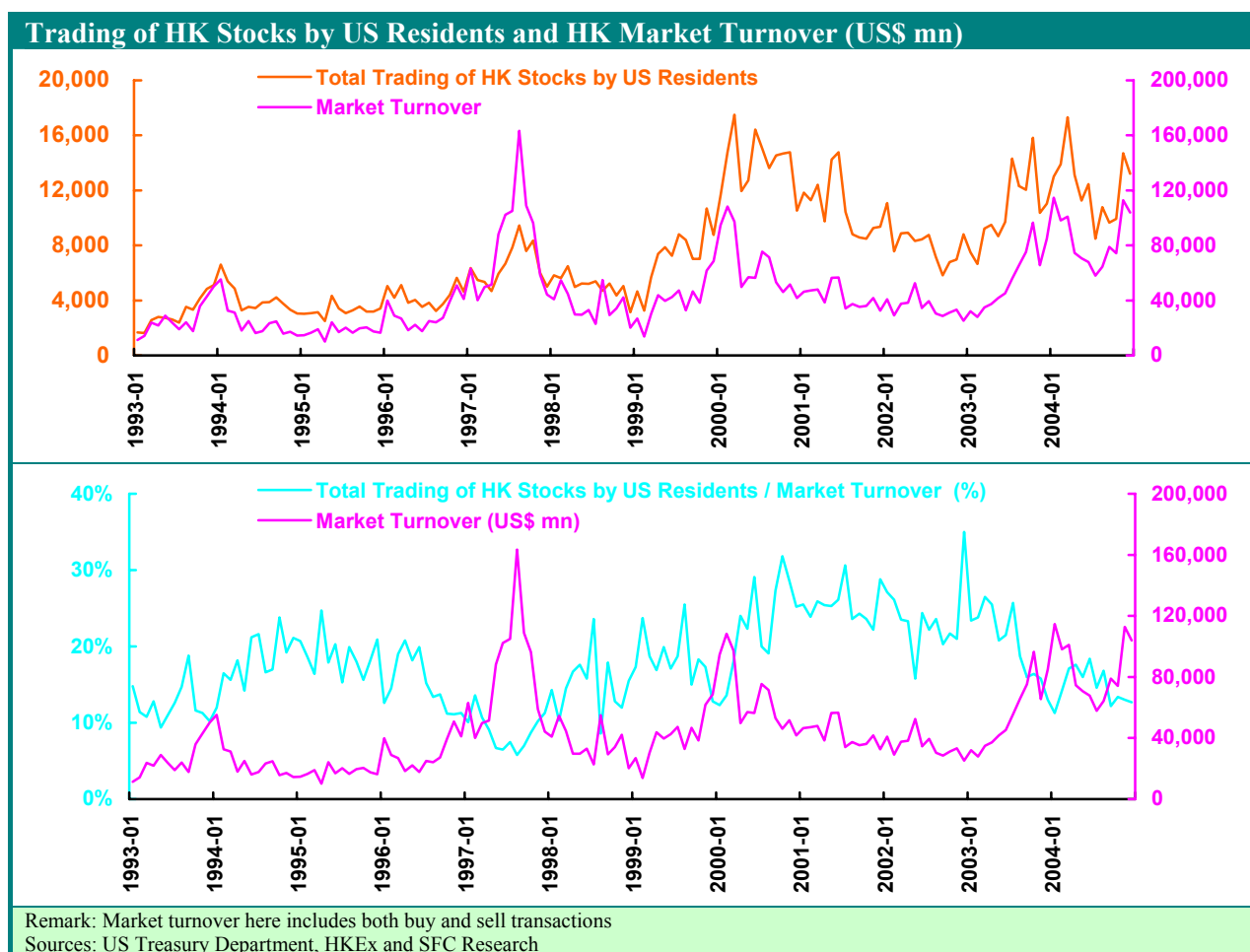
Trading of Hong Kong stocks by US residents seemed to be positively associated with the Hong Kong stock market

4. The trading of Hong Kong stocks by US residents seemed to be positively associated with Hong Kong's stock market capitalisation. The correlation coefficient between the total trading of Hong Kong stocks by US residents and Hong Kong's stock market capitalisation during January 1993 – December 2004 was 0.8794. Among other factors, this is attributable to the fact that as overseas investors are mainly institutional with many being index-tracking funds, trading activities of these investors grow in line with the size of the market. It is also found that the total trading of Hong Kong stocks by US residents appeared to be positively associated with the performance of the market (in terms of the HSI). Nevertheless, this is very much expected, as price effect should have been captured by market capitalisation. The details are therefore not repeated.



