Greater China – Week in Review

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Highlights

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Although the world has gone through a few rounds of major virus outbreak in the past two decades including SARS, MERS, Ebola and Zika etc, the uncertainty about its transmission and virulence has prompted more and more countries to impose entry restrictions to foreign nationals who have been to mainland China for the past 14 days. Meanwhile, more airlines reduced or suspended their flights to China. It is the first time since the end of cold war that the cross-border people movement has been largely stopped for the world's second largest economy.

Although most analysts agreed it is too early to estimate the impact of 2019 nCoV on the global economy, one thing I am increasingly more certain is that the near-term shock to Chinese economy will be much higher than that in SARS period. To recall, the impact of SARS outbreak on Chinese economy in 2003 was mainly on travel and consumption related service sectors while the impact on industrial sectors and exports were limited. However, there is no luck this time for Chinese industry sectors. The shock to Chinese manufacturing and industry sectors are likely to be unprecedented.

Here is why.

Although China only officially locked down most parts of Hubei Province, China is unofficially in self-quarantine mode now. This self-quarantine has happened in each condo in the city and village in the rural areas.

The most significant impact of the virus outbreak as of now appeared to be the breakdown of trust among strangers. All the villages and condos have literally become a self-ruling community even though the police has said it is illegal to block the entrance to the village. No outsiders are allowed to enter. This not only happens in Wuhan and rural areas in Hubei but in big cities like Shanghai and Beijing as well.

For some migrant workers who want to return to big cities to restart work after the extended Chinese New Year holiday, they may find themselves unwelcomed to return to their rental apartment. Some may be outright turned away by the community. I think it will still take some time for the whole community to sort it out how they want to overcome their fears to welcome their old neighbours who returned from their hometown.

For most cities, the Chinese New Year holiday has been extended to 9 February. The factory and company will only restart from 10 February assuming no further deterioration of virus outbreak. This is the 17th day of Chinese New Year, which will be later than usual. What's more, most migrant workers who returned to work will be forced to take leave of absence for 14 days. As such, most manufacturers in China will face two near term challenges including first whether their workers are able to return and second they still need to pay for their unproductive workers for two weeks before they can come back to office or factory. As such, there is high chance that we will see China's industrial production to fall sharply in February, which will affect the whole value chain in the region.

The pressure faced by China's industry sectors could be unprecedented other than already stalled service sectors. Whether this shock is temporary or permanent will depend on when will the peak come Although I don't have the expertise to forecast the turning point, I think we may still draw some insights from the daily briefing from China's Health Commission in both central and local level. That's why we have constructed a daily monitor system on all available data from the Health Commission.

Please refer to our daily Wuhan coronavirus monitor for the latest update. Based on the data from 1 February, we have four takeaways.

First, although the fatality rate in Wuhan has decline marginally to 5.5% as of 1 Feb, it remained high. The latest academic paper published by Chinese scientist showed that the Huanan seafood market may not be the only source of virus as the initial study of first batch of 41 infected patients show that not all had the exposure to the market. As such, it may be important for scientist to identify other sources if there is.

Second, the number of cases in other parts of Hubei province outside Wuhan has risen at a rapid pace, which has surpassed the number of cases in Wuhan. As most of resources have been dedicated to Wuhan, there is rising risks that outbreak in other parts of Hubei province may deteriorated. This may complicate China's battle against the virus.

Third, on the positive note, the daily increase of number of confirmed cases in other parts of China excluding Hubei has slowed down for two consecutive days. This shows that city lockdown may help alleviate the pace of transmission.

Fourth, the fatality rate outside Hubei province was at 0.2% much lower than that in Wuhan. This suggested that the virus may have mutated to a less potent form during the continuous transmission. This may help contain the initial fear in public.

