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## Highlights

Trade talk continued last week. However, the enaction of Hong Kong Human Rights bill after President Trump signed into law complicated the situation. China's threat that the implementation of the bill may affect the bilateral relationship in other areas hinted the risk for trade talk. Nevertheless, we still think a phase one deal is likely to be reached as US is unlikely to review the Hong Kong status anytime soon.

On economy, although October industrial profit data disappointed, the November manufacturing PMI surprised on the upside. This confirmed our view that China's economy has bottomed out in the near term thanks to improving trade talk and China's counter cyclical measures.

China's 2019 financial stability report highlighted the risk of rising household leverage ratio, which rose to 60.4% in 2018 although PBoC said the overall risk has abated gradually. The rapid increase of household leverage ratio suggests that there is limited room to loosen China's property tightening measures on national level.

PBoC Governor Yi Gang wrote in his latest article that China's monetary policy targets two stability including price stability and currency stability. Meanwhile, he also said that China will not pursue negative interest rate policy. Positive interest rate and steepening yield curve are more in line with China's traditional value. China's positive interest rate coupled with stable exchange rate are clearly attractive to foreign investors.

**In Hong Kong,** the pan-democratic parties won the local district council election by a comfortable margin, with a historical high voting rate of 71.2%. The victory of pan-democratic parties, which controlled over 85% seats in local district councils, may affect legislative council election in 2020 and chief executive election in 2022. Hong Kong's exports (-9.2% yoy) and imports (-11.5% yoy) dropped for the twelfth and eleventh consecutive month respectively in October. As the high base effect will dissipate from November, in addition to the market's optimism over the first-stage trade deal achieved, it might help to relieve the downside of trade performance of Hong Kong. Nevertheless, the trading activities might stay soft due to weakening economic outlook and prolonged trade war fears, which might dent the domestic and external demands. Therefore, we expect exports and imports to see single-digit negative growth in whole 2019. Supported by low base this year and the global monetary easing, we could expect some moderate rebound in Hong Kong's trading activities in 2020. The total loans and advances grew at a faster pace by 7% yoy in October. In terms of RMB deposits in HK, it increased by 2.1% mom to RMB636.4 billion in October. Moving forward, Hong Kong's RMB deposits may remain resilient above RMB600 billion in the coming months. **In Macau,** retail sales declined for the third consecutive quarter by 0.5% yoy to MOP18.06 billion in 3Q 2019. Weakening economic outlook and trade war fears may continue to dent local consumption while the two factors combined with a strong MOP may weigh down visitor spending. As such, retail sales may remain subdued in the near term.

| Key Events and Market Talk | |
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| **Facts** | **OCBC Opinions** |
| ▪ In his latest article, PBoC Governor Yi Gang reiterated to keep prudent monetary policy unchanged. | ▪ Yi Gang reviewed China's monetary policy in his article saying that China will not over stimulate its growth via monetary policy easing. Meanwhile, monetary policy is not the panacea and will work with other policies to pursue a more sustainable growth in China.<br>▪ Yi also said China will not pursue negative interest rate policy. A positive interest rate and steepening yield curve is in line with Chinese traditional value, which is positive for China.<br>▪ Looking ahead, the outlook of China's monetary policy will depend on two parameters. First, China's monetary condition should match China's potential output and stable price. Second, China will continue to work towards lowering the funding costs for small and private companies via targeted measures.<br>▪ Overall, we feel the most important targets for China's monetary policy include price stability and exchange rate stability. On currency, Yi also reckoned the benefit of a more flexible, which will help counter the external shock. However, China will not go to the path of competitive devaluation. Clearly, China engineered depreciation is in contrast to China's monetary policy target. |
| ▪ China's central bank published its 2019 financial stability report. The PBoC said the financial risks have been resolved gradually in the past years. | ▪ China's total leverage ratio declined slightly to 249.4% as of 2018 with non-financial corporate leverage fell from the peak of 157.8% in 1Q 2018 to 152% as of end of 2018.<br>▪ However, household leverage ratio rose by 3.4% to 60.4% according to PBoC's estimation, higher than 52.6% estimated by BIS. The rapid increase of household leverage ratio suggests that there is limited room to loosen China's property tightening measures on national level. However, the huge variance of household leverage ratio in each provinces (eg, household leverage ratio in Zhejiang province is more than 50% higher than that in Shanxi province) suggest China may fine tune property policies in those provinces with low household leverage ratio. |
| ▪ Trade talk continued between both countries.<br>▪ China's Ministry of Commerce did not offer details on how China will retaliate the Hong Kong Human Rights bill signed into law by President Trump. | ▪ China's threat that the implementation of US Human Rights bill may jeopardize the relationship between US and China in key event hinted the risk that the progress of trade talk could be affected by the Hong Kong bill.<br>▪ We think China will not hesitate to defend its sovereign dignity. However, given the US is unlikely to review Hong Kong's position any time soon, we think China may still go ahead with the phase one deal. |
| ▪ The democrats got a landslide victory in the local district council election, with a historical high voting rate of 71.2%. Democrats gained 388 seats out of 452 seats (over 85% of total seats) and obtained majority in 17 districts out of 18 districts, the first time since the first election in 1982. | ▪ In the near term, the victory may re-energize the campaign, which may create additional pressure for the HK government to react with more political solutions. This may give the city a break from those violent disruptions.<br>▪ In the longer term, there will be two crucial impacts on future legislative council election in 2020 and chief executive election in 2022. Firstly, since 2012 constitutional reform package, District Council (Second) of functional constituency in the |

