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Good EPU or Bad EPU? Asymmetric Effects on Herding Across China's Main, ChiNext, and STAR Markets

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Abstract

Purpose: This study challenges the conventional view of economic policy uncertainty (EPU) as a uniformly destabilizing force. It investigates the asymmetric effects of EPU on herding behavior across China's three major stock boards—the Main Board, ChiNext, and STAR Market—to determine whether it acts as a stabilizing mechanism or a speculative catalyst in different market contexts. **Design/methodology/approach:** This study employs panel regression analysis on monthly data from January 2011 to December 2023 for the Main Board, ChiNext and STAR Market. The empirical strategy examines the heterogeneous effects of the Chinese EPU index on herding across the three boards. The robustness of the baseline findings is verified through a dummy variable approach and a two-stage least squares (2SLS) estimation that addresses endogeneity. **Findings:** The results robustly support the core thesis of asymmetric effects. EPU significantly suppresses herding in the Main Board and ChiNext, consistent with a "stabilizing" role. In stark contrast, EPU exacerbates herding on the STAR Market. Crucially, this effect is driven specifically by a significant increase in buy-side herding, confirming its role as a catalyst for speculative purchasing. **Research limitations/implications:** A key limitation is the current inability to quantitatively distinguish between "good" and "bad" EPU, as existing indices capture only the magnitude, not the qualitative nature, of policy uncertainty. Future research could leverage artificial intelligence and natural language processing to classify policy, enabling a more precise measurement of its asymmetric impacts. **Practical implications:** Regulators should adopt market-tailored approaches: maintaining stability-enhancing transparency for the Main Board and ChiNext, while implementing targeted oversight on speculative trading in the STAR Market to curb the herding amplified by policy uncertainty. **Originality/value:** This study addresses a notable gap in the literature by systematically examining the impact of economic policy uncertainty (EPU) on herding behavior—a relationship that has received limited attention, particularly from a heterogeneous market perspective. It offers novel insights by revealing the asymmetric effects of EPU across China's three major boards, thereby enriching our understanding of how institutional context and market microstructure shape divergent investor responses to policy shocks.

Keywords: Economic Policy Uncertainty, Herding Behavior, China Stock Market, Asymmetric Effects

Introduction

In conventional financial theory and the empirical context of many advanced economies, frequent policy shifts are often perceived as signals of macroeconomic instability or intensified political and interest group conflicts. This perception exacerbates investor panic, amplifies market volatility, and triggers irrational herding behavior as investors scramble to decode opaque government intentions. Consequently, economic policy uncertainty (EPU) is predominantly characterized in the literature as a destabilizing force, or "bad EPU," that corrodes market efficiency. However, this prevailing view overlooks a critical possibility: not all EPU is inherently detrimental. The institutional context in which uncertainty emerges is paramount. China, as the world's largest emerging economy with a distinctive state-led governance model, presents a compelling paradox that challenges this conventional wisdom. Here, frequent policy adjustments are not merely reactive but are often proactive instruments aimed at economic restructuring, stabilizing long-term growth, and preemptively deflating systemic risks.

The Chinese government possesses a pronounced capability and willingness to intervene directly in capital markets. This interventionist stance fosters a unique "government support" expectation among investors. Despite the high levels of EPU generated by frequent policy announcements, the overarching emphasis on "stability" and "control" reassures the market that authorities will not allow a disorderly downturn. This phenomenon suggests that in China, EPU can be transformed into a unique stabilizer that suppresses, rather than amplifies, herding behavior. This stabilizing mechanism operates through several institutional channels: enhanced policy transparency, forward-looking expectation management, and decisive direct interventions.

First, initiatives since 2016, the People's Bank of China has strengthened policy communication by releasing quarterly monetary policy reports and holding regular press briefings, thereby releasing policy signals in advance to reduce the market’s misunderstanding of sudden policies (Nie & Shi, 2020). For instance, during the COVID-19 outbreak in 2020, the central bank repeatedly emphasized that it would avoid “flood-like stimulus,” which stabilized market expectations for monetary policy tightening and effectively curbed herd selling caused by panic (People’s Bank of China, 2020). Second, China’s policymaking is dominated by long-term strategic plans—most notably its Five-Year Plans and targeted industry directives, which are expressly designed to stabilize both the economy and financial markets (Zheng & Zhu, 2023). Unlike the more reactive, short-term policy shifts common in many advanced economies, these forward-looking initiatives constitute what is termed “good EPU”: economic policy uncertainty that is constructive rather than disruptive. By signaling clear, sustained commitment to growth and market stability, good EPU lowers investors’ fear of sudden regulatory changes, dampens panic-driven reactions, and thus reduces the propensity to herd. In this way, China’s model of economic policy uncertainty actually mitigates—rather than amplifies—herding behavior by giving market participants confidence in a predictable policy trajectory.

