Greater China – Week in Review

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Highlights

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I have a relatively quiet time last week when China was out for the golden week holiday to celebrate 70th anniversary of founding of PRC. The National Day parade is cool in any standard. What amazed me the most is to find out how patriotic the Chinese youngsters are nowadays. The Chinese youngsters growing up in digital era, which are deeply influenced by K-pop or western culture, are not shy of showing their love for the country. I can feel this is from the bottom of the heart.

The changing atmosphere, which may be fuelled by US's maximum pressure strategy during the trade war, may be fuelled by the escalating social unrest in Hong Kong, may be fuelled by China's accomplishments in the past 40 years, will probably lend more support to Chinese government in international stage. For this week, market will watch out for the resumption of trade talk on 10 Oct.

In **Hong Kong,** HKD deposits showed the largest month-on-month drop since May 2018 in Aug. This was partially due to the less buoyant fund-raising activities in August compared to July, as stated by the HKMA. In the meantime, USD deposits (excluding those placed by HKMA's exchange fund) and RMB deposits rose by 0.2% mom and 4.6% mom respectively. This indicates that investors might have transferred their HKD deposits to RMB or USD deposits, probably due to the less attractive yield of HKD and concern about capital outflows which could threaten the currency peg system. On a positive note, with commercial banks raising HKD fixed deposit rates and Budweiser resuming IPO in HK, HKD deposits showed a slight increase during the first three weeks of Sep. Going forward, as long as HKD deposits (+1.8% yoy in Aug) sustain year-on-year growth unlike what happened in 2003 and 2008, we may not read too much into any month-on-month volatility of HKD deposits.

That said, market still stays alert about potential outflows. Last Friday, the government invoked emergency powers for the first time in over 50 years to ban face masks. However, it failed to contain the outflow concerns with USDHKD spot moving to as high as 7.8444 while USDHKD forward swap points narrowing across the curve. On a positive note, neither USDHKD spot nor the USDHKD forward swap points kept edging higher, which indicates that the market is still in a wait-and-see mode at this moment. As such, the USDHKD spot may not easily touch 7.85 in the near term given limited USD-HKD yield differential. Nevertheless, unless social unrest comes to an end, market may still remain wary of outflow risks while the tourism, retail, restaurant, transportation and real estate sectors may continue to face downward pressure.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ Hong Kong's government invoked emergency powers for the first time in over 50 years to ban face masks on 4 Oct.	▪ As a knee-jerk reaction, USDHKD spot moved to as high as 7.8444 while USDHKD forward swap points narrowed across the curve with 12-month swap points moving to the premium levels. This reflects that the market might have been concerned about rising outflow risks. On one hand, market players might have fretted that the government's move could escalate the social unrest and in turn add further downward pressure to the already very weak economy. On the other hand, investors might have also been concerned that the government will continue to invoke emergency powers and in turn undermine the democracy of the international financial hub and accelerate the US Congress's process of passing the "HK Human Rights and Democracy Act". ▪ On a positive note, neither USDHKD spot nor the USDHKD forward swap points kept edging higher. This indicates that the market is still in a wait-and-see mode at this moment. As such, the USDHKD spot may not easily touch 7.85 in the near term given limited USD-HKD yield differential.
▪ HKMA's half-year monetary and financial stability report shows that household debt to GDP ratio rose the record high of 75.5% in 2Q19.	▪ On a positive note, the delinquency ratio remained at very low level of 0.02% in 2Q19. The average loan-to-value ratio of approved new mortgage loans rose to 47.5% in 2Q19 from 45.5% in 4Q18 but well below 64% in 3Q 2009 before the HKMA implemented the first round of counter-cyclical macro-prudential measures. Besides, the debt-service index of new mortgages reduced to 48.9 in 2Q19 from 49.0 in 4Q18, reflecting still stable and resilient debt servicing ability of households. ▪ Going forward, due to subdued performance of both housing market and stock market as well as muted consumption sentiments, we expect the growth of household debt to slow down in the second half of this year. Though the Fed has cut interest rates twice so far this year and is expected to reduce the rates further, HKD rates are likely to show limited downside due to low aggregate balance. As such, Fed's easing policy may not help to ease household debt servicing burdens or boost household loan demand in the near term. Worse still, due to the worsening prospects of income growth and rising concerns about retrenchments against the backdrop of sluggish local economic growth, household debt servicing ability could weaken. According to HKMA's sensitivity test, the debt-service index could go up notably from the current 48.9 to 54.3 provided that household income drops by 10% and other things remain unchanged.

