OCBC TREASURY RESEARCH

Greater China – Week in Review

30 September 2019

Highlights

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

The impact of trade war news on market sentiment has been increasingly asymmetrical for the past two weeks. The positive trade talk headline news has no longer been the key driver to China's assets prices recently as the focus shifts to China's domestic policy reaction.

However, the negative news still moves the market. The initial optimism from Trump's comments about a possible deal was overshadowed by the surprising delisting news. Clearly, the recent US-China tension is no longer restricted to trade issue. We have already witnessed a technology war and a financial war is not unthinkable. Market will continue to digest this news this week though it has been denied by US Treasury officials.

Domestically, China's modest policy reaction to its economic slowdown has been a new parameter to the global market, which kept global risk sentiment in check. PBoC Governor Yi Gang explained last week in the joint press conference why China has been so prudent. There are two interesting takeaways. First, Yi reminded the market that China has laid out a 3-year plan to battle the financial risk in 2018. This year is the second year of this 3-year plan, which is very critical. Second, although Yi confirmed that there is still room for China to cut both interest rate and RRR, China prefers to saving the ammunition for future. Yi's speech has lowered the market expectation for imminent interest rate cut.

In its 3Q monetary policy meeting, China's central bank reckoned that the economy is facing rising downward pressure. The PBoC said it will step up its counter cyclical measures to support growth. China's Ministry of Finance announced to lower the standard loan provision coverage ratio for banks to 150% with the maximum loan provision coverage ratio being advised to be no more than 2 times the standard level. We think this new ruling shows China's commitment to proactive fiscal policy as the possible higher dividend payment from city commercial banks will help alleviate the pressure on local government funding.

For today, market will continue to assess the impact of trade war on Chinese economy via September PMI data ahead of the golden week holiday. China's Commerce Ministry confirmed that Liu He will go to the US after the golden week holiday to resume the talk on 10 Oct.

In **Hong Kong**, front-end liquidity tightened amid quarter-end effect and IPO effect. After National Daily Holiday, we expect both HIBOR and HKD to retrace lower. However, given the potential large IPOs, year-end effect and low aggregate balance, we expect the downside of HKD rates to be limited in the coming months. More notably, the HKMA has granted four new banking licenses and said some virtual banks will have a soft launch of some services in 4Q19. This means that the competition for funds among the banking system will be fiercer going forward, which could also cap the downside of HKD rates. **On the trade sector front**, exports and imports dropped for the tenth and ninth consecutive month respectively in Aug and may continue to fall in the coming two months given new tariff imposed from Sep as well as the high base amid front-loading activities during Jul to Oct 2018. Even though high base will abate from Nov and US has resumed trade talks with China, trade activities may still stay sluggish due to the new tariff to be imposed from Dec, sluggish demand at home and abroad as well as the largely affected electronic value chain in Asia. Market will monitor whether US Congress will pass the “Hong Kong Human Rights and Democracy Act” in the coming weeks as this could ultimately threaten HK’s status as a separate customs territory. **Elsewhere,** the government withdrew commercial land sale last week as the tendered premium did not meet the government’s reserve price for the site. JLL’s latest report also showed that the combined vacancy rate in HK’s main business districts rose above 3% for the first time in five years in Aug. This indicates that private investment could remain a main drag on economic growth in 3Q19.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ President Trump said that a trade deal with China could happen sooner than people thinks. He also said there is a good chance of reaching an agreement with China. ▪ Bloomberg reported last Friday that Trump administration is considering restricting the US investment in China including delisting Chinese companies from the US market. ▪ However, it was denied by a US Treasury official that there is no plan to stop Chinese companies from listing on US exchanges. ▪ China's Commerce Ministry confirmed that Liu He will visit the US after the golden week holiday and the talk will resume on 10 Oct.	▪ The initial optimism from Trump's comments about a possible deal was over shadowed by the surprising delisting news, which weighed down on risk sentiment on Friday. ▪ Clearly, the recent US-China tension is no longer restricted to trade issue. We have already witnessed a technology war and a financial war is not unthinkable. ▪ Nevertheless, we think market may have overacted to this news. The latest news shows that it may be part of the internal assessment on various options. It is far from a concrete measure. We don't think it will be the focus of the upcoming trade talk on 10 Oct.
▪ In its 3Q monetary policy meeting, China's central bank reckoned that the economy is facing rising downward pressure. The PBoC said it will step up its counter cyclical measures to support growth though it will keep prudent monetary policy intact and will not flood the economy with the excessive liquidity.	▪ Given China will continue to battle its financial risk, monetary policy is unlikely to be the key driver to support growth in the next two years. As such, China may rely more on fiscal policy as part of counter cyclical measures such as bringing forward next year's local government special bond quota to this year.
▪ In the joint press conference last week, PBoC Governor Yi Gang hinted that China is in no rush to ease its monetary policy aggressively.	▪ China's modest policy reaction to its economic slowdown has been a new parameter to the global market, which kept global risk sentiment in check. PBoC Governor Yi Gang explained last week in the joint press conference why China has been so prudent. There are two interesting takeaways. First, Yi reminded the market that China has laid out a 3-year plan to battle the financial risk in 2018. This year is the second year of this 3-year plan, which is very critical. Second, although Yi confirmed that there is still room for China to cut both interest rate and RRR, China prefers to saving the ammunition for future. Yi's speech has lowered the market expectation for imminent interest rate cut.
▪ China's Ministry of Finance announced to lower the standard loan provision coverage ratio for banks to 150% with the maximum loan provision coverage ratio being advised to be no more than 2 times the standard level.	▪ China's banking shares surged as a result of this new rule as the excessive loan provisions will be treated as unallocated profits. From macro perspective, we think this new ruling shows China's commitment to proactive fiscal policy as the possible higher dividend payment from city commercial banks will help alleviate the pressure on local government funding given local governments are usually the key shareholders for banks.
▪ The retail book of Budweiser's IPO was closed on 23rd Sept and was oversubscribed by 2.56 times.	▪ As the response has not be very strong, HKD liquidity eased across the curve with USDHKD forward swap curve collapsing. 1M HIBOR and 3M HIBOR also tumbled to 1.86% and 2.24% last Wednesday respectively before rebounding to 1.89% and 2.25% last Friday respectively amid quarter-end effect and IPO effect (locked-up money will not return to the market before IPO is launched on 30th Sep). ▪ Deloitte, one of the Big Four auditors, expects that there will be 98 IPOs in Hong Kong during the first three quarters with the total IPO proceeds falling by 49% yoy to about HK$124.8