Finally, during episodes of extreme market turbulence, the Chinese government implements direct policy interventions specifically aimed at curbing herding behavior and stabilizing market expectations. For instance, in the 2015 stock market crash, regulators swiftly suspended new IPO approvals and imposed selling restrictions on major shareholders, thereby steering investor behavior away from panic selling; concurrently, the China Securities Finance Corporation conducted large-scale purchases of blue-chip stocks, reshaping market sentiment and halting the “sell-more-as-prices-fall” cycle (Zhang & Chen, 2023). Likewise, during the 2022 Chinese ADR crisis, sovereign entities such as Central Huijin and the National Social Security Fund intervened once again—acquiring key assets and providing market support—to restore investor confidence (Hu, 2024). These direct interventions in the A-share market are explicitly designed to “stabilize volatility and reduce herding”.Collectively, these institutional characteristics create a unique mechanism in China's broader market (e.g., the Main Board), where elevated EPU does not necessarily amplify herding but can instead suppress it.

However, this calming effect is not uniform across all market segments. The central argument of this paper is that the impact of EPU on herding is fundamentally asymmetric, contingent on the policy's intent and the specific market's ecosystem. This dichotomy is most vividly illustrated by the contrasting natures of China's Main Board/ChiNext and the STAR Market. While "good EPU" may prevail in the former, the latter often exhibits characteristics of speculative "bad EPU."

On the STAR Market, the policy context is fundamentally different. Policies related to this board carry a strong, unambiguous pro-innovation and pro-growth orientation. The rollout of the registration-based IPO system, incentives for long-term capital, and differentiated trading rules are consistently interpreted by investors as potent "support signals." In this environment, EPU does not signal risk but opportunity. It acts as a catalyst for speculative buying, as a cohort of investors believes that any policy uncertainty heralds a new "policy window" or "new stimulus," prompting them to buy heavily in pursuit of excess returns. Even when policy language is vague, investors are driven by a "buy early, benefit early" mindset. This preemptive action reinforces speculative sentiment and fuels the emergence of irrational buying herds during periods of policy uncertainty, representing a clear case where EPU amplifies, rather than mitigates, herding behavior.

Given this backdrop, this study seeks to answer a pivotal question: Is EPU in China's multi-tiered capital market a "good" stabilizer or a "bad" catalyst for herding? We posit that the answer is not monolithic. By conducting a comparative empirical analysis of China's three major boards—the stable, blue-chip-dominated Main Board; the growth-oriented ChiNext; and the innovation-centric, high-risk STAR Market—this research aims to uncover the asymmetric effects of EPU on herding. Our findings underscore that the core of EPU's impact lies not in its level, but in its perceived intent and the context of the market it targets, offering critical insights for regulators and investors navigating the complexities of modern financial markets.

Literature Review

Scholars have focused on the relationship between herding behavior and factors such as firm-level characteristics, social factors, market state, stock volatility, and so on.

For the firm-level characteristics—turnover rate, market capitalization, return, Earnings-to-Price (E/P) Ratio, and trading volume—existing studies generally agree that these factors significantly influence investors' herding behavior. For example, turnover rate is often used as a control variable in herding behavior studies (Deng et al., 2018; Ng et al., 2022; Xue et al., 2023) to account for its potential impact on herding behavior. Additionally, Chang et al. (2000) and Demirer & Kutan (2006) found that large-cap stocks, with better information disclosure and broader analyst coverage, exhibit weaker herding effects. Hsieh et al. (2020) further highlighted that retail investor herding is more prevalent in small-cap stocks, particularly during bull markets, whereas sell-side herding is stronger in large-cap stocks during bear markets. Hsieh et al. (2020)also find a significant positive relationship between herding behavior and stock returns, particularly among retail investors. However, Costa et al., (2024) observe that increasing herding tends to occur during periods of lower returns and higher volatility. Zhou and Lai (2009) find that herding behavior is more prevalent in stocks with very high or very low E/P ratios.

Social interaction plays a pivotal role in financial markets, affecting decision-making through two key modes of information transmission. The first involves traditional social interactions, such as face-to-face conversations, which Li (2006) focused on China's stock market, finding that investors often base their decisions on information from their social circles, impacting their stock market participation. Pool et al. (2013) explored how mutual fund managers are influenced by their peers, noting that managers residing in the same neighbourhood tend to have more similar investment portfolios, especially if they share the same ethnicity, due to stronger social ties. The second mode of social interaction involves digital and media channels, including TV, social media, and online forums. Research by Veldkamp (2006) showed that media has a strong influence on investor behavior, often heightening stock price volatility. Frijns and Huynh (2018) demonstrated that news reports and media opinions significantly impact analysts' herd behavior, underscoring the powerful role of digital media in financial decision-making.