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong's retail sales (-23% yoy) dropped by the most on record in August due to subdued consumption sentiments and sharp reversal in	▪ On one hand, sales of clothing and footwear (-33.4% yoy), jewellery and watches (-47.4% yoy) as well as medicines and cosmetics (-30% yoy) fell at a faster rate, mainly attributed to

inbound tourism.	the deterioration in tourism activities. Due to a strong HKD against major currencies especially RMB and the ongoing protests, total visitor arrivals decreased at the fastest pace since 2003 by 39.1% yoy in August. On the other hand, sales of food, alcoholic drinks and tobacco (-0.3% yoy) and consumer durable goods (-14.3% yoy) continued to shrink. This reflects sour consumption sentiments amid negative wealth effect from housing market correction. Prolonged trade war and local political turmoil have also raised concerns about labor market outlook and income growth prospects, in turn deterring households from consumption. Elsewhere, sales of goods in department stores plunged by 29.9% yoy as the persistent protests have affected normal operation of department stores (most of which were closed during National Day Holiday). ▪ Going forward, as the protests show no signs of termination anytime soon and the HKD remains relatively strong, we expect tourism activities and visitor spending to stay sluggish. Adding on subdued local consumption, we hold onto our view that retail sales will drop about 10% this year. This will highly likely result in further weakness in retail sector's employment as well as the retail shop market.
▪ Hong Kong's property price index dropped at the fastest pace since Sep 2016 by 1.2% in Aug. CCL index which tracks secondary housing prices fell for the sixth consecutive month to the lowest level in 24 weeks as of 29th Sep.	▪ Though housing transaction volume decreased at a milder rate by 1.5%, it was mainly due to low base effect as the last round of property market correction started around last Sep. In fact, the transaction volume plunged for fourth straight months and reached the lowest since Dec 2018 at 3447 deals. Taken all together, it reflects the souring housing market sentiments amid bleak local economic outlook, prolonged political turmoil, lingering trade war risks, rising concerns about retrenchment and elevated local rates (some banks lifted the prime-based cap of HIBOR-based mortgages to 2.625%). On top of these, the increasing short-term supply also added downward pressure to the housing prices. With the government moving on vacancy tax bill, property developers have been front-loading their new property projects with sweeteners amid weakening demand. This as result urged the homeowners to cut the asking prices. For the rest of the year, we expect housing transaction to remain low and housing price index (8.5% YTD as of Aug) to fall by 3% to 8%. ▪ In the long term, however, the housing market's downside may still be capped by scarce housing supply and prospects of lower interests. On long-run supply, housing starts dropped by 55% yoy to 4207 units in the first seven months of 2019. We will closely monitor the Policy Address out around mid-Oct to see how the government will do to ease the imbalance of long-term housing supply and demand.
▪ HK's total loans and advances grew at a slightly faster pace by 5.1% yoy in August.	▪ Trade finance has dropped consecutively for a year and was down 6.1% yoy due to weak trade activities. Surprisingly, the growth of loans for use in Hong Kong (excluding trade finance) accelerated to 6.1% yoy. That said, the number of mortgage applications and approved new mortgage loans dropped by 26.5% mom and 2.8% mom (or -5.1% yoy) respectively in August. Lately, some banks raised the prime cap for HIBOR-

