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Is U.S. economic policy uncertainty priced in China’s A-shares market? Evidence from market, industry, and individual stocks

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Abstract: This paper is motivated by Bali et al. (2017) who find U.S. economic policy uncertainty (EPU) is priced in the cross-section of U.S. stock returns, and uses weekly data from March 2006 to April 2016 to study whether shocks in U.S. EPU also influence prices of China's A-shares from a market, industry, and individual stock perspective. Our methodology relies on an ARMA (1,1) model to extract shocks in the U.S. EPU series and a GARCH (1,1) model to examine how returns of China’s A-shares respond to these shocks after controlling for business conditions proxied by term and credit spread in China. Generally, we find that shocks in U.S. EPU significantly and negatively explain returns of Chinese A-shares with a lag of one week. In addition, the market index containing small and growth stocks is more sensitive to shocks in U.S. EPU than the index containing big and value stocks. Furthermore, we find that firms in manufacturing, information technology, and media industries in China are more sensitive to shocks in U.S. EPU, while firms in agriculture and real estate industries respond less to shocks in U.S. EPU. Finally, China's A-shares which decline more in response to shocks in U.S. EPU have higher returns, smaller market capitalization, weaker operating profitability, higher asset growth, and better past year’s cumulative returns. Overall, our findings show that investors in the Chinese A-shares market require a premium to hold stocks that are sensitive to shocks in U.S. economic policy uncertainty.

JEL classification: E32, G12, G15

Key words: economic policy uncertainty; stock returns; A-shares; China; U.S.

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