There is evidence revealing that herding behavior can depend on the state of the overall market. Studies conducted by Chang et al. (2000), Demirer and Kutan (2006), Yao et al. (2014), Tao et al. (2015) and others have found that herding behavior tends to be more pronounced during market downturns. This could be attributed to investors being inclined to adopt a "flight to safety" strategy in bearish markets, especially in emerging markets (Babalos et al., 2015; Balcilar and Demirer, 2015). However, Ben et al. (2006) conducted research on the Shanghai stock market and found that pronounced market fluctuations, especially extreme positive returns, can encourage herding behavior. This view is supported by Qiao et al. (2014) and Arjoon and Bhatnagar (2017), who argue that herding behavior tends to be more pronounced during market upswings.

Additionally, some literature has focused on the roles of factors such as volatility, investment context uncertainty in herding behavior. Kabir and Shakur (2018) demonstrated that herding behavior is prevalent in high-volatility systems. Nath and Brooks (2020) found that herding behavior emerges during extreme days of stock returns, and volatility amplifies its effects. Arjoon and Bhatnagar (2017) conducted time-varying analysis that indicates herding behavior evolves over time. Investment context uncertainty also influences investors' herding behavior. The high risk nature of the securities market leads investors to align their decisions

with the crowd to mitigate risk (Kameda and Tamura, 2007; Lakonishok et al., 1992; Lin, 2018; Quiamzade and L'Huillier, 2009; Schmeling, 2009). Lin (2018) examined whether overall uncertainty affects the herding behavior of analysts. The results indicated that aside from market risk and firm-level uncertainty, the herding tendency of analysts increases with overall uncertainty, particularly for small stocks and less-experienced analysts.

However, the impact of exogenous shocks such as policy has often been overlooked in previous studies. This gap in academic research is becoming obvious, especially during periods of frequent policy adjustments by governments, caused by ongoing global uncertainties such as public health events and trade protectionism. Therefore, there is a need to examine the impact of policy uncertainty on herding other than the common determinants. It can provide new insight into understanding the investment behavior of investors in trading stocks during the adjustment of policy.

However, the impact of a specific and potent exogenous shock—policy has received comparatively scant attention. This gap in academic research is becoming obvious, especially during periods of frequent policy adjustments by governments, caused by ongoing global uncertainties such as public health events and trade protectionism. Meanwhile, past studies have also overlooked how policy-driven uncertainty, with its unique signals and intent, can asymmetrically shape investor behavior. This gap is critical, as governments frequently employ policy adjustments to steer economies, making EPU a central, yet underexplored, determinant of herd dynamics. Our study addresses this by interrogating whether EPU acts as "good" or "bad" uncertainty, providing a novel policy-centric lens to understand herding in China's segmented markets.

Hypothesis Development

The core thesis of this study is that the impact of economic policy uncertainty (EPU) on herding behavior is not uniform but exhibits significant asymmetry across China's multi-tiered stock markets. This asymmetry stems from the distinct policy sensitivities and information environments inherent to each board. We develop our hypotheses by contrasting the stabilizing mechanisms likely at play in the Main and ChiNext Boards with the speculative catalysts predominant in the STAR Market.

In China's institutional context, EPU can function as a signal of government engagement rather than one of mere instability. For the large, cyclical, and systemically important firms listed on the Main Board, policy adjustments are often signals of impending government intervention to stabilize the market. Consequently, elevated EPU reassures Main Board investors that authorities are actively monitoring and will stabilize the market, thereby reducing panic-driven collective action and suppressing herding.

While the ChiNext Board also hosts established growth companies, the transmission mechanism for this calming effect differs and is potentially weaker than on the Main Board. According to Attention Allocation Theory (Peng and Xiong, 2006), market attention is limited. Policy shocks typically focus first on cyclical sectors in the main board, while ChiNext market are relatively less sensitive to macro policy interventions. In terms of information dissemination, the ChiNext market receives significantly less attention and coverage compared to the main board during periods of frequent policy announcements (Wang et

al.,2022). On one hand, the main board is flooded with policy interpretations, media content, and analyst reports. On the other hand, ChiNext-related analyses are relatively scarce. This "information island" effect further diminishes the likelihood of collective herding behavior, thereby suppressing the emergence of herd effects. Thus, we posit:

H1: Economic policy uncertainty has a significant suppressive effect on herding behavior in both the Main Board and the ChiNext Board. The suppressive effect of economic policy uncertainty on herding behavior is stronger in the Main Board than in the ChiNext Board.

