China A-shares inclusion: Still a no go

June 16, 2016

MSCI announcement on June 15

MSCI announced that China A-shares would not be included as part of their benchmark Emerging Markets Index after their latest market classification review. This will be the third year in a row where it has come under consideration and not been accepted.

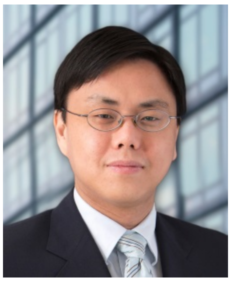
As mentioned in the ***Market Insights publication "China's bond and equity market: Inclusion the new hope?"*** earlier in May this year, we regarded inclusion at this review a possibility, but not a certainty, due to some lingering issues with accessibility. China has done much to improve the situation on trading halts, looser restrictions on capital flows and opening up markets further, but still has room to improve. Intervention in markets earlier this year may have made market participants uncomfortable, which would have added to MSCI's concerns.

In a statement, MSCI said there was a need for a period of observation to assess the effectiveness of new policies and that the 20% monthly repatriation limit remains a "significant hurdle". They also said the pre-approval for financial products from local exchanges was "unaddressed". In a more optimistic point for the Chinese market, MSCI did not rule out a potential off-cycle announcement if there were positive developments ahead of the next review in June 2017.

Investment implications

Inclusion is an important factor for international recognition; it will be another step in China gaining more prominence as a major part of the world economy and investment market. The rejection will come as a slight setback to China's plans.

This result should not be a significant negative. In our view, rejection or inclusion would not have resulted in major flows given the somewhat divided market opinion and small initial inclusion factor if it did go ahead. We still believe that it is a question of when, and not if, for China's A-share inclusion, with chances very likely within the next one or two years after more reforms take place. Opening up China and allowing it to gather more attention on the global stage should be good news for China's development in the long term. The efforts so far may have already attracted greater investment interest. China's market has seen many reforms to tackle MSCI's concerns, and given MSCI's consideration of market participant's worries, China's regulators may also roll out more transparency and communication with the investment community. With an off-cycle announcement still on the table, we may see further positive reforms in the near future.



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