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| | elections for the Legislative Council of Hong Kong has been created. 5 legislative council seats, which must be the district councilor of current term, would be nominated by other elected members of the District Councils (at least 15 nominations) and voted by those registered voters who were not eligible for voting in other the functional constituencies. With the benefit of majority, democrats could be able to nominate more District Council members from pro-democracy camp to participate in the election. This could offset the influence of pro-Beijing camp on functional constituency and increase the seats owned by pro-democracy camp in legislative council. Secondly, more importantly, there would be 117 out of 1200 members of Election Committee (CE election) nominated by District Council members. Under the current system, the plurality-at-large voting method has been adopted, meaning that District Council members could nominate all 117 members from pro-democracy camp to be the members of Election Committee theoretically, which will give more influential power to pro-democracy camp on the result of chief executive election. |

| Key Economic News | |
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| **Facts** | **OCBC Opinions** |
| ▪ China's industrial profit fell by 9.9% yoy in October, widening from 5.3% contraction in September. | ▪ The decline of industrial profit was mainly the result of weak performance in commodity sectors., led by ferrous metal, crude oil, coal refinery and chemical manufacturing, which dragged down the profit growth by about 7%.<br>▪ Profit from car manufacturers fell by 14.7% year to date but improving from the contraction of 16.6% in the first three quarters. We expect China's car sector to bottom out, which may provide support to consumption.<br>▪ On the positive note, the profit for high-tech industries remained resilient. Profit growth for computer, communication and electronic equipment industry improved to 6% while profit growth for machinery equipment improved to 15%. |
| ▪ China's PMI rebounded to 50.2 in November, up by 0.9 from 49.3 in October. | ▪ Both demand and supply improved. New export order improved by 1.8 to 48.8 on the back of hopes on phase one trade deal. Meanwhile, new orders rose by 1.7 to 51.3, returning to expansionary territory. This was partially attributable to China's fiscal stimulus such as tax cuts. On supply, output index rose by 1.8 to 52.6.<br>▪ The stronger than expected PMI confirmed our view that the Chinese economy has bottomed out in the near term. |
| ▪ Hong Kong's exports (-9.2% yoy) and imports (-11.5% yoy) dropped for the twelfth and eleventh consecutive month respectively in October. | ▪ By country, exports to Asia as a whole dropped by 6.4% yoy while those to the US declined by 21.1% yoy. On the positive note, exports to Taiwan grew for the sixth consecutive month by 16.8% yoy. On the flip side, imports from major trading partners other than Taiwan and Malaysia continued to decrease. Specifically, the imports from China and USA dropped by 14.5% yoy and 23.9% yoy respectively. By commodity, imports of electrical machinery (-3.8% yoy), office |