The dynamics reverse fundamentally in the STAR Market. Companies listed here are concentrated in cutting-edge, innovation-driven fields like advanced technology and biomedicine. Their high valuation hinges on future growth potential and is heavily dependent on government policies regarding R&D support, industry promotion, and financing access. In this context, any policy signal—be it an official statement or a pilot program—is swiftly interpreted as a potential major positive. Consequently, policy uncertainty is not perceived as a risk but is reframed as a "potential upside" or a short-term speculative opportunity. Investors, speculating that new stimulus is imminent, are incentivized to "buy early, benefit early." This triggers concentrated speculative buying. The EPU, therefore, does not suppress but actively stimulates herd behavior as investors chase perceived policy-driven windfalls. Therefore, we hypothesize:
H2: Economic policy uncertainty has a significant increase in herding behavior in the STAR Market.

Methods

Sample Selection

This study selects monthly data from January 2011 to December 2023, totaling 156 months. The Chinese stock market consists of several segments, including the Main Board, ChiNext, and the STAR Market. The Main Board hosts large, mature companies, while ChiNext focuses on innovative and growth-oriented enterprises. The STAR Market, launched in late 2019, targets high-tech and strategically emerging industries, and was the first in China to implement a registration-based IPO system. For the STAR Market, which was established later, the sample period ranges from January 2020 to December 2023, totaling 48 months. This study selected all ChiNext stocks established before 2011. For the main board, nearly 1,400 stocks were established before 2011. Therefore, we chose the component stocks of the CSI 300 Index. The CSI 300 Index comprises the 300 most representative stocks from the main boards, distinguished by their substantial scale and robust liquidity, effectively reflecting the overall performance of China's mainboard market. Additionally, we selected all STAR Market stocks established before 2020. Then, excluding those that have been delisted or marked with ST or *ST, we have 281 remaining stocks in the main board, 137 remaining stocks in ChiNext, and 70 remaining stocks in the STAR Market.

Description of Data

We first follow Zhou and Lai (2009) and Hsieh (2013, 2020) 's herding measure, which modify the Lakonishok et al.(1992) model by focusing on the number of trades rather than changes in institutional investor stockholdings. The model for investor herding behavior for stock i in any given period t is as follows:

$$\mathrm{Herd}_{i,t} = \left|\mathrm{P}_{i,t} - \mathrm{P}_{t}\right| - \mathrm{AF}_{i,t} \quad (1)$$

$$P_{i,t} = \frac{B_{i,t}}{N_{i,t}} \quad (2)$$

$$AF_{i,t} = E|P_{i,t} - P_t| \quad (3)$$

where $B_{i,t}$ and $S_{i,t}$ denote the number of buy orders and sell orders of stock i in period t, respectively. The aggregate quantity of overall orders of stock i at time t is $N_{i,t} = B_{i,t} + S_{i,t}$. So, $P_{i,t}$ is the buy ratio of stock i. P_t represents the mean of $P_{i,t}$ over all stock at time t. The adjustment factor $AF_{i,t}$ represents the expected value of $|P_{i,t} - P_t|$ in the case of no herding. It means that $AF_{i,t}$ is driven by the assumption that $B_{i,t}$ is randomly selected from a binomial distribution characterized by a probability of P_t and dimension $N_{i,t}$ as follow:

$$AF_{i,t} = \sum_{k=0}^{N_{i,t}} \text{proba}\,(B_{i,t} = k) \left|\frac{k}{N_{i,t}} - P_t\right| = \sum_{k=0}^{N_{i,t}} \binom{N_{i,t}}{k} P_t^{\,k} (1 - P_t)^{N_{i,t}-k} \left|\frac{k}{N_{i,t}} - P_t\right| \quad (4)$$

A simple Python script can be utilized to compute the adjustment factor $AF_{i,t}$. After computing $AF_{i,t}$, $P_{i,t}$ and P_t, substituting the values into Equation (1) yields the monthly herding measure for each stock. The larger $Herd_{i,t}$ is, the stronger the herding effect. Drawing on the method proposed by Wermers (1999), we further categorize herd behavior into buying herd behavior $HB_{i,t}$ and selling herd behavior $HS_{i,t}$. The data on the number of stock transactions was obtained from the CSMAR database[1].

$$HB_{i,t} = Herd_{i,t} \quad \text{if } P_{i,t} > E(P_{i,t}) \quad (5)$$

$$HS_{i,t} = Herd_{i,t} \quad \text{if } P_{i,t} < E(P_{i,t}) \quad (6)$$

Then, for EPU, we choose CNEPU which developed by Huang and Luk(2020), is based on ten different newspapers from mainland China. In comparison to other measurements, CNEPU encompasses a broader spectrum of newspapers and a more extensive array of terms, rendering it less susceptible to media biases. Therefore, this paper uses the CNEPU to measure China's Economic Policy Uncertainty. An elevated CNEPU index signifies an increased degree of economic policy uncertainty. The CNEPU data is sourced from the China Economic Policy Uncertainty website maintained by Huang and Luk of Hong Kong Baptist University.

