Greater China – Week in Review

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Highlights

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US and China announced to reach a "historic" phase one trade deal. The partial deal will cover a wide range of topics including intellectual property, technology transfer, agriculture, financial services and currency. Meanwhile, the factsheet from the USTR also showed that China commits to increase imports of US goods and services over the next two years by no less than US$200 billion from the annual level in 2017.

Although the rollback of existing tariff was smaller than expected with only 15% additional tariff on US$120 billion products which took effect from September will be cut by half to 7.5%, the cancellation of planned additional tariff from 15 December was still supportive of global risk sentiment.

In the last episode of Game of Thrones, Tyrion Lannister gave a great ending with his best line that "No one is very happy, which means it's a good compromise, I suppose". This line probably fit into the phase one deal as well. I suppose it is a good compromise, which will buy global markets peaceful time for a few months. However, this is a truce deal rather than a peace deal in our opinion as discrepancy about rollback of tariff between both sides remain. As mentioned by US chief trade negotiator that there is no guarantee on additional rollback of tariff while most officials in China including China's foreign minister Wang Yi believe that the existing tariff will be phased out gradually.

A 7.5% rollback on existing US$120 billion goods will only bring down China's effective tariff rate by about 1.7%. This explains why RMB failed to gain further after breaking down 6.95 initially. Based on the current level of rollback, we think 7 is a reasonable level for USDCNY. Given both sides will prepare for the signature of the deal in early January, we expect RMB to consolidate around 7.

China concluded its annual central economic working conference on 12 December setting the policy tone for 2020. Stability and flexibility are two key words for next year. Overall, we think China's increasing flexibility shows that it will lean towards more easing should growth slow than expected. However, we don't expect any massive stimulus as China has shifted its focus to new development engine led by innovation. We expect China to set its growth target for 2020 at around 6%.

In **Hong Kong,** USDHKD spot free-fell to 7.7990 briefly last week, jumping into the strong half of the trading band, in spite of calm funding. There might be some possible reasons behind. Firstly, HKD cash demand increased from banks and corporates due to year-end factor. Secondly, equity inflows into HK's stock market coupled with USD weakness. Thirdly, some rumours related to Chinese corporates switching out of USD deposits into HKD amid the uncertainty over the US-China trade talk. Moving forward, we believe that the USDHKD spot might rebound in the near term if this round selling flow of the pair was driven by one-off factors. The 1-month HIBOR might face greater downside pressure while 3-month HIBOR remain relatively sticky after the year end. The USDHKD spot might keep the two-way movements in the near term. HK government has launched four waves of stimulus packages amounting to more than HKD 25 billion in order to mitigate the downside risks from a weaker economic outlook and prolonged social unrest. Nevertheless, the business activity in Hong Kong remained sluggish. As those unfavourable factors persist, which might continue to dent investment and business sentiments, the possibility of further deceleration of GDP in 4Q cannot be ruled out. On the positive note, we believe that government has strong capability to provide further supports to local economy if need to be. **In Macau,** average housing price dropped by 12.3% yoy (or -1.6% mom) to MOP 101,813/square meter in October. The data showed that the downtrend of Macau's housing market persisted. It might be attributed to several unfavourable factors, including rising concerns over bleak economic outlook and retrenchment and negative spill-over effects from HK's social unrest. Moving forward, we expect that the housing market of Macau will likely continue to slow down in the coming months. The housing prices (+0.6% YTD as of October) may drop by 1.5% yoy by end of this year.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US and China announced to reach a "historic" phase one trade deal. ▪ According to the USTR factsheet, the deal will cover longstanding issues in the areas of intellectual property, technology transfer, agriculture, financial services and currency. Meanwhile, the US also said China has committed to increase imports of US goods and services over the next two years by no less than US$200 billion from the annual level in 2017. ▪ The 15% additional tariff on about US$120 billion Chinese imports which took effect from September will be cut half to 7.5% while 25% additional tariff on US$250 billion will remain unchanged. ▪ The additional tariff which will take effect from 15 Dec will be cancelled. In return, China also announced to suspend the planned additional 5-10% tariff some US imports as well as tariffs on US cars and auto parts. ▪ US trade negotiator Lighthizer said on Friday that both sides are aiming to sign a phase one deal in early January in Washington DC. However, the ceremony will not involve President Trump and President Xi.	▪ The announcement means that the wordings of the phase one deal has finally been agreed by both sides. This is a good achievement but is this a good deal for both sides? For some people in China, they might not be satisfied as the rollback of existing tariff is smaller than expectation (not even back to August level). A 7.5% rollback on existing US$120 billion goods will only bring down China's effective tariff rate by about 1.7%. In the US, although President Trump considered this as a great deal, people such as Senator Marco Rubio are still concerned about giving away leverage to press China on structural changes. ▪ In the last episode of Game of Thrones, Tyrion Lannister gave a great ending with his best line that "No one is very happy, which means it's a good compromise, I suppose". This line probably fit into the phase one deal as well. I suppose it is a good compromise, which will buy global markets peaceful time for a few months. ▪ However, this is a truce deal rather than a peace deal in our opinion as discrepancy about rollback of tariff between both sides remain. As mentioned by US chief trade negotiator that there is no guarantee on additional rollback of tariff while most officials including China's foreign minister Wang Yi believe that the existing tariff will be phased out gradually. ▪
▪ China concluded its annual central economic working conference on 12 December setting the policy tone for 2020.	▪ Stability and flexibility are two key words for next year. The target of "six stabilities" has been the key focus in the past year and will remain the guiding principle for 2020. ▪ Although China reiterated to adhere to proactive fiscal policy and prudent monetary policy in the CEWC as well as its famous slogan "housing is for living not for speculating", the twist of fine print under each policy shows China has been more flexible in supporting its growth. For example, added the wording flexibility into its prudent monetary policy. Meanwhile, China also added stabilizing land price and housing price into its long term expectation management mechanism in its housing policy. We think those changes do not mean the shift of policy tone, however, it help assure that China will keep the tail risk in check should the growth lose the steam. ▪ For the economic focuses in 2020, the promotion of concept of "new development philosophy" was the top priority. The new development philosophy will cover five areas including innovation, coordination, green, open and shared development. Those five areas will ensure a long-term sustainable growth China. ▪ In addition, China will also continue its "three critical battles" including prevention of financial risks, targeted poverty reduction and pollution control. ▪ Overall, we think China's increasing flexibility shows that it will lean towards more easing should growth slow than expected. However, we don't expect any massive stimulus as China has