5. Trading of Hong Kong stocks by US residents also seemed to be positively associated with the turnover of the Hong Kong stock market. The correlation coefficient between the total trading of Hong Kong stocks by US residents and market turnover during January 1993 – December 2004 was 0.6862. As a percentage of market turnover, the trading of Hong Kong stocks by US residents has been moving within the range of 6-32% prior to 2000 and the range of 11-35% after 2000.

6. However, the share of the trading of Hong Kong stocks by US residents in total market turnover appeared to be negatively associated with market turnover. In other words, as market turnover increases, the share of the total trading of Hong Kong stocks by US residents in total market turnover declines. Among other factors, this could be attributable to the fact that local investors (in particular, local retail investors) are relatively more sensitive to market sentiment. During a bull market, trading of local investors becomes more active, which leads to a drop in the share of US residents. Similarly, during a bear market, local investors become less active. This may lead to a rise in the share of US residents. Therefore, trading of Hong Kong stocks by US residents help stabilize trading activities.

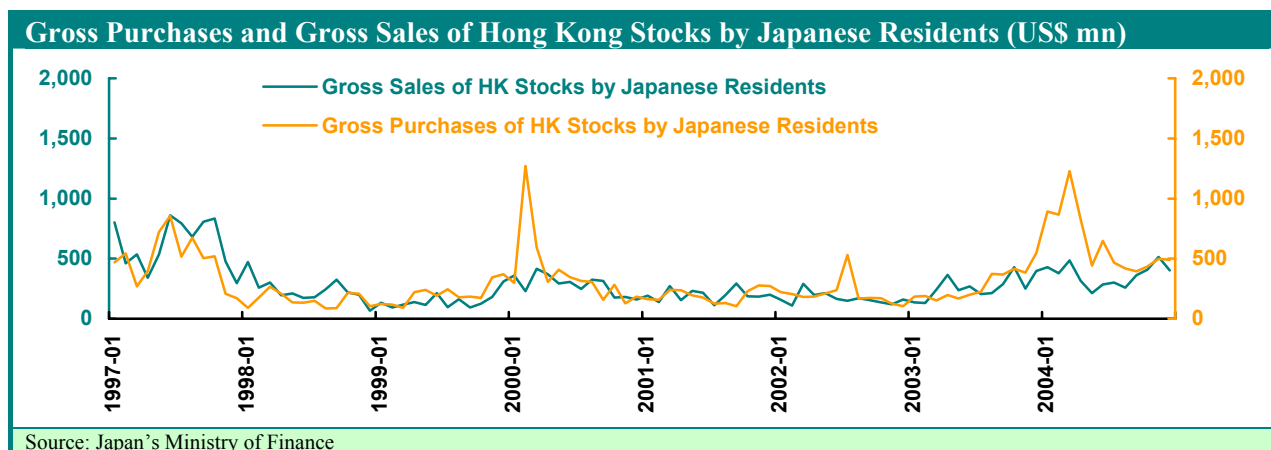


Other factors affecting trading of Hong Kong stocks by US residents

7. Other factors which may affect the trading of Hong Kong stocks by US residents have also been analysed. These included:
- the yield levels of US Treasury bonds of different maturity;
 - the yield spreads between Treasury bonds and their Hong Kong counterparts;
 - the yield spreads between various US Treasury bonds (e.g. the difference between the yield of 10-year US Treasury bonds and the yield of 2-year US Treasury bonds);
 - the cost of borrowing USD of different terms (e.g. the LIBORs); and
 - the spreads between the costs of borrowing USD and those of HKD (i.e.: LIBORs – HIBORs).

However, the impacts of these factors appeared to be inconclusive on the amount of trading of Hong Kong stocks by US residents.