In accordance with Zhou and Lai (2009), Vlastakis and Markellos (2012), Hsieh et al.(2013, 2020), we also account for and control the additional variables that influence herd behavior, like the turnover rate, total market capitalization, return rate, the inverse of price-to-earnings ratio, and trading volume of stocks.The control variables data is sourced from RESSET database.

Econometric Technique

Drawing on prior studies that integrate macro-level time-series measures of policy uncertainty with micro-level firm financial and accounting panel data (Bonaime et al., 2018; Li & Qiu, 2020; Sun, 2024; Zhang et al., 2015), this study employs the following regression specification to examine the heterogeneous effects of EPU on herding behavior across the three market boards.

$$Herd_{i,t} = \beta_0 + \beta_1 EPU_t + \beta_4 Control_{i,t} + \varepsilon_{i,t} \quad (7)$$

$$HB_{i,t} = \beta_0 + \beta_2 EPU_t + \beta_5 Control_{i,t} + \varepsilon_{i,t} \quad (8)$$

$$HS_{i,t} = \beta_0 + \beta_3 EPU_t + \beta_6 Control_{i,t} + \varepsilon_{i,t} \quad (9)$$

[1] In the Realized Indicators Research Database of CSMAR

To examine whether EPU acts as a stabilizing "good EPU" or a destabilizing "bad EPU" across China's market segments, Equations (7)–(9) are estimated using HERD, Herd Buy, and Herd Sell as dependent variables and are applied separately to the Main Board, ChiNext, and STAR Market.

Findings

Based on the diagnostic tests, the results of the VIF test for all the estimations to analyse herd data are below 10, indicating the absence of multicollinearity problem among the variables. The results of the Breusch and Pagan LM test obtained for all the regressions allow the analysis for the further estimated using REM besides the OLS estimator. Further to that, the results of the Hausman test (p-value < 0.05) indicate that FEM is more appropriate than the REM estimator is. We ultimately selected the individual fixed effects model to control for individual heterogeneity and reduce endogeneity issues. The problems of heteroscedasticity and autocorrelation are corrected for robust standard errors. Then, panel regression result as follows:

Table 1
Herding Behavior Across China's Main, ChiNext, and STAR Markets

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
VARIABLES	MAIN HERD	MAIN HB	MAIN HS	ChiNext HERD	ChiNext HB	ChiNext HS	STAR HERD	STAR HB	STAR HS
CNEPU	-0.054***	-0.057***	-0.051***	-0.018***	-0.019***	-0.018**	0.022***	0.030***	0.005
	(-14.23)	(-11.47)	(-10.68)	(-3.58)	(-3.09)	(-2.52)	(2.80)	(2.81)	(0.36)
TUR	-0.161***	-0.129***	-0.210***	-0.076***	-0.058***	-0.104***	-0.156***	-0.141***	-0.169***
	(-15.78)	(-12.77)	(-17.02)	(-10.22)	(-7.99)	(-11.25)	(-6.70)	(-3.81)	(-5.09)
RET	-5.723***	-6.389***	-4.190***	1.733**	3.596***	-0.828	5.606***	14.010***	-10.805***
	(-7.31)	(-6.14)	(-3.36)	(1.93)	(2.66)	(-0.77)	(3.86)	(3.98)	(-4.06)
VOL	0.00002	0.00016	-0.001***	-0.00017	-0.00026	-0.001	-0.008*	-0.012**	0.004
	(0.09)	(0.93)	(-4.03)	(-0.29)	(-0.49)	(-0.72)	(-1.68)	(-2.53)	(0.35)
CAP	-0.010*	-0.010*	-0.009*	-0.026***	-0.019***	-0.067***	-0.023	0.010	-0.111***
	(-1.88)	(-1.86)	(-1.82)	(-2.97)	(-2.90)	(-4.94)	(-0.87)	(0.29)	(-3.19)
EP	-2.990	-1.597	-4.518	1.067	-0.792	1.457	7.561	2.674	10.571
	(-1.59)	(-1.14)	(-1.19)	(0.36)	(-0.24)	(0.32)	(0.82)	(0.10)	(0.62)
Constant	31.294***	30.587***	32.682***	20.988***	20.143***	22.684***	17.949***	15.946***	20.923***
Individual fixed effects	YES	YES	YES	YES	YES	YES	YES	YES	YES
Adjusted R-squared	0.039	0.036	0.051	0.031	0.025	0.044	0.028	0.044	0.044

Note: The problems of heteroscedasticity and autocorrelation are corrected for robust standard errors. Robust t-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.1. The table

1 presents panel regression results using HERD (overall herding behavior index), HB (buy-side herding), and HS (sell-side herding) as dependent variables. Columns (1)–(3) report results for overall, buy-side, and sell-side herding on the Main Board, respectively; columns (4)–(6) correspond to ChiNext; and columns (7)–(9) correspond to the STAR Market.