	shifted its focus to new development engine led by innovation.
▪ USDHKD spot free-fell to 7.7990 briefly last week, jumping into the strong half of the trading band, in spite of calm funding.	▪ There might be some possible reasons behind. Firstly, HKD cash demand from banks and corporates due to year-end factor. Secondly, equity inflows into HK's stock market coupled with USD weakness. Thirdly, some rumours related to Chinese corporates switching out of USD deposits into HKD amid the uncertainty over the US-China trade talk. Taking all together, the selling flow might be driven by some one-off factors. ▪ Moving forward, we believe that the USDHKD spot might rebound in the near term if this round selling flow of the pair was driven by one-off factors. In the coming weeks, the short-end HKD liquidity might continue to tighten amid the approaching year-end factor. Nevertheless, the 1-month HIBOR might face greater downside pressure while 3-month HIBOR remain relatively sticky after the year end. The USDHKD spot might keep the two-way movements in the near term. ▪ According to Eddie Yu, the Chief Executive of HKMA, Hong Kong has "sufficient ammunition" to maintain the stability of the currency peg system. Currently, the Exchange Fund has more than HK$ 4 trillion, equivalent to 2.5 times the Hong Kong monetary base (80% are highly liquid foreign exchange reserves). Therefore, HK's banking system has enough capital and liquidity to resist any shocks.
▪ According to Paul Chan, Hong Kong's Financial Secretary, despite that government has rolled out multiple rounds of relief measures, those measures could not be able to resolve all problems.	▪ In fact, HK government has launched four waves of stimulus packages amounting to more than HKD 25 billion in order to mitigate the downside risks from a weaker economic outlook and prolonged social unrest. Nevertheless, the business activity in Hong Kong remained sluggish. Specifically, PMI dropped to 38.5 in November, the worst performance since the SARS epidemic in early 2003. ▪ As those unfavourable factors persist, which might continue to dent investment and business sentiments, we expect that it is hardly to see significant recovery in December. Therefore, the possibility of further deceleration of GDP in 4Q cannot be ruled out. On the positive note, with a strong fiscal reserve amounting to HKD 1051 billion as of the end of October, we believe that government has strong capability to provide further supports to local economy if need to be.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's financial data beat market expectation in November. ▪ Aggregate social financing increased by CNY1.754 trillion. Total new Yuan loan increased by CNY1.39 trillion. ▪ However, M2 decelerated slightly to 8.2%.	▪ The stronger than expected credit expansion was partially due to recovery bill financing in both on-balance sheet and off-balance sheet. Nevertheless, off-balance sheet financing remained weak with entrust loan and trust loan fell by CNY95.9 billion and CNY67.3 billion respectively. ▪ Medium to long term demand from corporate sector and household sector remained stable. This also shows that property market remained resilient.

▪ China's CPI grew by 4.5% yoy in November while PPI fell by 1.4% yoy.	▪ China's inflation remained a pork centric story. Although the rise of pork prices has slowed in November, the contribution to CPI remained significant due to base effect. ▪ However, core CPI excluding food and energy decelerated to 1.4% yoy, lowest since early 2016. ▪ Although CPI is expected to break 5% in early 2020. We think it is unlikely to be a major driver to policy change.
▪ Macau's average housing price dropped by 12.3% yoy (or -1.6% mom) to MOP 101,813/square meter in October. Approved new residential mortgage loans ended the downtrend for the past few months and grew by 4.4% yoy to MOP3.52 billion in October. Despite that, the housing transaction edged lower by 12.3% yoy to 659 deals during the same period.	▪ The data showed that the downtrend of Macau's housing market persisted. It might be attributed to several unfavourable factors, including rising concerns over bleak economic outlook and retrenchment and negative spill-over effects from HK's social unrest. Meanwhile, the housing control measures continued to trim speculative demand as local home buyers holding more than one property represented less than 4% of total local buyers in October. First-home local buyers remained the major drive of the housing market, which took over 82% of total local home buyers during the same period. Moving forward, we expect that the housing market of Macau will likely continue to slow down in the coming months. The housing prices (+0.6% YTD as of October) may drop by 1.5% yoy by end of this year. ▪ In the longer term, the housing market correction might be limited. In terms of supply, the housing start and completion dropped by 78% yoy and 33% yoy respectively for the first ten months of 2019, reflecting that the long-term supply remained limited. We will continue to watch out what the new government will do to ease the housing supply shortage.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended the week above 7 though the pair briefly broke down 6.95 for a while.	▪ RMB swung on trade talk news. RMB surged initially after President Trump announced that a trade deal is very close. Meanwhile, the Wall Street Journal news on rollback half of existing tariff sent the pair down to low of 6.92. Nevertheless, as a result of smaller than expected rollback of tariff, which will only bring down the effective tariff rate by 1.7%, the USDCNY returned to above 7. ▪ We think 7 is the reasonable level based on the current marginal rollback of existing tariff. Given both sides will prepare for the signature of the deal in early January, we expect RMB to consolidate around 7.

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