Trading of Hong Kong Stocks by Japanese Residents



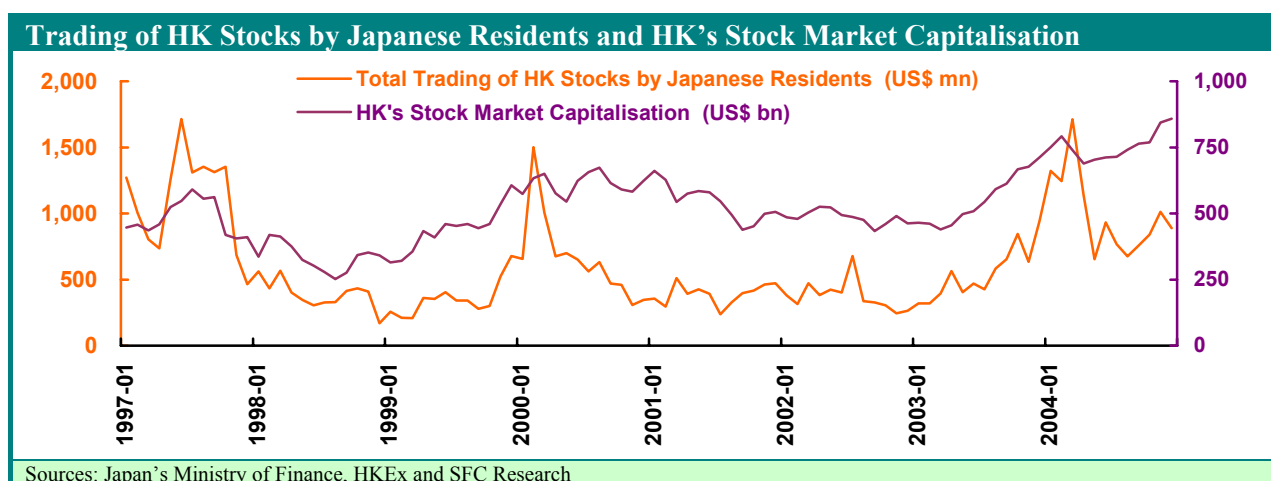
8. Monthly gross purchases of Hong Kong stocks by Japanese residents have also been moving somewhat in the line with monthly gross sales of Hong Kong stocks by Japanese residents. Nevertheless, the pattern is different from the US in the following characteristics.
- trading of Hong Kong stocks by Japanese residents have been much smaller than their US counterparts. Total trading of Hong Kong stocks by Japanese residents has usually been less than US\$1,800 mn during 1997-2004. With a few exceptions, the total trading has been in fact less than US\$1,000 mn since 2000. The total trading is much smaller than their US counterparts (which has usually been within the range of US\$5,800-17,500 mn since 2000).
 - trading of Hong Kong stocks by Japanese investors as percentage of market turnover has been less than 2% since 2000. Again, this is smaller than their US counterparts (which has been about 11-35%).

Trading of Hong Kong Stocks by Japanese Residents (US\$ mn)				
Year	Gross Purchases of HK Stocks by Japanese Residents	Gross Sales of HK Stocks by Japanese Residents	Total Trading of HK Stocks by Japanese Residents	Total Trading of HK Stocks by Japanese Residents / HK Market Turnover (%)
1997	5,845	7,423	13,268	1.4%
1998	1,860	2,840	4,700	1.1%
1999	2,478	1,777	4,255	0.9%
2000	4,591	3,379	7,971	1.0%
2001	2,304	2,377	4,681	0.9%
2002	2,510	2,021	4,531	1.1%
2003	3,395	3,162	6,557	1.0%
2004	7,595	4,348	11,942	1.2%

Sources: Japan's Ministry of Finance, HKEx and SFC Research

Trading of Hong Kong stocks by Japanese residents seemed to be somewhat positively associated with the Hong Kong stock market

9. Trading of Hong Kong stocks by Japanese residents also seemed to be somewhat positively associated with Hong Kong's stock market capitalisation. The correlation coefficient between the total trading of Hong Kong stocks by Japanese residents and Hong Kong's stock market capitalisation during January 1997 – December 2004 was 0.4991.



10. Trading of Hong Kong stocks by Japanese residents also looks positively associated with the turnover of the Hong Kong stock market. The correlation coefficient between the total trading of Hong Kong stocks by Japanese residents and market turnover during January 1997 – December 2004 was 0.8441. As a percentage of market turnover, the trading of Hong Kong stocks by Japanese residents has been moving narrowly at the range of 0.6-2.5% over the period.

11. In contrast to the pattern of US residents, the share of the trading of Hong Kong stocks by Japanese residents in total market turnover looks positively associated with market turnover. In other words, as market turnover increases, the share of the total trading of Hong Kong stocks by Japanese residents in total market turnover increases. Among other factors, this seems to suggest that the pattern of Japanese investors resembles to that of local investors which may be attributable to the fact that both Hong Kong and Japan belong to the same region and time zone. As Japanese investors appear to be sensitive to market sentiment, trading of Hong Kong stocks by Japanese residents do not help stabilize the market shares of trading activities.

