Greater China – Week in Review

21 October 2019

Highlights

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

The Chinese economy decelerated further to 6% yoy in 3Q, weakest quarterly reading since 1992. Nevertheless, we do see silver linings from the latest data. First, China's property market was more resilient than expected. Second, manufacturing sector may bottom out soon. And third, infrastructure investment started to pick up on the back of proactive fiscal policies. Together with the favourable base effect, we expect China's growth to maintain at 6% yoy in 4Q.

Disinflationary and inflationary pressures coexist. CPI is expected to test 4% in January 2020 as a result of rising pork prices and base effect. The jump of headline CPI above government's target created a more complicated backdrop for monetary policy.

The positive factors such as the trade truce, low base effect, stabilization of manufacturing sector and pickup of infrastructure investment may give PBoC more reason to take a wait and see approach. Market will watch out for the upcoming LPR fixing on Monday, which is expected to decline further by 5bps to reflect the narrowing credit spread.

On trade talk, China's Commerce Ministry said China hopes to reach a trade deal and remove additional tariff as soon as possible. Although China has compromised in the phase one deal, the road to a complete deal remains unchanged. China will continue to fight for the removal of existing tariff.

In Hong Kong, market focused on two hot topics last week. **First, the 2019 Policy Address** which mainly focuses on housing, land supply, improving people's livelihood and economic development. In the near term, the loosening mortgage rules on first-home buyers may unleash pent-up demand and in turn push up the transaction volume and value of private flats priced at HK$5-10 million. As such, despite multiple headwinds, housing prices may be able to show a growth of up to 5% yoy by end-2019. In the longer term, the housing market's outlook may still hinge on HK's economic outlook, labour market outlook and the public housing supply. On the other hand, to ease the financial burden on households and SMEs, the government has rolled out one-off relief measures in August and added more measures in the Policy Address. All these measures coupled with the positive outcome of US-China trade talks and global monetary easing may help to ease some downward pressure on HK's economy in the coming quarters. As such, overall unemployment rate (stabilized at 2.9% in 3Q) may go up only moderately towards 3% and then 3.1% in the coming year. **Second, the HKMA reduced the countercyclical capital buffer ratio from 2.5% to 2%** and expected to inject HK$200-300 billion of bank credit. Though this move may not necessarily support all the SMEs given the rising concerns about their debt-servicing ability against a worsening business environment, it may help to ease HKD liquidity. Adding on the absence of massive outflows, seasonal factor and large IPO in the near term, 1M HIBOR and 3M HIBOR dropped. That said, given low aggregate balance and uneven distribution of HKD liquidity in the banking system, a combination of outflow concerns (US Senate is said to vote on HK bill as early as this week), upcoming virtual bank launches, year-end effect and potential IPOs is expected to continue capping the downside of HIBORs.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's Commerce Ministry said China hopes to reach a trade deal and remove additional tariff as soon as possible. Meanwhile, Premier Li also reiterated the fair treatment to foreign firms investing in China as well as the strict protection of property and intellectual property rights.	▪ Although China has compromised in the phase one deal, the road to a complete deal remains unchanged. China will continue to fight for the removal of existing tariff.
▪ China net injected CNY230 billion liquidity into the system including unexpected CNY200 billion 1-year MLF injection.	▪ The interest rate for MLF remained unchanged, signalling that China will keep its prudent monetary policy unchanged. Market will watch out for the third LPR fixing on Monday, which could fall by another 5bps to reflect the narrowing credit spread. ▪ The increasing use of MLF could be China's new plan to swap short term liquidity with longer term liquidity to provide stable funding for banks. ▪ Meanwhile, the 1-year MLF operation ahead of the LPR fixing on 20th each month could be a new normal, which could set the tone for LPR fixing.
▪ China's Vice Premier Han Zheng said over the weekend that China will create a better business environment for multinational companies by further lowering tariffs and scrapping non-tariff barriers.	▪ This is another reassurance from Chinese leaders that China's opening attitude will not be disrupted by the recent escalation of trade war.
▪ China's central bank Governor Yi Gang said China is deeply disappointed about the lack of progress on IMF quota reform.	▪ The US still holds de-facto veto power with 16.5% quota. The under-representation of voices from emerging markets may remain the focus of IMF quota reform.
▪ Hong Kong's 2019 Policy Address mainly focuses on housing, land supply, improving people's livelihood and economic development.	▪ Specifically, the government will strive to increase public housing supply and relax the mortgage rules on first-time private home buyers. Moreover, the government will increase the transitional housing units, resume three types of private land for developing public housing and Starter Homes and announce a proposed framework for the Land Sharing Pilot Scheme with the target of accepting applications in early 2020. ▪ In the near term, the latest housing correction is expected to be capped by the prospects of lower borrowing costs and the loosening mortgage rules on first-home buyers. We expect the transaction volume of private flats priced at HK$5-10 million (which took up 58% of total transaction volume) to rebound. Owing to the new measures, the property developers which have brought forward their new project launches with sweeteners in the run-up to the implementation of vacancy tax may refrain from cutting offering price going forward. The same may be true to the homeowners. As such, despite multiple headwinds, housing prices (+8.5% YTD as of August) may be able to show a growth of up to 5% yoy by end of this year. In the longer term, the housing market's outlook may still hinge on HK's economic outlook, labour market outlook and the public housing supply. ▪ On a positive note, housing and infrastructure construction projects will translate into an increase in public investment in the medium term and therefore help to weather some

