Greater China – Week in Review

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Highlights

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Dick Yu
Dicksnyu@ocbcwh.com

China kicked off 2020 with major announcements from its key financial regulators. China's banking and insurance regulator unveiled the guideline to further develop the sectors covering hot topics such as prevention of financial risk, further opening of domestic financial market as well as initiatives to bring down the funding costs for the real economy. Chinese regulators said they plan to handle default risk via multiple channels including direct restructuring, M&A, setup of special funds and bridge bank as well as bringing in new investors with the bridge bank is relatively a new concept. We will find out more about this bridge bank.

Meanwhile, in its working conference on 2-3 January, PBoC reiterated to keep its monetary policy prudent with new element of "flexibility" as first mentioned in China's Economic Working Conference in December 2019. This suggests that China's monetary policy will be more sensitive to the downside risk. However, given China will not flood the economy with excessive liquidity, there is no room for China to ease its monetary policy aggressively.

In addition, PBoC announced to expedite the adoption of new Loan Prime Rate (LPR). The green light to allow the repricing of existing loan to LPR is likely to bring down the overall funding costs to the real economy as LPR is expected to decline further in 2020 in particular after China cut the RRR effective from 6 January. This is likely to support overall economic sentiment.

China's announcement on RRR cut on 1 January did not come as a big surprise as market has speculated the cut since mid-December due to estimated liquidity gap in January. The speculation was reinforced by Premier Li Keqiang's comments about the RRR cut on 23 December during his working trip to Sichuan province.

China's equity market rose on the back of RRR cut news while China's bond market failed to respond to that with yields actually went up in the first trading day of 2020. The divergent performance between equity market and bond market was mainly due to different focus as equity investors tend to focus more on attitude of the central bank while bond investors are more sensitive to magnitude.

The CNY800 billion liquidity injection is not enough to cover estimated CNY3 trillion liquidity gap due to earlier Chinese New Year, heavy issuance calendar and tax payment factors. Given the large liquidity gap in January, we expect PBoC to roll out more counter cyclical measures to fill the gap to ensure liquidity remains reasonable and adequate.

On currency, China announced to revise the weights of RMB index effective from 2020 based on the trade structure in 2018. Weights of USD, JPY, HKD, SGD and GBP will be revised down while weights of EUR, AUD, RUB and MXN will be revised higher. On implication, although dollar's weights have been lowered via both USD and HKD, the direct impact of dollar performance on RMB did not change much. In particular, the impact on RMB's fixing is limited based on our estimation.

In **Hong Kong,** the decline of exports and imports narrowed to 1.4% yoy and 5.8% yoy respectively in November, amid easing trade tensions between US and China and dissipating high base effect. As the high base effect dissipated starting from November, in addition to US-China first-stage trade deal achieved in December, it might help to improve the trade performance of Hong Kong. Nevertheless, as the trading sentiments might need some time to restore, therefore, the trading activities of Hong Kong might be still under pressure in the near term. All in all, we expect exports and imports to see single-digit negative growth in whole 2019. Meanwhile, retail sales plunged by 23.6% yoy in November. Moving forward, we expect retail sales to continue showing double-digit year-on-year decline in the coming months. We hold onto our view that retail sales will drop by 10% in whole 2019. This might further push up the unemployment rate of the retail sector. HKD loan-to-deposit ratio edged lower to 90% in November. Moving forward, we expect that the current trend of HKD deposit's distribution might persist in the coming months. As HKD interest rates continued to pick up in December, it might provide incentives for depositors to hold more fixed deposits. Nevertheless, the percentage share of HKD deposit's composition is unlikely to have drastic change. **In Macau,** unemployment rate dropped to 1.7% during the three-month period from September to November. Moving forward, as domestic economic outlook has been clouded by external uncertainties, the labor market of Macau might soften. Therefore, we hold onto our view that overall unemployment rate will climb gradually towards 1.9% and even 2% in 2020. Gaming revenue dropped for the third consecutive month by 13.7% yoy in December, the most since Mar 2016, amid negative spill-over effects from recent social unrest of HK, weaker RMB against MOP. We expect that the downtrend of gaming revenue growth might persist in the coming months.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's banking and insurance regulator unveiled the guideline to further develop banking and insurance sectors in the beginning of 2020.	▪ The key purpose of the new guideline is to encourage financial sectors to support the real economy and contain the systemic risk while improving the structure for the sectors. ▪ The new guideline encourages foreign banks to enhance cooperation with headquarters to further develop financial products such as trade finance, SME financing, commodity financing and wealth management to Chinese market. Meanwhile, foreign banks are also encouraged to open its branches in less developed areas such as central China, western China and northeastern China. ▪ Banks and insurance companies are also encouraged to further support the development of direct financing in China and increase the share of direct financing in China's total financing. ▪ Meanwhile, China will step up its support to strategic important industry and advanced manufacturing industry via medium to long term loan. ▪ On prevention of systemic risk, China's regulator will handle the risk via multiple channels including direct restructuring, M&A, setup of special funds and bridge bank as well as bringing in new investors.
▪ China's central bank concluded its 4Q monetary policy meeting on 27 December 2019 and held the working conference in the beginning of January setting the tone for 2020.	▪ PBoC reiterated to keep its monetary policy prudent with new element of "flexibility" as first mentioned in China's Economic Working Conference in December 2019. This suggests that China's monetary policy will be more sensitive to the downside risk. However, given China will not flood the economy with excessive liquidity, there is no room for China to ease its monetary policy aggressively. As such, we expect PBoC will continue to rely on its counter-cyclical measures such as open market operation, MLF and TMLF etc to balance the growth and preventing risks.
▪ PBoC announced at the end of 2019 to expedite the adoption of new Loan Prime Rate (LPR). ▪ From 2020, all new loans will be priced in LPR while for the existing loans, borrowers will have the option to covert its floating rate reference to benchmark interest rate to either floating rate benchmarked to LPR or fixed interest rate from March to August 2020. ▪ However, interest rate for housing loan will remain unchanged initially.	▪ The repricing of loan using LPR reinforced LPR's role as the key benchmark interest rate going into 2020, which pave the way for China to move towards a market-based interest rate system. ▪ In addition, the green light to allow the repricing of existing loan to LPR is likely to bring down the overall funding costs to the real economy as LPR is expected to decline further in 2020 in particular after China cut the RRR effective from 6 January. This is likely to support overall economic sentiment. ▪ Although mortgage rate will be kept unchanged in 2020 as part of China's commitment to property tightening measures, mortgage rate is likely to go down from 2021 should LPR decline as expected in 2020.
▪ China accounted to cut its Reserve Requirement Ratio (RRR) effective from 6 January. The RRR cut is expected to unfreeze about CNY800 billion liquidity into the system.	▪ The RRR cut did not come as a big surprise as market has speculated the cut since mid-December due to estimated liquidity gap in January. The speculation was reinforced by Premier Li Keqiang's comments about the RRR cut on 23 December during his working trip to Sichuan province. ▪ China's equity market rose on the back of RRR cut news while China's bond market failed to respond to that with yields