Let's pray for those infected. Hopefully, China's unprecedented reaction may be met by a preferred outcome that the outbreak will peak around mid-Feb and dialled down gradually after that. Clearly, the next one week will be the most crucial moment to gauge whether the turning point is around the corner as the 14-day incubation period will expire on about 6-8 February.

China cut its 7-day reverse repo rate and 14-day reverse repo rate by 10bps in reaction to the sharp sell-off of China's equity market this morning. The rate cut shows China's central bank remained flexible. Although it may be too early to argue that China's monetary stance has changed, we think the priority of monetary policy has clearly shifted to support the growth. Given the near-term shock to Chinese economy is likely to be higher than that during the SARS outbreak, it is time for China's monetary policy to play a part.

In **Hong Kong,** the trade performance of Hong Kong improved in December 2019, amid easing US-China trade war risks and low base effect. The exports reversed the downtrend and grew by 3.3% yoy in December while the decline of imports narrowed to 1.9% yoy during the same period. Moving forward, as the first stage US-China trade deal signed in January 2020 restoring the trade and investment sentiments gradually, in addition to dissipating high base effect, we believe that the overall trade performance of Hong Kong might improve in the coming months. Nevertheless, with the outbreak of Wuhan coronavirus, the trade activities with China might deteriorate significantly, in turns weighing on the overall trade performance of Hong Kong. Hong Kong's total loans and advances grew by 6.73% yoy in December 2019. Despite that the HK's trade performance improved in December, with total trade reversing the downtrend and picking up by 0.5% yoy, the trade finance dropped by 0.7% yoy. Moving forward, with easing US-China trade war risks, restoring the trade sentiment gradually, trade finance might improve in January. Nevertheless, we will keep monitoring the impacts of coronavirus on HK's trade performance in the coming months. The loans for use in Hong Kong (excluding trade finance) accelerated to 7.7% yoy, amid easing US-China trade war risks and local social unrest in December, improving the local loan demands. Meanwhile, new mortgage loans picked up by 13.21% yoy in December and drove up the overall loans for use in Hong Kong. In a nutshell, we expect the growth of total loans and advances to see single-digit year-on-year growth in the first half of 2020. HKD loan-to-deposit ratio rebounded to 90.3% in December 2019 as Hong Kong-dollar deposits declined while Hong Kong-dollar loans stayed unchanged. Moving forward, we expect that the current trend of HKD deposit's distribution might persist in the coming months. As HKD interest rates remained relatively strong in January, it might continue to provide incentives for depositors to hold more HKD fixed deposits. Nevertheless, the percentage share of HKD deposit's composition is unlikely to have drastic change.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's central bank said on Sunday ahead of market opening that it will inject CNY1.2 trillion liquidity into the system on Monday via open market operation to ensure liquidity is "reasonably ample" during the outbreak. ▪ On Monday, China cut its 7-day reverse repo rate and 14-day reverse repo rate by 10bps in reaction to the sharp sell-off of China's equity market.	▪ It is all about market sentiment. The rare preview of liquidity injection is a way to calm market sentiment. ▪ Nevertheless, the amount of net injection is not huge given almost CNY1.18 trillion previous injections will mature this week. ▪ The rate cut shows China's central bank remained flexible. Although it may be too early to argue that China's monetary stance has changed, we think the priority of monetary policy has clearly shifted to support the growth. Given the near term shock to Chinese economy is likely to be higher than that during the SARS outbreak, it is time for China's monetary policy to play a part.