	external headwinds to HK's economy. ▪ Against the backdrop of worsening economic outlook, the government proposes to support the SMEs as well as the transportation & logistics sector. Besides, the government continues to focus on the development of the innovation & technology, in order to help diversify the economy. Finally, to ease the financial burden on households especially the low-income ones against the backdrop of faltering growth and labor market outlook, the government has rolled out one-off relief measures in August and added more measures in the Policy Address. All these measures coupled with the positive outcome of US-China trade talks and global monetary easing may help to ease some downward pressure on HK's economy in the coming quarters. ▪ With the government rolling out a raft of relief measures, we may see the first fiscal deficit since 2003-04. However, it may not have much impact on the still sizeable fiscal reserve (HK$1.17 trillion for 2018-19 which represented over 40% of GDP). As such, we still believe that the government will continue to implement expansionary fiscal policy for 2020-21 to shore up growth.
▪ The Hong Kong Monetary Authority (HKMA) reduced the countercyclical capital buffer (CCyB) ratio from 2.5% to 2%, effective from 14th October.	▪ This will inject HK$200-300 billion of bank credit, aiming to support the funding needs of the SMEs against the backdrop of weakening economic outlook and subdued risk appetite across the banking system. ▪ According to the HKMA, the Countercyclical Capital Buffer (CCyB) is part of the Basel III regulatory capital framework. It is a mechanism to build up additional capital during periods of excessive credit growth when risks of system-wide stress are growing rapidly. This capital can then be "released" when the credit cycle turns to absorb losses and enable the banking system to continue lending in the subsequent downturn. ▪ During the latest rate hike cycle in the US, HKD rates moved up gradually while the resilient economic growth accelerated loan growth. As such, to pre-emptively contain the credit risk facing banking system, the HKMA gradually lifted the CCyB ratio from 0.625% (effective from 1st January 2016) to 2.5% (effective from 1 January 2019). Recently, global central banks including the Fed have started to reduce interest rates while HK's economic environment has deteriorated and dented loan demand. This prompts the HKMA to adjust lower the CCyB ratio, allowing banks to support the domestic economy. ▪ In fact, banking system has been suffering from high funding pressure as HKD loan-to-deposit ratio surged to the highest since April 2002 at 90.1% while the ratio of HKD CASA deposits dropped to the lowest since January 2009 at 55.6% in August. Therefore, banks might have been increasingly cautious about offering new loans. HKMA's move could help to ease HKD liquidity, in turn improving their risk appetite. Nevertheless, banks may not necessarily increase credit exposure to SMEs given concerns about the SMEs' debt-servicing ability against a worsening business environment. In other words, probably only the companies including the SMEs with short-term liquidity issue but positive long-term business outlook could

	benefit from HKMA's move.
▪ 1M HIBOR and 3M HIBOR dropped from last Monday's 1.73% and 2.23% respectively to last Friday's 1.56% and 2.13%.	▪ HKD rates retraced lower with market expecting HKD liquidity to ease following HKMA's move to lower the CCyB ratio. The absence of massive outflows, seasonal factor and large IPO in the near term also helped to ease the HKD liquidity. ▪ However, US House approved Hong Kong bills including the "Hong Kong Human Rights and Democracy Act" last Tuesday and Senate is said to vote as early as this week. This seemed to spark concerns about capital outflows again and cap the downside of USDHKD forward swap points. Against the backdrop of low aggregate balance and uneven distribution of HKD liquidity in the banking system, a combination of outflow concerns, upcoming virtual bank launches, year-end effect and potential IPOs is expected to continue capping the downside of HIBORs. We hold onto our view that 1M HIBOR and 3M HIBOR will find support at 1.5% and 2.0% respectively in the near term. As such, though easing liquidity may keep USDHKD spot above 7.84, it may not push the currency pair to touch 7.85 anytime soon.
▪ Hong Kong: On top of the various measures to support the SMEs' funding needs, the HKMA has established the Banking Sector SME Lending Coordination Mechanism.	▪ During the first meeting, the HKMA clarified that if a bank proactively revises the repayment terms to support a borrower with overdue payments for a short period, and the revised repayment terms are "commercial", the loan to the borrower does not fall within the definition of 'rescheduled loan'. Accordingly, the bank need not categorise the loan as non-performing nor make any provision. A revision of repayment terms will generally be regarded as "commercial" if it does not involve a reduction in principal repayment, and the applicable interest rates of the loan are not substantially below prevailing market levels. ▪ The clarification about the definition of "rescheduled loan" seemed to have incentivised banks to extend credit to the SMEs. However, unless economic outlook improves, we still believe that only the SMEs with positive business outlook and strong fundamentals will be able to access bank loans in the near term.