	actually went up in the first trading day of 2020. The divergent performance between equity market and bond market was mainly due to different focus as equity investors tend to focus on attitude of the central bank while bond investors are more sensitive to magnitude. Clearly, the RRR cut in the beginning of the year is considered as positive attitude to support growth. However, the magnitude of RRR cut was smaller than expectation. The CNY800 billion liquidity injection is not enough to cover estimated CNY3 trillion liquidity gap due to earlier Chinese New Year, heavy issuance calendar and tax payment factors. ▪ Overall, we think the RRR cut is still within China's prudent monetary policy framework. Given the large liquidity gap in January, we expect PBoC to roll out more counter cyclical measures to fill the gap to ensure liquidity remains reasonable and adequate.
▪ China announced to revise the weights of RMB index effective from 2020 based on the trade structure in 2018. Weights of USD, JPY, HKD, SGD and GBP will be revised down while weights of EUR, AUD, RUB and MXN will be revised higher.	▪ This was the second revision since China introduced the concept of RMB index in 2016. As compared to the first revision in 2017 when China expanded the number of currencies in the basket to 24 from 13, the revision this time only changed the weights of each currency marginally to better reflect China's trade structure. ▪ On implication, although dollar's weights have been lowered via both USD and HKD, the direct impact of dollar performance on RMB did not change much. In particular, the impact on RMB's fixing is limited in our opinion.
▪ China announced a new appointment as the head of its Hong Kong Liasion Office. Former Party chief in Shanxi province Luo Huinin will replace outgoing Wang Zhimin as the new chief.	▪ Although the 65-year Luo has no prior experience related to Hong Kong, his latest experience in coal-rich Shanxi province to restore the political system, which was broken down by massive corruption scandal, may add value to his new position.
▪ As part of China's commitment to further open its domestic financial market, China's Ministry of Finance will remove restrictions for foreign banks to underwrite local government bonds.	▪ With the rising demand for local government financing, the involvement of foreign banks will help broaden channels of investor base.
▪ Last Friday, HKD spot advanced to the strongest level since May 2017, despite that year-end factor dissipated. It might be driven by the rise of USDHKD forward points.	▪ In terms of HIBOR, due to the year end-factor, overnight HIBOR fixing jumped to the highest level in 2019 at 4.5623% on 31 Dec 2019 while 1-month HIBOR fixing stood above the level of 2.7% on 30 Dec 2019. The tighter front-end HKD liquidity eased after the subsided year-end factor, with 1-month HIBOR fixing declining to the lowest level since 27 Nov 2019 at 2.14% on 3 Jan. ▪ Moving forward, we expect 1-month and 3-month HIBOR might stabilize at 2.2% and 2.4% respectively in the near term. The USDHKD spot might keep the two-way movements and return to the level above 7.80 gradually.

