Greater China — Week in Review

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Highlights: No Change in Major Calls for China

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In light of the delayed expectation of a Fed rate cut, the market has recently adjusted its outlook on central banks across Asia. Similarly, at OCBC, we have revised our expectations for easing measures by most Asian central banks. However, China remains a standalone case. Our view for China's monetary policy remains unchanged.

Despite some initial indications of recovery after Chinese economy beat expectation in the first quarter, recent inflation and credit data continue to reflect an uncertain outlook for domestic demand. China's GDP deflator, estimated to be more than -1% in the first quarter, has remained negative for the fourth consecutive quarter. Given the uncertainties surrounding both domestic and external demand, we believe that the stronger-than-expected first-quarter GDP data is unlikely to deter further monetary easing and demand-side measures. We still expect China to cut its loan prime rate by 20bps though the timing of rate cut may be delayed slightly.

The interest rate for newly issued corporate loans in the first quarter was recorded at 3.75%, marking a decrease of 22 basis points year-on-year. Notably, the interest rate for new mortgage loan also saw a significant reduction, standing at 3.71%, down by 46 basis points compared to the previous year.

Addressing concerns about whether real interest rates are high, the central bank emphasized the importance of considering the structural aspects of interest rates. Furthermore, in sectors requiring tighter financial resource allocation, slightly higher real interest rates can facilitate enterprise capacity control and destocking efforts. Under the guidance of "maintain reasonable and adequate overall liquidity while adjusting the structure as needed.", China may remain calm towards elevated real interest rates.

On the inflows into China's onshore bond market, from October last year to March this year, foreign investment in bonds with a maturity of over one year accounted for 56% of the total foreign investment indicating a reasonable investment structure from foreign investors.

On the same day that China unveiled its first-quarter GDP figures last week, there was a tentative relaxation observed in RMB fixing, permitting the USD/CNY daily fixing to exceed 7.10. The pair surged initially as a knee jerk reaction. However, bolstered by the robust first-quarter GDP data and intervention via tighter RMB liquidity in the offshore market, the USDCNY found stability soon. The recent adjustment proved effective, paving the way for more flexible fixing rate in future.

During the first quarter of 2024, the total amount of foreign exchange derivative products, including forwards, swaps, and options, employed by enterprises to manage exchange rate risk, surged to $395.8 billion, marking a substantial 23% year-on-year increase. Moreover, the hedging ratio of enterprises reached record high of 28.1%, indicating a notable rise of 3.2 percentage points compared to the same period in 2023. This indicates increasing awareness of corporates regarding exchange rate risk neutrality.

In addition, the recent data showed an accelerating EV adoption in China. In the first half of April 2024, retail sales of passenger vehicles in China surged to 516,000 units. Notably, the market for new energy vehicles (NEVs) saw remarkable growth, with sales totalling 260,000 units, reflecting a remarkable 32% year-on-year increase. The penetration rate surpassing 50% for the first time in history.

Following the revision of our in-house Fed rate cut profile (expecting a total of 75bps of rate cuts this year, instead of 100bps), we also removed 25bp HKD prime rate cut from the projection this year. We now see a total of 25bps cut in 2024, with the first cut likely in the third quarter.

Based on historical record, the pass-through from Fed's rate decision to Hong Kong commercial banks' prime rate change decision is usually higher in a rate cut cycle than in a hike cycle. Meanwhile, factors such as cost of funding, deposit bases, loan demand, liquidity situation and economic climate also contributes to such decision. In this round, we expect the pass-through to be around 33%, i.e. 75bp cut in Fed fund rate vs. 25bp cut in HKD prime rate, in the face of still-weak loan demand and ample Hong Kong dollar liquidity.

Hong Kong's job market softened marginally, with both the seasonally adjusted unemployment rate and underemployment rate edging up by 0.1 percentage point, to 3.0% and 1.1% respectively in the first quarter of 2024. Meanwhile, total labour force saw a mild uptick, alongside the steady labour participation rate. The increase in unemployment rate in March was broad-based. Breaking down by industry, unemployment rate in retail, accommodation and food services sector (3.8%) rose the most, when comparing to the figure in December 2023 - February 2024, amid the slackening consumer demand.