The regression results provide strong and consistent evidence supporting our hypotheses regarding the asymmetric impact of EPU on herding across different markets.
As predicted in H1, CNEPU exerts a significant suppressive effect on herding in both the Main Board and the ChiNext Board. The coefficient for the Main Board (HERD = -0.054, t = -14.23) is not only statistically significant at the 1% level but also economically larger in magnitude than that for the ChiNext Board (HERD = -0.018, t = -3.58). This confirms that the calming effect of EPU is more pronounced in the core Main Board.

Crucially, the decomposition into buy-side (HB) and sell-side (HS) herding offers finer-grained evidence. On both the Main and ChiNext Boards, EPU significantly suppresses herding on both the buy and sell sides (Main Board: HB = -0.057, HS = -0.051; ChiNext: HB = -0.019, HS = -0.018). This indicates that "good EPU" fosters overall market stability by curbing both irrational buying frenzies and panic-driven selling, encouraging more independent judgment across all trading activities.

Strikingly, the results for the STAR Market present a complete reversal, robustly supporting H2. Contrary to the other boards, EPU significantly promotes herding behavior on the STAR Market (HERD = 0.022, t = 2.80). This effect is overwhelmingly driven by speculative buying, as evidenced by the significant positive coefficient for buy-side herding (HB = 0.030, t = 2.81), while the effect on sell-side herding (HS = 0.005) is negligible and statistically insignificant. This pattern aligns perfectly with the narrative of investors interpreting policy signals as a "potential upside," triggering a preemptive, herd-like buying surge rather than a retreat.

In summary, the data unequivocally answers our central research question: EPU serves as "good EPU" that stabilizes the Main and ChiNext Boards by dampening herding on both sides of the market, but transforms into "bad EPU" that fuels speculative, buy-side herding in the innovation-driven STAR Market.

For the Main Board and ChiNext, the conclusion is that EPU reduces herding behavior in both markets, with a larger effect on the Main Board. However, directly comparing the coefficients could lead to potential issues. To further explore whether the impact of EPU on the Main Board and ChiNext differs significantly, we specify a dummy interaction model, following the methodology outlined in Wooldridge (2016, Chapter 7). The following model is specified:

$$Herd_{i,t} = \beta_0 + \beta_1 EPU_t + \beta_2 \mathrm{D} + \beta_3(\mathrm{EPU_t} \times \mathrm{D}) + \beta_4 Control_{i,t} + \varepsilon_{i,t} \quad (10)$$

$Where$,

D is a dummy variable that equals 1 if the stock belongs to the ChiNext market and 0 belongs to Main Board.

β_1 represents the effect of EPU on herding behavior in the Main Board.

$\beta_1 + \beta_3$ represents the effect of EPU on herding behavior in the ChiNext.

β_3 indicates the difference in the EPU effect between the Main Board and ChiNext.

The key coefficient is, which indicates the difference in EPU's impact on herding behavior between the Main Board and ChiNext. If is statistically significant, it confirms that the effect of EPU on the two markets herding is indeed different, even though they both exhibit a similar directional response. This approach ensures that the difference is formally tested, avoiding the biases that might arise from simple coefficient comparisons.

Table 2
Interaction Regression Results with Dummy Variables

VARIABLES	Herd
CNEPU	-0.052***
	(-13.70)
BoardDummy	0
	(omitted)
EPU_Dummy_Interaction	0.030***
	(4.89)
CAP	-0.010*
	(-1.92)
VOL	-0.000*
	(-1.76)
TUR	-0.099***
	(-14.79)
RET	-2.607***
	(-4.04)
EP	-2.363
	(-1.44)
Constant	27.647***
	(49.09)
Individual fixed effects	YES
r2_a	0.0327
F-statistics	74.99
	[0.0000]

Note: Robust t-statistics in parentheses*** p<0.01, ** p<0.05, * p<0.1

The empirical results reveal that EPU significantly reduces herding behavior in the Main Board (β_1=−0.052, p<0.01), which is consistent with the previous findings from the initial regression results. This suggests that during periods of higher economic policy uncertainty, investors in the Main Board tend to act more independently, leading to a decline in herding behavior.