	billion. Thanks to the return of Budweiser's IPO, Hong Kong will be the third largest IPO market in the world. According to Deloitte, as a raft of large IPOs have been approved by the HKEX, the total IPO proceeds are expected to reach at least HK$180 billion. ▪ After National Daily Holiday, we expect both HIBOR and HKD to retrace lower. However, given the potential large IPOs ahead, coupled with year-end effect and low aggregate balance, we expect the downside of HKD rates to be limited in the coming months. More notably, the HKMA approved the upgrading of the restricted banking license of Morgan Stanley Asia International Limited to a banking license, and has granted banking licenses to Qatar National Bank, Ping An Bank Co., Ltd. and Hua Xia Bank Co., Limited. As a result, the number of licensed banks will be increased to 164. Besides, HKMA said some virtual banks will have a soft launch of some services in 4Q19. This means that the competition for funds among the banking system will be fiercer going forward, which could also cap the downside of HKD rates. As such, limited USD-HKD yield differential coupled with cautious carry trade mean slim chance of USDHKD touching 7.85 in the near term.
▪ Hong Kong government withdrew commercial land sale last week. The government rejected all the five bids as the tendered premium did not meet the government's reserve price for the site. ▪ The latest report of Jones Lang LaSalle (JLL), an American commercial real estate services firm, showed that the combined vacancy rate in Hong Kong's main business districts rose above 3% for the first time in five years in August amid soft leasing demand.	▪ With business sentiments dented heavily by the ongoing social unrest and US-China trade war, commercial property market took a hit lately. This indicates that private investment could remain a main drag on economic growth in 3Q19. On the other hand, according to 2019-20 Budget, the government estimated that land premium will reach HK$143 billion and take up 22.8% of total government revenue. However, due to the latest correction in real estate market, land premium has totalled HK$42.3 billion during Apr to Sep 2019, much lower than estimate. Adding that the government rolled out one-off relief measures in Aug, it is very likely for the fiscal balance to see the first deficit since 2003-04. This however 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.
▪	▪

