Greater China – Week in Review

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Highlights

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News flow prior to the trade talk is not encouraging with the US added 28 Chinese public security bureaus and commercial companies such as China's leading AI companies into the entity list. This showed the further escalation of technology war.

Nevertheless, a phase one trade deal has been reached on Friday, which will delay the additional tariff hike previously scheduled on 15 Oct. Five areas have been covered in phase one including agriculture purchase, opening of China's financial services, currency agreement, intellectual property and technology transfer. The first three areas have been covered entirely in phase one while the latter two will be discussed further in phase two.

The documentation of the phase one deal is expected to take about one month. Ideally, the deal will be signed formally by both leaders during the APEC meeting in Chile in mid-November.

Five uncertainties remain including the delay of December tariff hike, Huawei, the new US entity list, currency manipulation designation and removal of existing tariff.

It seems China's commitment to US$40-50 billion annual agriculture purchase surprised the Trump Administration on the upside. Put quantity of agriculture purchase aside, we think China did make compromise to reach this partial deal as removal of existing tariff is no longer the pre-condition for a bilateral deal.

We saw the same movie before in April. President Trump thought this time is different as both negotiators have known each other a lot better now. We think timing could be the catalyst for both sides to go ahead with the talk without derailing the situation.

On currency, we think RMB has not fully priced in the cease of trade war probably due to the memory about previous back-and-forth. Market will watch closely whether a partial deal will be documented in the next one month for both leaders to sign officially in mid-Nov.

Domestically, China's State Council unveiled a new reform plan to redistribute the tax revenue between central government and local government. By giving local government more spending power, it will give local governments more room to support growth and reduce local government's reliance on land sales.

In **Hong Kong,** despite the escalation of social unrest over the previous weekend, Hang Seng Index closed higher by 1.8% last week on hopes for a partial deal between US and China as well as the rising expectations of Fed

rate cut in Oct. Meanwhile, USDHKD spot has been rather stable in the range of 7.8400-7.8460. Elsewhere, unlike Fitch and Moody's, S&P affirmed HK's AA+ sovereign rating with a stable outlook, citing HK's strong economic and financial metrics. Taken all together, it suggests that unless we see structural change to HK's status as an independent financial hub, there may not be massive capital outflows or any huge shock to the stability of HK's market and the currency peg system. Going ahead, in the absence of massive capital outflows, large IPOs and seasonal factors, HKD liquidity is likely to remain relatively flushed. That said, against the backdrop of low aggregate balance, market players may continue buying dips to collect HKD liquidity in the run-up to year-end and virtual banks launches as well as due to potential large IPOs and lingering outflow concerns. As such, even if HIBORs retrace lower, we expect 1M HIBOR and 3M HIBOR to find support at 1.5% and 2.0% respectively in the coming months. If this is the case, USDHKD spot may hover in the range of 7.84-7.85 albeit with low probability of touching 7.85. This week, market will closely eye on the release of 2019 Policy Address. HK's Chief Executive Carrie Lam has hinted at bold measures to be announced in the Policy Address to shore up growth. The focus will be on the government's proposal to ease the long-term housing supply shortage and support the sectors (including retail, tourism, hotel, restaurant and transport) which have been largely hit by the prolonged protests.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The US and China has reached a phase one trade deal last Friday which will delay the additional tariff hike previously scheduled on 15 Oct. ▪ According to President Trump, the phase one deal will be documented in 3-5 weeks before being signed by both leaders in possible mid-November. ▪ Five areas have been covered in phase one including agriculture purchase, opening of China's financial services, currency agreement, intellectual property and technology transfer.	▪ As mentioned by President Trump that the US is surprised by China's generous offer to increase its purchase of US agriculture products to US$40-50 billion per annum from currently US$8 billion, much higher than US's previous target of about US$20 billion. Put quantity of agriculture purchase aside, we think China did make compromise to reach this partial deal as removal of existing tariff is no longer the pre-condition for a bilateral deal. ▪ **What's next?** ▪ Market will watch out for two things going forwards. First, the documentation of the phase one deal is expected to take about one month. Ideally, the deal will be signed formally during the APEC meeting in Chile in mid-November. Second, the phase two will also start very soon. As mentioned by the President Trump, three areas including agriculture, financial services and currency have been covered by phase one entirely. As such, phase two will mainly cover intellectual property and technology transfer with key focus will be on technology transfer. President Trump did not rule out the possibility of phase three to cover technology transfer. Overall, we think it remains uncertain how far we are from the complete trade deal. ▪ **Five uncertainties remain** ▪ Although the 15 Oct planned tariff hike has been officially delayed, there are at least five events remaining uncertain. First, the second planned tariff hike on 15 Dec will still be subject to President's decision. Second, Huawei is a separate case and is not part of the deal. Third, companies in US's entity lists will be subject to review. Fourth, US's decision on China's currency manipulation designation will depend on US Treasury's evaluation. And Fifth, for existing tariff, the Trump Administration has no plan to remove for now after President Trump reiterated that he likes tariffs. ▪ **Is this time different?** ▪ The positive headline is encouraging. However, we saw the same movie before in April. President Trump thought this time is different as both negotiators have known each other a lot better after a few rounds of back and forth. We think timing could be the catalyst for both sides to go ahead with the talk without derailing the situation as the US is approaching the new Presidential election.
▪ China reopened the market with a series of bad news. According to Reuters news, 28 Chinese public bureaus and companies including eight commercial companies such as China listed video surveillance company Hikvision on a US entity list due to human rights violation in Xinjiang region.	▪ The Chinese technology companies such as Hikvision and Dahua will be cut off from the US suppliers such as Intel, Nividia, Ambarella etc should they are put in the entity list which may affect their operations. ▪ The new entity list signalled the re-escalation of technology war as China's emerging AI leaders such as Mveii and Sensetime are also in the list.
▪ China's State Council unveiled a new reform plan to redistribute the tax revenue between central government and local government.	▪ The new redistribution plan will cover three areas. ▪ First, China will keep the equal distribution of value added tax between central government and local government