Key Economic News

Facts	**OCBC Opinions**
▪ China's 3Q economic growth decelerated further to 6%, slightly below market expectation. However, China's three key economic indicators stabilized in September. Retail sales rebounded slightly to 7.8% yoy from 7.5% yoy in line with expectation though fixed asset investment decelerated slightly to 5.4% yoy in the first three quarters from 5.5% yoy in the first eight months. Industrial production rebounded strongly to 5.8% yoy from 4.4% yoy.	▪ First, property market was more resilient than initial expectation. China's property investment grew by 10.5% yoy in the first three quarters intact from previous month's reading despite tightening measures and falling land acquisition. Given land acquisition usually led China's property investment by 6-12 months, we still expect property investment to slow down further. Nevertheless, the rising investment in central and western China partially offset the decelerating investment growth in highly regulated eastern area. ▪ Meanwhile, China's medium to long term loan to household sector rose by CNY494 billion, highest since January 2019. The strong loan demand from household sector shows that

	demand for property market remained resilient. ▪ Second, manufacturing sector may find its bottom soon. China's manufacturing output rebounded from 4.3% yoy in August to 5.6% yoy in September. This is in line with the surprise rebound of September manufacturing PMI. We think the recent stabilization in China's manufacturing sector was mainly the result of supportive tax cuts and rebate. ▪ However, investments in China's manufacturing sector remained weak. For the first three quarters, fixed asset investment in manufacturing slowed down further to 2.5% yoy from 2.6% yoy, lowest since China started to publish the data from 2004. This weak investment sentiment could be mainly attributable to uncertain outlook on US-China trade war. However, the investments in high-tech manufacturing sector remained strong up by 12.6% yoy in the first three quarters. We expect the investments in high-tech manufacturing to keep its momentum in the coming months regardless the progress of the trade talk as profits of those high-tech companies are less sensitive to the global slowdown and trade war. As such, we expect manufacturing sector to bottom out soon. ▪ Third, China's infrastructure investment growth reaccelerated to 4.5% yoy in the first three quarters from 4.2% yoy, a sign that China's fiscal policy started to take effect. We have no doubt about China's commitment to support growth via fiscal policy. However, the key question hinges on China's capacity to roll out more fiscal policy, especially at local government level. On the positive news, China has unveiled more measures to allocate more revenue to local government. For example, the latest reform plan to redistribute the tax revenue between central and local governments will give local government more room to manoeuvre against the backdrop of economic slowdown and decline of land sales. ▪ Looking ahead, the slower than expected deceleration of property investment, bottoming out of manufacturing sector and reacceleration of infrastructure investment may provide some buffer to counter the impact of external uncertainties on Chinese economy. Together with the favourable base effect, we expect China's growth to maintain at 6% yoy in 4Q.
▪ China's CPI rose to 3% yoy in September, hitting 3% handle for the first time since November 2013, beating market expectation. ▪ PPI, on the other hand, fell by 1.2% yoy in September.	▪ The surge of CPI recently was mainly driven by rising pork prices due to the outbreak of African swine flu. Pork prices under the CPI component rose by 19.70% mom in September after expanding by 23.1% mom in August. China's CPI rose by 0.9% mom in September. Among the changes, 0.65% out of 0.9% came from the change of pork prices. ▪ Given the pork prices rose further by close to 20% in the first half of October according to the daily nationwide wholesale prices monitored by agriculture department, the pork prices may further create upward pressure on China's CPI in the coming sessions. We think there is risk for CPI to hit 4% in January 2020. ▪ Nevertheless, excluding pork prices. China's non-pork inflationary pressure remains modest. Core inflation, which excludes food prices and energy prices, only rose by 1.5% yoy