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong's exports (-6.3% yoy) and imports (-11.1% yoy) dropped for the tenth and ninth consecutive month respectively in Aug. ▪	▪ Zooming in, exports to Mainland China and the US continued to fall by 5.2% yoy and 8.8% yoy respectively. Imports from Mainland China and the US also tumbled by 12.5% yoy and 16.1% yoy respectively. Different from the same period last year, exporters in both US and China seemed to have not front-loaded much orders before both sides imposed new tariff from 1st September. As such, the high base amid front-loading activities during July to October 2018 resulted in continuous decrease in both exports and imports. This may

	persist into the coming two months. ▪ More notably, total exports to Asia as a whole dropped by 4.8% yoy in Aug. Also, imports from all ten major partners plunged in Aug. As such, even though high base will abate from Nov and US has resumed trade talks with China, trade activities may still stay sluggish due to the new tariff to be imposed from December, sluggish demand at home and abroad as well as the largely affected electronic value chain in Asia. In conclusion, we hold onto our view that both exports (-4.2% yoy during the first eight months) and imports (-6% yoy during the first eight months) will register single-digit decrease for 2019 as a whole. Hong Kong Trade and Development Council also lowered the forecast on HK's export growth from +2% to -4%. ▪ Elsewhere, should the "Hong Kong Human Rights and Democracy Act" get passed by US Congress in the coming weeks, it may result in change to the "US-Hong Kong Policy Act" which could deprive Hong Kong of the status of separate customs territory and the right to import sensitive technologies from the US. Though HK's exports to US merely took up 8.4% of its total exports, it is still of a concern as other countries could be prompted to amend their policy with HK and HK port has mainly shipped high-tech products (taking up 65.3% of total trade in HK).
▪ Macau: total visitor arrivals grew at the slowest pace since September 2018 by 6.5% yoy in August, despite summer holiday effect.	▪ Same-day visitors continued to register double-digit growth and increased by 20.2% yoy whereas overnight visitors dropped for the first time since July 2015 by 5.8% yoy. As such, the percentage share of same-day visitors in total visitors climbed further to 53.2%. More notably, visitor arrivals by land continued to surge by 33.7% yoy with 16.3% travelling via Hong Kong-Zhuhai-Macau Bridge. This reinforces that infrastructure improvement continued to lend supports to the same-day tourism of Macau. ▪ By source of visitors, tourists from Hong Kong increased further by 19.7% yoy. Due to the social unrest in Hong Kong which affected the operation of airport, potential outbound tourists might have preferred short trip like visiting Macau. That said, the political turmoil in Hong Kong still has some negative spill-over effect on Macau's tourism. Specifically, for those who plan to visit Hong Kong and Macau at the same time, the prolonged protests in Hong Kong might have propelled them to cancel the whole trip. As such, tourists from Japan and South Korea decreased notably by 14% yoy and 5% yoy respectively. Besides, the number of Mainland visitors advanced at the slowest rate since January 2018 by 4.7% yoy while that of Mainland visitors travelling under the Individual Visit Scheme dropped by 1.3% yoy, mainly due to China's economic slowdown and a weaker RMB against MOP. Furthermore, the lack of new entertainment project openings and the high accommodation costs might have trimmed the incentives for the visitors to stay overnight as well. ▪ On a positive note, visitor arrivals increased by 12.8% yoy during the Mid-Autumn Festival in late September. Meanwhile, inbound tourism may benefit from the Golden

	Week Holiday in early October and the infrastructure improvement. In a nutshell, we expect same-day visitors to sustain strong growth in the coming months. However, the growth of total visitor arrivals may remain moderate due to China's economic slowdown, a strong MOP and spill-over effect of Hong Kong's
▪ Macau's unemployment rate remained unchanged at 1.8% for the three months through August.	▪ By industry, the employed population in gaming sector and that in hotel sector continued to increase by 0.7% yoy and 2.3% yoy respectively. This may be attributed to the resilient tourism activities and mass-market gaming activities. However, the employed population in the retail sector and that in the restaurant sector dropped for the seventh and sixth consecutive three-month period respectively by 1.6% yoy and 2.4% yoy. This was mainly due to the tepid hiring sentiments of these sectors whose outlook has been clouded by the weak consumption sentiments of local households and visitors. Worse still, in the absence of much private or public projects under construction, the employed population in the construction sector decreased for the fourth three-month period by 9.7% yoy. ▪ Going forward, the hiring sentiments of retail, restaurant and construction sectors are expected to stay sluggish. More notably, both tourism and gaming sectors seemed to have been affected by a strong MOP, China's economic slowdown and the spill-over effect of HK's social unrest. This will continue to cloud Macau's economic outlook and weigh on the labour market. As a lagging economic indicator, unemployment rate may be sticky at 1.8% in the near term. That said, we expect the jobless rate will inevitably move towards 1.9% and then 2% in the coming year.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened against the dollar last week with the USDCNY rose to 7.12 range. However, RMB index rebounded as a result of stronger than expected RMB fixing.	▪ RMB's weakness against the dollar last week was mainly the result of strong dollar. In addition, the concern about the trade talk prospect also kept RMB in check.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W