The interaction term EPU_Dummy_Interaction (β_3=0.030, p<0.01) confirms that there is a statistically significant difference in the impact of EPU between the Main Board and ChiNext. Specifically, the total effect of EPU on the ChiNext market is less negative ($\beta_1 + \beta_3$=−0.022), because the absolute value of the effect in the ChiNext market is smaller than that in the Main Board. This indicates that while EPU also reduces herding in the ChiNext market, the magnitude of this effect is notably smaller than in the Main Board. This result supports the previous coefficient comparison, where the Main Board was shown to be more sensitive to EPU shocks, resulting in a stronger reduction in herding behavior.

Although the baseline regression results indicate that economic policy uncertainty has a significant impact on herd behavior, this finding may be affected by endogeneity issues.

Specifically, reverse causality may exist, whereby herd behavior induces sharp fluctuations in asset prices, which subsequently prompts policy adjustments and affects the current level of EPU. Moreover, omitted variable bias may arise if some unobserved factors simultaneously drive both EPU and herd behavior. To address these endogeneity concerns, this study employs the Two-Stage Least Squares (2SLS) method, using lagged EPU (EPU_{t-1}) as an instrumental variable (IV).

Table 32
SLS Regression Results for the Main Board

VARIABLES	(1) MAIN first stage	(2) MAIN second stage	(3) ChiNext first stage	(4) ChiNext second stage	(5) STAR first stage	(6) STAR second stage
L_CNEPU	0.545***		0.539***		0.467***	
	(147.04)		(101.41)		(28.32)	
CNEPU		-0.080***		-0.033***		0.039***
		(-13.47)		(-3.95)		(2.95)
Control variables	Included	Included	Included	Included	Included	Included
Individual fixed effects	YES	YES	YES	YES	YES	YES
Underidentification Test	7417.478		3609.062		527.140	
LMstatistic	[0.00]		[0.00]		[0.00]	
Weak Instrument Test	2.2e+04		8529.060		964.272	
	[16.38]		[16.38]		[16.38]	

Note: Robust t-statistics in parentheses *** p<0.01, ** p<0.05, * p<0.1
[0.00] represents the p-value from the Anderson LM underidentification test, while [16.38] is the critical value at the 10% level for the Cragg-Donald Wald F weak instrument test.

Table 3 presents the 2SLS regression results, indicating that the instrumental variable satisfies both relevance and exogeneity conditions. The validity tests show that the under-identification test and the weak instrument test are both passed, confirming that lagged economic policy uncertainty (EPU_{t-1}) is a valid instrumental variable.

Across the three boards, the first-stage regressions confirm that lagged EPU significantly predicts current EPU, indicating that historical policy uncertainty effectively captures shifts in the policy environment (Main Board: 0.545, t = 147.04; ChiNext: 0.539, t = 101.41; STAR: 0.467, t = 28.32; all p < 0.01). In the second-stage regressions controlling for endogeneity, the effects of EPU on herd behavior remain consistent with the baseline results: it reduces herding on the Main Board (-0.080, p < 0.01) and ChiNext (-0.033, p < 0.01), but increases herding on the STAR Market (0.039, p < 0.01). Moreover, the effect of economic policy uncertainty on herd behavior becomes more pronounced after controlling for endogeneity. This result suggests that endogeneity issues may have caused the baseline regression to underestimate the true impact of EPU. However, after addressing endogeneity, the core conclusion remains valid: economic policy uncertainty significantly affects herd behavior, exhibiting a suppressive effect in the Main board and ChiNext market, exhibiting a positive effect in the STAR board market. This implies that the empirical results are robust.

Discussion and Conclusion

In China's stock market, the Main Board operates with a primary focus on risk prevention and overall market stability. It concentrates key sectors that are fundamental to the national economy, such as finance, energy, and real estate (e.g., the "Big Four" banks and state-owned oil giants). A collapse of this board could trigger systemic shocks to the broader emerging economy. Based on the principles of "too big to fail" and "tail-risk hedging," Chinese regulators prioritize market stability through a variety of interventions: state-backed institutional buying (e.g., Central Huijin), liquidity injections (such as the RMB 1.5 trillion market rescue by China Securities Finance Corporation in 2015), and administrative controls (e.g., restrictions on major shareholders' stock sales). Against this backdrop, investors have developed a widely shared belief in a "policy floor"—the expectation that the government will intervene to prevent the market from falling too far. As such, EPU on the Main Board is often interpreted as a stabilizing signal rather than a threat, thereby serving as "good EPU" that decrease irrational herding behavior.

The ChiNext Board, established in 2009, is similar in maturity to the Main Board. Its investor base and trading mechanisms have become relatively stable. Like the Main Board, ChiNext is also subject to the expectation that EPU signals efforts to reduce excessive volatility. However, since macro-level policy initiatives tend to concentrate on the Main Board, ChiNext receives less direct regulatory intervention and constraints, and information support is relatively insufficient. Therefore, although EPU also plays a significant role in decreasing the herd on the ChiNext, it is not as strong as the main board. After investors feel the signal of stabilization from the main board, they rely more on their own fundamental research rather than policy preferences to judge the risks of the ChiNext.