	unchanged. China has granted local government 50% share of value added tax on the trial basis since the change from business tax to value added tax. Local government's access to value added tax will broaden its tax base to alleviate the pressure on local government funding. ▪ Second, the central government will share more burden of VAT tax rebate. Previously, local government will be responsible for half of the tax rebate. Under the new proposal, local government will be responsible for 15% of VAT tax rebate and the remaining 35% will be partially supported by the central government based on the formula. ▪ Third, the collection of some consumption tax will be postponed from production stage to wholesale and retail stages. Consumption tax is the fourth largest tax avenue and is purely collected and managed by the central government in the past. The redistribution of some consumption tax to local government will help broaden channel of revenue. ▪ The recent fiscal reform is in line with China's broad strategy to kill three birds with one stone. First, by broadening revenue channel for local government, it will give local government more room to support the economy via proactive fiscal policy. Second, it will also help local governments reduce their reliance on land sales, which is in line with China's property tightening measures. Third, it will also help reduce the burden on local government debt problem.
▪ S&P affirmed Hong Kong's AA+ sovereign rating with a stable outlook and did not follow the action taken by Fitch and Moody's.	▪ S&P pointed out that Hong Kong's strong economic and financial metrics will allow the government's credit standing to withstand the fallout from the ongoing social unrest. Meanwhile, S&P said "abrupt changes in HK's relationship with Chinese central government could weaken the outlook." ▪ We believe that as long as there is no substantial change to HK's status as an international financial hub with separate customs territory, independent regulatory system and free capital flows, its financial market will be able to weather the external and internal headwinds with its healthy reserves. In other words, there may not be massive capital outflows or any huge shock to the stability of HK's market and the currency peg system in the near term.
▪ Despite the escalation of social unrest over the previous weekend, Hang Seng Index closed higher by 1.8% last week on hopes for partial deal between US and China as well as the rising expectations of Fed rate cut in Oct.	▪ Meanwhile, USDHKD forward swap points retraced lower from the high levels seen last Monday while USDHKD spot has been rather stable in the range of 7.8400-7.8460. Taken all together, it suggests that unless we see structural change to HK's status as an independent financial hub, market may not react so drastically to the prolonged protests. ▪ Going ahead, in the absence of massive capital outflows, large IPOs and seasonal factors, HKD liquidity is likely to remain relatively flushed. That said, against the backdrop of low aggregate balance, market players may continue buying dips to collect HKD liquidity in the run-up to year-end and virtual banks launches as well as due to potential large IPOs and lingering outflow concerns. As such, even if HIBORs retrace lower, we expect 1M HIBOR (currently 1.73%) and 3M HIBOR (currently 2.23%) to find support at 1.5% and 2.0% respectively in the coming months. If this is the case, USDHKD

	spot may hover in the range of 7.84-7.85 albeit with low probability of touching 7.85.