	based mortgages while cutting the cash rebate for both new mortgages and re-mortgages. This coupled with housing market correction might have weighed down mortgage loan growth. Besides, a combination of US-China trade war re-escalation, local political turmoil and elevated local rates have dented both consumer and business sentiments. As such, we doubt the sustainability of the rebound in local loan demand. ▪ Elsewhere, loans for use outside of Hong Kong increased at a faster pace by 4.8% yoy. However, this seems unlikely to sustain as Mainland companies might have preferred to borrow at home after the PBOC returned to traditional monetary easing with RRR and targeted RRR cuts. ▪ In a nutshell, we expect the growth of total loans and advances to slow down in the coming months and see low single-digit year-on-year growth by end of this year amid internal and external uncertainties.
▪ HKD loan-to-deposit ratio surged to 90.1% (a level last seen since Apr 2002) in Aug as HKD deposits dropped by 1.6% mom and HKD loans fell by 0.3% mom.	▪ HKD deposits showed the largest month-on-month drop since May 2018 in Aug. This was partially due to the less buoyant fund-raising activities in August compared to July, as stated by the HKMA. In the meantime, USD deposits (excluding those placed by HKMA's exchange fund) and RMB deposits rose by 0.2% mom and 4.6% mom respectively. This indicates that investors might have transferred their HKD deposits to RMB or USD deposits, probably due to the less attractive yield of HKD and concern about capital outflows which could threaten the currency peg system. On a positive note, with commercial banks raising HKD fixed deposit rates and Budweiser resuming IPO in HK, HKD deposits showed a slight increase during the first three weeks of Sep. Going forward, as long as HKD deposits (+1.8% yoy in Aug) sustain year-on-year growth unlike what happened in 2003 and 2008, we may not read too much into any month-on-month volatility of HKD deposits. ▪ Elsewhere, HKD CASA deposits dropped by 3.2% mom while HKD fixed deposits rose by 0.5% mom. As such, the percentage share of HKD CASA deposits in total HKD deposits retreated to the lowest since Jan 2009 at 55.6%. This coupled with the high HKD loan-to-deposit ratio suggests that the funding pressure on commercial banks has remained high. It also helps to explain why commercial banks chose to keep prime rate unchanged in September despite the Fed's rate cuts. ▪ As commercial banks scrambled for HKD fixed deposits with higher interest rates in Sep, the funding costs of banks might have grown further. After quarter-end, the funding pressure may ease a bit. However, the downside of HKD rates is expected to be limited given low aggregate balance, fierce competition from new licensed banks including virtual banks, potential large IPOs and seasonal factors. On the other hand, though loan growth could slow down in the near term, deposits growth may also remain muted given internal and external uncertainties. High HKD loan-to-deposit ratio and lower ratio of HKD CASA deposits may continue to prevent commercial banks from cutting prime rate.
▪ Hong Kong's RMB deposits increased by 4.6% mom	▪ Though RMB depreciated notably by 3.4% mom against the

to RMB644.1 billion in August.	HKD in August, RMB deposits remained attractive probably due to the relatively high yield and the concerns about HKD's outlook. Going ahead, as RMB has stabilized lately after a slump in August and market has been more rational about RMB's outlook than previous years, we expect HK's RMB deposits to remain resilient above RMB600 billion in the near term.
▪ Macau's gross gaming revenue rebounded marginally by 0.6% yoy to MOP22.1 billion in September owing to holiday effect (visitor arrivals increased by 12.8% yoy during the Mid-Autumn Festival) and a low base from the same period last year when all gaming centers were closed amid Typhoon Mangkhut.	▪ Moving into October, inbound tourism and the gaming sector may benefit from the Golden Week Holiday and the infrastructure improvement. That said, both tourism and gaming revenue growth may remain moderate due to China's economic slowdown, a strong MOP and spill-over effect of Hong Kong's social unrest. Worse still, policy risks related to anti-money laundering may continue to dent high-roller demand. As such, we expect gross gaming revenue (-1.7% yoy during Jan-Sep) to fall by around 2% in 2019.

RMB	
Facts	**OCBC Opinions**
▪ As China was out for golden week holiday last week, CNH mainly took the cue from the broad dollar.	▪ CNH gave up the gain this morning with the USDCNH rose to 7.13 region again due to concerns about the upcoming trade talk on 10 Oct after news reported that China narrows scope for trade deal ahead of the talk.

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