Key events	
Facts	**OCBC Opinions**
▪ The Chinese bond market has seen significant international participation, with over 1,129 overseas institutions from more than 70 countries and regions entering the market as of the end of March this year.	▪ Foreign holdings in Chinese bonds have surpassed $570 billion, representing approximately 2.6% of the total custody volume of domestic bonds. This marks a notable increase of about 0.2 percentage points from the end of last year. ▪ Moreover, the investment structure appears to be reasonable and balanced. Overseas central banks, banks, and other financial institutions have been steadily increasing their holdings of domestic bonds, focusing primarily on long-term bonds such as government bonds and policy financial bonds. Notably, from October last year to March this year, foreign investment in bonds with a maturity of over one year accounted for 56% of the total foreign investment.
▪ The interest rate for newly issued corporate loans in the first quarter was recorded at 3.75%, marking a decrease of 0.22 percentage points year-on-year. Notably, the interest rate for new individual housing loans also saw a significant reduction, standing at 3.71%, down by 0.46 percentage points compared to the previous year.	▪ Addressing concerns about whether real interest rates are excessively high, the central bank emphasized the importance of considering the structural aspects of interest rates. It highlighted that different industries and enterprises have varying loan interest rates, and the magnitude of price changes for their products varies accordingly. As a result, the perceived real interest rates differ across sectors. ▪ For example, in sectors such as cultural entertainment and emerging industries, where prices have consistently risen, financial institutions are actively providing financing, leading to relatively lower nominal interest rates. When these price increases are factored in, the perceived real interest rates are lower. Conversely, in industries closely tied to real estate, such as ferrous metals, where product prices have experienced significant declines, financial institutions tend to be more cautious, resulting in relatively higher nominal interest rates and higher real interest rates. ▪ Furthermore, in sectors requiring tighter financial resource allocation, slightly higher real interest rates can facilitate enterprise capacity control and destocking efforts. This approach aligns with the spirit of the Central Economic Work Conference's directive to maintain reasonable and adequate overall liquidity while adjusting the structure as needed.
▪ Hong Kong: Following the revision of our in-house Fed rate cut profile (expecting a total of 75bps of rate cuts this year, instead of 100bps), we also removed 25bp HKD prime rate cut from the projection this year. We now see a total of 25bps cut in 2024, with the first cut likely in the third quarter.	▪ Based on historical record, the pass-through from Fed's rate decision to Hong Kong commercial banks' prime rate change decision is usually higher in a rate cut cycle than in a hike cycle. Meanwhile, factors such as cost of funding, deposit bases, loan demand, liquidity situation and economic climate also contributes to such decision. In this round, we expect the pass-through to be around 33%, i.e. 75bp cut in Fed fund rate vs. 25bp cut in HKD prime rate, in the face of still-weak loan demand and ample Hong Kong dollar liquidity. ▪ More recently, HIBORs are fixed lower across curve passing quarter-end, and in the absence of stronger inflows except the usual Southbound Stock Connect flows. HKD liquidity has stayed largely flush, while loan demands stayed on the weak side (loan-to-deposit ratio at 33-month low of 83.71% at end-February 2024). On a multi-month horizon, potential inflows may mean HKD rates underperformance as and when USD rates fall in a more sustained manner. At the same time, the rebound in housing market transactions after the removal of cooling measures, as well as corporates dividend payout and funding activities, may drive up loan demand and HKD rates in the months ahead.

Key Economic News	
Facts	**OCBC Opinions**
▪ The Chinese economy exceeded expectations, growing by 5.3% year-on-year in the first quarter, accompanied by a sequential quarter-on-quarter growth of 1.6% after seasonally adjusted.	▪ This robust expansion was underpinned by several key factors: resilient industrial activities, strong service consumption, and a rebound in external demand. ▪ Despite some initial indications of recovery, recent inflation and credit data continue to reflect an uncertain outlook for domestic demand. China's GDP deflator, estimated to be around -1.07% in the first quarter, has remained negative for the fourth consecutive quarter. ▪ Given the uncertainties surrounding both domestic and external demand, we believe that the stronger-than-expected first-quarter GDP data is unlikely to deter further monetary easing and demand-side measures.
▪ Hong Kong's job market softened marginally, with both the seasonally adjusted unemployment rate and underemployment rate edging up by 0.1 percentage point, to 3.0% and 1.1% respectively in the first quarter of 2024. Meanwhile, total labour force saw a mild uptick, alongside the steady labour participation rate.	▪ The increase in unemployment rate in March was broad-based. Breaking down by industry, unemployment rate in retail, accommodation and food services sector (3.8%) rose the most, when comparing to the figure in December 2023 - February 2024, amid the slackening consumer demand. ▪ While Hong Kong's total labour force rebounded by 3100 in Jan-Mar 2024, from that of Dec 2023 – Feb 2024, after five consecutive months of decline. Meanwhile, the labour participation rate was steady at 57%, the record low.

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