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong: the total value of buyer's stamp duty (BSD), double stamp duty (DSD) and seller's stamp duty (SSD) decreased further by 24% mom to HK$0.978 billion in September. During the same month, the volume of housing transactions which involved these three types of stamp duty dropped for the third consecutive month by 29.4% mom to 1220 deals, the lowest since July 2014.	▪ Specifically, the volume of housing transactions which involved BSD (imposed on non-local buyers) plunged by 55.8% mom to 107 deals, which merely taking up 8.8% of total transactions. This indicates that non-local buyers have not been the main driver of HK's housing market frenzy. Rather, the scarce supply of both private and public housing is the root cause. On the other hand, the volume of housing transactions which involved DSD (imposed on non-first home buyers) fell by 37% mom to 247 deals, indicating that the housing control measures and multiple headwinds have dented speculative demand. ▪ As government's revenue from stamp duty and land sales looks set to be weaker than expected for 2019/20 while government unleashed off-cycle fiscal stimulus measures in August, it is possible for HK to see the first fiscal deficit for 2019/20 since 2003/04. This week, market will closely eye on the release of 2019 Policy Address. HK's Chief Executive Carrie Lam has hinted at bold measures to be announced in the Policy Address to shore up growth. The focus will be on the government's proposal to ease the long-term housing supply shortage and support the sectors (including retail, tourism, hotel, restaurant and transport) which have been largely hit by the prolonged protests.
▪ Macau's average housing price dropped for the second consecutive month by 7.1% mom to MOP102,220/square meter in August, the lowest since February. During the same month, approved new residential mortgage loans fell by the seventh consecutive month by 44.1% yoy to MOP4.1 billion whereas housing transaction volume (+7.8% yoy) decreased slightly from July's 898 deals to 894 deals.	▪ The year-on-year growth of housing transaction was due to the property developers' sweeteners which boosted new home sales as well as the low base of late 2018. That said, the housing market has still slowed down from mid-2019, mainly attributed to summer holiday effect, negative wealth effect from stock market correction, rising concerns about labour market outlook and a bleak economic outlook. On top of these unfavorable factors, the housing control measures continued to take effect in suppressing speculative demand as local home buyers holding more than one property represented merely 3.3% of total local buyers. Though measures supporting first-home local buyers, who took over 82.5% of total local home buyers in August, remained a support to the housing market, the support is poised to wane gradually as local residents have increasingly entered the housing market. Going ahead, all the factors mentioned above will likely continue to slow down the housing market. We expect housing prices (+1% YTD as of August) to drop 1.5% yoy by end of this year. ▪ In the medium term, any housing market correction may be capped by the scarce home supply and prospects of lower borrowing costs. On the supply front, housing completion and housing start continued to shrink by 89% yoy and 84% yoy to 224 units and 225 units respectively during the first eight

	months of this year. Worse, the year of building completion of over 40% existing homes is more than 30 years which if without re-construction would not be able to meet any demand. We will closely watch what the new government will do to ease the housing supply shortage. In terms of interest rate, with global central banks continuing to ease monetary policy, we expect HKD rates to converge with USD rates gradually.

RMB	
Facts	**OCBC Opinions**
▪ RMB extended its gain against the dollar last week on the back of trade deal hope and weakening broad dollar.	▪ The USDCNY and USDCNH ended the week below 7.10. However, interestingly, RMB failed to outperform its peers amid broad dollar weakness as RMB index actually slipped slightly last week. We expect RMB index to pick up to reflect the partial deal inked on Friday. Overall, we think RMB has not fully priced in the cease of trade war probably due to the memory about previous back-and-forth. Market will watch closely whether a partial deal will be documented in the next one month for both leaders to sign officially in mid-Nov.

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