	in September, no change from August reading. This is also the lowest reading since April 2016. ▪ Service CPI fell by 0.1% mom in September despite the higher than expected headline reading. Together with the deeper negative reading of PPI, it seems disinflationary pressure and inflationary pressure coexists in China. ▪ This leads to a more complicated backdrop for monetary policy. Although the disinflationary pressure in producer prices argues for a easing monetary policy, the jump of headline CPI above government's target may give PBoC more reason to keep its modest policy reaction intact.
▪ China's credit expansion in September beat market expectation. New Yuan loan increased by CNY1.69 trillion, up from CNY1.21 trillion in August while aggregate social financing increased by CNY2.27 trillion, up from CNY2.017 trillion in August.	▪ The stronger than expected aggregate social financing was mainly the result of on-balance sheet lending. Total medium to long term loan increased by CNY1.058 trillion, much higher than the same period last year. Medium to long term loan to household sector rose by CNY494 billion highest since January 2019 while medium to long term loan to corporate sector rose by CNY563.7 billion highest since March 2019. The strong loan demand from household sector shows that demand for property market remained resilient despite China's tightening bias. In addition, the strong loan demand from corporate sector signals that China's previous counter cyclical measures may have started to generate the positive impact. ▪ Off balance sheet lending remained a drag on credit creation although the decline has narrowed recently. Entrusted loan fell by CNY2.1 billion, smallest single month decline since December 2017. However, trust loan fell by a high of CNY67.2 billion probably due to China's previous tightening on the use of trust for property financing. ▪ Meanwhile, China reclassified the aggregate social financing data adding enterprise ABS listed in the exchange to corporate bond subcomponent. However, we think the impact on the data is unlikely to be significant given the relatively small amount of ABS market. ▪ Looking ahead, China's social financing growth may decelerate slightly for three reasons. First, off-balance sheet lending is unlikely to rebound due to falling demand for non-standard investment products. Second, property market is expected to slow down further, which may affect the financing. Third, the issuance of special bond is also likely to slow down given most of the quota has been filled. Nevertheless, despite the weak prospect on credit expansion, the current resilient data is not strong enough to call for more monetary easing.
▪ Hong Kong's jobless rate stabilized at 2.9% in 3Q 2019 despite the weakening economic growth.	▪ The unemployment rate of retail, accommodation and food services sector rose to an over two-year high of 4.9% as the prolonged social incidents have hit hard on the retail, hotel and catering sectors. As social unrest shows no sign of termination, the business environment for these sectors is set to worsen further with their unemployment rate to continue going up. In contrast, the unemployment rate of trade sector kept static at 2.4%, despite trade war re-escalation in August. In early October, US and China reached the phase one trade deal. Whether this coupled with global monetary easing could help to revive external demand and ease downward pressure

	on HK's trade sector will be closely watched. Before the outlook is confirmed to worsen further, the trade sector's employers may not push the unemployment rate up drastically. For the financial sector, its unemployment rate reduced to 2.1% as the sector has not felt much pain from local social unrest. With the recent improvement in global risk appetite and the raft of local fiscal stimulus to support the financial and real estate markets, the financial sector's employment may remain resilient. In a nutshell, those sectors largely affected by local political turmoil will likely see their unemployment rate edging higher in the coming months. Meanwhile, overall hiring sentiments could soften on bleak economic outlook. However, overall jobless rates as a lagging indicator may still go up only moderately towards 3% and then 3.1% in the coming year.
▪ Macau's gross gaming revenue decreased for the third consecutive quarter by 4.1% yoy in 3Q 2019, the largest decline since 2Q 2016.	▪ This was mainly due to the weakness of VIP gaming sector (-22.5% yoy) which well offset the resilient growth of the mass-market segment (+18.7% yoy). Owing to the infrastructure improvement, tourism activities continued to mark growth with visitor arrivals increasing by 11.1% yoy during July and August. This thereby translated into a boost to the mass-market segment of the gaming centres. Combined with the significant contraction in high-roller demand amid China's economic slowdown, a weaker RMB and anti-money laundering policies, the percentage share of VIP gaming revenue in gross gaming revenue fell further to a record low of 43.9%. ▪ Though the casino operators' efforts to diversify the gaming center from over-reliance on high-roller demand, the mass-market segment seems unlikely to bring the gaming sector back to the good old days, probably due to the relatively low gaming mount of leisure gamblers. Moving ahead, visitor arrivals and Mainland visitors grew by 11.5% yoy and 9.4% yoy respectively during the Golden Week Holiday. This could have been a good start for the fourth quarter. However, we are concerned that the tourism growth will slow down due to a strong MOP, global economic slowdown and the spill-over effect of HK's social unrest. Therefore, we expect the growth of mass-market revenue will decelerate in 4Q while VIP gaming revenue will continue to drop. In conclusion, gross gaming revenue is expected to fall by around 2% in 2019.

RMB	
Facts	**OCBC Opinions**
▪ RMB underperformed amid the broad dollar weakness. RMB failed to appreciate against the dollar with the pair is supported at 7.05. RMB index slipped to 91 again.	▪ RMB's underperformance amid broad dollar weakness shows market's jittery about the progress of trade talk due to negative headlines. In the near term, RMB may remain the function of broad dollar movement.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W