Key Economic News	
Facts	**OCBC Opinions**
▪ The trade performance of Hong Kong improved in December 2019, amid easing US-China trade war risks and low base effect. The exports reversed the downtrend and grew by 3.3% yoy in December while the decline of imports narrowed to 1.9% yoy during the same period.	▪ By country, the growth of exports to China and Taiwan strengthen to 15.7% yoy and 7.8% yoy respectively while the exports to USA remained sluggish, continuing to drop by 22.5% yoy. In terms of imports, imports from Taiwan and South Korea remained robust, growing for the fourth and second consecutive month respectively. Nevertheless, the imports from China and USA dropped by 4.9% yoy and 21.6% yoy respectively. ▪ Supported by easing concerns over US-China trade war risks, the Asian electronic supply chain showed signs of recovery gradually. Specifically, the imports of electrical machinery, apparatus and appliances, and electrical parts thereof reversed the downtrend and grew by 11.4% yoy in December while the exports of the above items grew by the second consecutive month. ▪ Moving forward, as the first stage US-China trade deal signed in January 2020 restoring the trade and investment sentiments gradually, in addition to dissipating high base effect, we believe that the overall trade performance of Hong Kong might improve in the coming months. Nevertheless, with the outbreak of Wuhan coronavirus, the trade activities with China might deteriorate significantly, in turns weighing on the overall trade performance of Hong Kong.
▪ Hong Kong's total loans and advances grew by 6.73% yoy in December 2019.	▪ Despite that the HK's trade performance improved in December, with total trade reversing the downtrend and picking up by 0.5% yoy, the trade finance dropped by 0.7% yoy. Moving forward, with easing US-China trade war risks, restoring the trade sentiment gradually, trade finance might improve in January. Nevertheless, we will keep monitoring the impacts of coronavirus on HK's trade performance in the coming months. The loans for use in Hong Kong (excluding trade finance) accelerated to 7.7% yoy, amid easing US-China trade war risks and local social unrest in December, improving the local loan demands. Meanwhile, new mortgage loans

	picked up by 13.21% yoy in December and drove up the overall loans for use in Hong Kong. Loans for use outside of Hong Kong decelerated to 5.8% yoy. We expect the growth of loans for use outside of Hong Kong might continue to remain moderate. Amid the concerns over Wuhan coronavirus' s impacts on China economy, market expect that PBoC might impose more accommodative polices to relieve the downside risks. With the expectations of lower onshore borrowing costs, it might reduce the incentives for those Chinese enterprises to have offshore loans. In a nutshell, we expect the growth of total loans and advances to see single-digit year-on-year growth in the first half of 2020.
▪ HKD loan-to-deposit ratio rebounded to 90.3% in December 2019 as Hong Kong-dollar deposits declined while Hong Kong-dollar loans stayed unchanged.	▪ HKD deposits grew by 2.5% yoy in December, thanks to the easing US-China trade war risks and local social unrest during the same period. With the improved risk appetite, Hang Seng Index grew by nearly 7% compared to November 2019. Specifically, in terms of the composition of HKD deposits, the percentage share of HKD CASA deposits dropped further to 53.5%, the lowest level since 2009, while the percentage share of HKD fixed deposits edged up to 46.5%. The amount of HKD CASA deposits and HKD fixed deposits stayed virtually unchanged in terms of month-on-month comparison. Given higher HKD interest rates in December (1-month HIBOR picking up to 2.66%), depositors tended to transfer those CASA deposits to fixed deposits, in order to seek for higher returns. ▪ Moving forward, we expect that the current trend of HKD deposit's distribution might persist in the coming months. As HKD interest rates remained relatively strong in January, it might continue to provide incentives for depositors to hold more HKD fixed deposits. Nevertheless, the percentage share of HKD deposit's composition is unlikely to have drastic change.
▪ Hong Kong's RMB deposits decreased by 0.9% mom to RMB632.2 billion in December.	▪ The decline of RMB deposits might be attributed to strong performance of onshore financial market of China during the same period, lowering the incentives for investors to hold offshore RMB assets. Moving forward, the growth of Hong Kong's RMB deposit might remain mild as weaker RMB in January might lower the incentives for investors to hold RMB assets. Overall speaking, we expect Hong Kong's RMB deposits to stand above RMB600 billion in the coming months.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened with the USDCNY broke 7 this morning.	▪ The near-term outlook of the currency will largely depend on the prospect of the development of disease outbreak.

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