In contrast, the STAR Market exhibits a different herding dynamic driven by strategic policy goals. Amid intensifying global competition in science and technology, China's 14th Five-Year Plan positions technological innovation as a central growth engine. Emerging technologies such as artificial intelligence, quantum computing, and big data have been elevated to matters of national strategic importance. Since its launch in 2019, the STAR Market has been designated as a policy "testbed," receiving exceptional support through mechanisms such as the registration-based IPO system and targeted fiscal incentives. Many STAR Market firms depend heavily on government-led initiatives—such as technology innovation incentives, intellectual property protections, and strategic emerging industry policies—for their growth trajectory. Within this framework, policy uncertainty is not perceived as a source of panic but rather as a potential upside signal. Every time there is a vague policy adjustment, investors are worried about missing a new round of development opportunities, so they quickly buy, forming a buying herd. In this context, EPU functions more like a "catalyst," amplifying speculative sentiment and contributing to valuation bubbles, even before the official statement is clear, it has triggered concentrated buying herding.

However, this apparent buy-side herding under economic policy uncertainty should in fact be viewed as a warning sign. Although the STAR Market was created to direct capital into technological innovation, its role as a reform "testing ground" with frequent new adjustment policies, such as the registration-based IPO system, allowance for unprofitable and dual-class companies (Zheng et al., 2025)—has distorted investors' risk preferences rather than clarified them. Lacking historical valuation anchors, investors substitute policy signals for

fundamentals (Guan et al., 2024), racing to “buy early” in hopes of catching a fleeting subsidy window and thus driving prices away from intrinsic values. For example, after the State Council signaled financing support for loss-making firms under the “Strategic Emerging Industries Catalogue,” market valuations for these companies surged despite their weak earnings companies (Zheng et al., 2025). Likewise, high R&D tax incentives such as the increase of the incremental deduction rate to 100%, investors equate this policy support conflated with implicit guarantees, prompting even persistently money-loss chip makers to raise funds at levels ten times their revenues simply because they appeared on the “domestic substitution whitelist” (Zhang & Zhang, 2024).

In summary, the effects of EPU on herding behavior differ across China’s three major stock boards due to their distinct policy contexts. On the Main Board and ChiNext, EPU often serves as a stabilizing signal—“good EPU”—that reassures investors and reduces irrational herding. In contrast, on the STAR Market, EPU can act as a catalyst for speculative buying, the market's focus on cutting-edge technologies transform policy uncertainty into a gamble on potential massive rewards, thereby stimulating herd behavior.

These findings underscore that the impact of EPU is not monolithic but is critically mediated by policy intent. Consequently, a one-size-fits-all approach to financial regulation is inadequate. Regulators should tailor their communication strategies: providing clear, forward-looking guidance for the Main Board and ChiNext to reinforce the "stabilizing" effect, while enhancing investor education and risk disclosure on the STAR Market to mitigate speculative herding. For investors, this study highlights the necessity of adopting differentiated investment strategies across various market segments, moving beyond a uniform interpretation of policy news.

Theoretical Implications

This study challenges the monolithic view of EPU by proposing a context-dependent duality: "good EPU" stabilizes whereas "bad EPU" stimulates herding. This theoretical refinement demonstrates that herding is not a universal reflex but is critically mediated by market-specific structures and policy intent. Our cross-market comparison thus provides a more nuanced behavioral finance framework for understanding investor reactions to policy uncertainty in complex financial systems.

Practical Implications

From a regulatory perspective, the results suggest that policymakers should tailor regulatory approaches based on market-specific characteristics, rather than adopting a one-size-fits-all policy framework. The Main Board, ChiNext, and STAR Market exhibit different investor behaviors and reactions to policy uncertainty, highlighting the need for targeted measures to address market-specific risks. For instance, in the Main Board and ChiNext, where EPU reduces herding behavior, policymakers should focus on maintaining market stability and liquidity to prevent excessive risk aversion. In contrast, in the STAR Market, where policy uncertainty increase speculative herding, regulators may need to implement additional oversight on speculative trading activities to curb excessive volatility and bubble formation.

Limitations and Suggestions for Future Research

A key limitation of this study is that "good" and "bad" EPU cannot currently be quantified. Existing indices do not distinguish whether policy uncertainty is perceived as stabilizing or disruptive, which may explain differing effects across markets. Manual classification is challenging due to the volume of announcements and subjective interpretations. Future research could explore using artificial intelligence and natural language processing to systematically extract policy sentiment and quantify "good" versus "bad" EPU, enabling more precise analysis of its impact on herding behavior.

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