Emerging Markets Finance and Trade ›

Volume 54, 2018 - Issue 13

Symposium: Financial Development and Regulation; Guest Editors: Chung-Hua Shen, HaiChi Lee, Xu Li, and Xiaojian Liu

The Dynamics of Financial Market Integration Between Chinese A- and H-Shares

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Pages 2909-2924 | Accepted author version posted online: 05 Mar 2018, Published online: 24 Jul 2018

Cite this article https://doi.org/10.1080/1540496X.2017.1410128 Check for updates

ABSTRACT

This study examines the dynamics and underlying determinants of integration based on cross-listed Chinese A-shares and Hong Kong H-shares from January 1996 to December 2016. We focus mainly on three liberalization reforms: the qualified foreign institutional investors (QFII) policy, the qualified domestic institutional investors (QDII) policy, and the Shanghai-Hong Kong Stock Connect program. Our results show that the QDII policy has significantly increased the integration between the Mainland China and Hong Kong stock markets, although the extent to which any stock has been affected is partly dependent upon certain firm-specific characteristics, including liquidity, market value, and volatility. However, we do not document the similar effect of the QFII policy and the Shanghai-Hong Kong Stock Connect program on the integration dynamics.

KEY WORDS:

A-shares and H-shares cross-listing dynamic integration QDII Shanghai-Hong Kong Stock Connect

Acknowledgments

We thank Haocong Song for his excellent research assistance. We are also grateful to the editor and anonymous referees for helpful suggestions.

Notes

1. Market integration is generally defined as the correlation between markets, which show different expected returns. As Bekaert and Harvey (1995) argue: “Markets are completely integrated if assets with the same risk have identical expected returns irrespective of the market.” and “If a market is segmented from the rest of the world, its covariance with a common world factor may have little or no ability to explain its expected return.”

2. Cai, McGuinness, and Zhang (2011) hypothesize a decrease in H-share price discount relative to A-share price, indicating an increase in cointegration between A- and H-shares.

3. As the Shanghai-Hong Kong Stock Connect scheme only has impact on companies listed in Shanghai, we have also examined the impact based on the companies listed in Shanghai and found qualitatively similar results. We thank an anonymous referee to point this out.

4. According to Securities Daily, QDII have invested almost 70% of their net assets into Hong Kong until September 2016.

Additional information

Funding

This project is supported by the National Natural Science Foundation of China [No. 71790601], the National Social Science Foundation of China [No. 15CTJ010], the Fundamental Research Funds for the Central Universities [No. 20720151042], and the Project of Social Science funded by the Education Department of Fujian Province [No. JAS160024]. Xiafei Zhou acknowledges the support from the Fundamental Research Funds for the Central Universities.