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| | machines (-22.0% yoy) and telecommunications (-21% yoy) maintained a downtrend while the exports of these items also decreased for the sixth, fifth and twelfth consecutive month respectively.<br>▪ The sluggish trading performance might be attributed to two factors. Firstly, the high base effect persisted in October due to the front-loading activities last October. Secondly, lingering trade war fears and concerns over global economic slowdown continued to dent the trade and investment sentiments. Suggested by the data, weakening electronic supply chain of Asia still observed due to trade war risks.<br>▪ As the high base effect will dissipate from November, in addition to the market's optimism over the first-stage trade deal achieved, it might help to relieve the downside of trade performance of Hong Kong. Nevertheless, the trading activities might stay soft due to weakening economic outlook and prolonged trade war fears, which might dent the domestic and external demands. Therefore, we expect exports and imports to see single-digit negative growth in whole 2019. Supported by low base this year and the global monetary easing, we could expect some moderate rebound in Hong Kong's trading activities in 2020. |
| ▪ Hong Kong's total loans and advances grew at a faster pace by 7% yoy in October. | ▪ Despite that the trade performance remained weak (total trade dropped by 10.4% yoy in October), trade finance reversed the downtrend and rebounded by 1.1% yoy, thanks to the easing high base factor. The loans for use in Hong Kong (excluding trade finance) grew by 7.1% yoy. It might be supported by two factors. Firstly, as the government eased the mortgage rules for first-time homebuyers, mortgage demand remained resilient in October (new mortgage loans increased by 8.2% yoy during the same period). Secondly, with positive expectations of US-China trade talks, it may help to partially offset the impact of local social unrest on local loan demand. Loans for use outside of Hong Kong picked up by 6.5% yoy. Nevertheless, the growth of loans for use outside of Hong Kong may not be strengthen much further in the coming months. PBoC lowered the seven-day reverse repurchase rate to 2.50% from 2.55%, the first time since 2015. With the expectations of lower onshore borrowing costs, it might reduce the incentives for those Chinese enterprises to have offshore loans. In a nutshell, we expect the growth of total loans and advances to see low single-digit year-on-year growth in 2019. |
| ▪ HKD loan-to-deposit ratio picked up to 90.7% (a level last seen since March 2002) in October as the growth of Hong Kong dollar loans increased faster than the growth of Hong Kong dollar deposits. | ▪ Despite the prolonged social unrest, HKD deposits continued to grow by 2.75% yoy in October. It might be supported by improved risk appetite, with more IPOs returning with some seeing positive response during the same period. Specifically, HKD CASA deposits was nearly unchanged in terms of month-on-month comparison while HKD fixed deposits increased by 1% mom. With the relatively stable HKD and HIBOR, we believe that there is no sign of significant outflows.<br>▪ In terms of the composition of HKD deposits, the percentage share of HKD CASA deposits dropped further to 54.7%, the lowest level since January 2009, while the percentage share of |

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| | HKD fixed deposits edged up to 45.3%. Moving forward, we expect the further downside of the percentage share of HKD CASA deposits might be limited and the ratio might stabilize around the current level. Firstly, the further decline in HKD CASA deposits is expected to be moderate, amid still robust housing and stock market. Secondly, the reduction of CCyB ratio by HKMA might help to ease the funding pressure of commercial banks. |
| ▪ Hong Kong's RMB deposits increased by 2.1% mom to RMB636.4 billion in October. | ▪ It might be attributed to the appreciation of RMB in October due to market's optimisms over trade talk development, providing more incentives for investors to hold more RMB assets. Moving forward, HK's RMB deposits might be affected by two factors. Firstly, PBOC's monetary policy stance. Secondly, the development of US-China trade talk. As US passed the HK Human Right Law, it might add some uncertainties over the trade talk's development. Overall speaking, we expect Hong Kong's RMB deposits to remain resilient above RMB600 billion in the coming months. |
| ▪ Macau's retail sales declined for the third consecutive quarter by 0.5% yoy to MOP18.06 billion in 3Q 2019. | ▪ The decline was mainly attributed to weaker retail sales of adults' clothing (-18.1% yoy) and motor vehicles (-9.3% yoy). Affected by uncertain economic outlook, the domestic consumption sentiments turned prudent. Nevertheless, on the positive notes, the retail sales of cosmetics & sanitary articles and goods in department stores remained strong with 15.9% and 10.5% year-on-year growth observed respectively. Meanwhile, the retail sales of watches, clocks and jewellery reversed the downtrend and grew by 1.6% yoy. It might be supported by resilient inbound tourism of Macau in the past few months.<br>▪ Moving forward, weakening economic outlook and trade war fears may continue to dent local consumption while the two factors combined with a strong MOP may weigh down visitor spending. As such, retail sales may remain subdued in the near term. |
| ▪ Macau's unemployment rate kept static at 1.8% during the three-month period from August to October, while the employed population rebounded slightly from 387,100 to 387,300. | ▪ Delving into details, the employed population of construction sector dropped for the sixth consecutive three-month period by 4.2% yoy, amid lack of new mega entertainment and infrastructure projects under construction, in turns weakening labor demand. Meanwhile, the employed population of retail sector and hotels and restaurants sector continued to drop by 1.2% yoy and 2.1% yoy respectively. It might be attributed to stronger MoP denting visitor spending and more cautious domestic consumption sentiments driven by uncertain economic outlook and rising concerns over retrenchment. On a positive note, supported by the strong performance of mass-market segment due to persistent tourism growth, the employed population of gaming sector grew for the eighth consecutive three-month period by 3.6% yoy.<br>▪ Moving forward, as domestic economic outlook has been clouded by external uncertainties as well as a strong MOP, the labor market of Macau might soften. Therefore, we hold onto our view that overall unemployment rate will climb gradually towards 1.9% and even 2% in the coming year |

| RMB | |
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| **Facts** | **OCBC Opinions** |
| ▪ RMB consolidated within 7-7.05 range. | ▪ RMB jumped in the first half of the week on the back of trade talk news but later gave up initial gain after President Trump signed the Hong Kong bill into law. The outlook will depend on the progress of trade talk. |

# Treasury Research & Strategy

## OCBC Greater China Research

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