Key Economic News	
Facts	**OCBC Opinions**
▪ It was tipped by Reuters that China is likely to keep its annual inflation target at 3% unchanged despite the recent rise of CPI in the second half of 2019.	▪ China's CPI is expected to reach 5% in the beginning of 2020 as a result of higher pork prices. The intact of inflation target shows that China expects the structural inflation problem to

	taper gradually in the second half of 2020. Although some people called for a higher inflation target to give policy makers more room to support the growth, the intact of inflation target does not mean a tightening policy bias in our opinion.
▪ Hong Kong's total loans and advances continued to grow by 7% yoy in November.	▪ Trade finance grew by 1% yoy in November, thanks to easing high base effect and improving trading activities during the same period (the decline of total trade narrowed to 3.7% yoy). The loans for use in Hong Kong (excluding trade finance) decelerated to 6.4% yoy. With positive expectations of US-China trade talks, it may help to partially offset the impact of local social unrest on local loan demand. Nevertheless, mortgage demand weakened in November as new mortgage loans dropped by 4.99% yoy during the same period, which weighed down the loans for use in Hong Kong (excluding trade finance). Loans for use outside of Hong Kong picked up by 9.4% yoy. Nevertheless, the growth of loans for use outside of Hong Kong may not strengthen much further in the coming months. PBoC will cut the required reserve ratio by 50 bps starting from 6 January. 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 2019.
▪ HKD loan-to-deposit ratio edged lower to 90% in November as Hong Kong dollar deposits decreased at a slower pace than Hong Kong dollar loans.	▪ Despite the prolonged social unrest, it had only limited impacts on HKD deposits. The growth of HKD deposits accelerated to 3.2% yoy in November. It might be supported by improved risk appetite, with more IPOs returning with some seeing positive response (including Alibaba's secondary listing in HK) during the same period. Specifically, HKD CASA deposits dropped by 1.6% in terms of month-on-month comparison while HKD fixed deposits increased by 1.7% mom. In terms of the composition of HKD deposits, the percentage share of HKD CASA deposits dropped further to 53.8%, the lowest level since 2009, while the percentage share of HKD fixed deposits edged up to 46.2%. Given higher HKD interest rates in November, 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 continued to pick up in December, it might provide incentives for depositors to hold more fixed deposits. Nevertheless, the percentage share of HKD deposit's composition is unlikely to have drastic change.
▪ Hong Kong's RMB deposits increased by 0.2% mom to RMB637.8 billion in November.	▪ We expect the growth of RMB deposits might persist, amid two reasons. Firstly, supported by the US-China first stage trade deal achieved in December, RMB strengthened accordingly. Secondly, PBOC is expected to keep neutral monetary policy stance. Therefore, we expect Hong Kong's RMB deposits to remain resilient above RMB600 billion in the coming months.
▪ The decline of HK's exports and imports narrowed to 1.4% yoy and 5.8% yoy respectively in November, amid easing trade tensions between US and China and dissipating high base effect.	▪ By country, the performance of exports was mixed. The exports to China rebounded by 5.2% yoy in November while exports to US continued to drop by -23.7% yoy. In terms of imports, the situation remained sluggish. The imports from

	China and US dropped by the eighth and sixth consecutive months by -7.8% yoy and 11.5% yoy respectively in November. On the positive notes, the trading activities with Taiwan remained robust in November, with the exports and imports picking up for the seventh and third consecutive month respectively observed. ▪ As the high base effect dissipated starting from November, in addition to US-China first-stage trade deal achieved in December, it might help to improve the trade performance of Hong Kong. Nevertheless, as the investment and trading sentiments might need some time to restore, therefore, the trading activities of Hong Kong might be still under pressure in the near term. All in all, we expect exports and imports to see single-digit negative growth in whole 2019.
▪ Hong Kong retail sales plunged by 23.6% yoy in November.	▪ Internally, the retail sales of food, alcohol drinks and tobacco continued to drop by 11% yoy while the retail sales of clothing, footwear and allied products declined by 31.8% yoy. Nevertheless, the retail sales of those of goods in supermarket picked up by 2.6% yoy. Despite that, affected by concerns over faltering outlook of local economy and retrenchment, the domestic consumption sentiment is expected to remain weak. Externally, the retail sales of jewellery, clocks and watches and goods in department stores continued to plummet by 43.5% yoy and 32.9% yoy respectively. Sluggish tourist spending might be attributed to two reasons. Firstly, the visitor arrivals plunged by 56% yoy in November. Secondly, amid the prolonged local social unrest, the normal operation of shopping malls has been affected during the weekend, in turns weakening the retail sales of the goods in department stores. ▪ Moving forward, we expect retail sales to continue showing double-digit year-on-year decline in the coming months. We hold onto our view that retail sales will drop by 10% in whole 2019. This might further push up the unemployment rate of the retail sector and weigh down the retail shop property market.
▪ Macau's gaming revenue dropped for the third consecutive month by 13.7% yoy in December, the most since Mar 2016. The weaker gaming performance might be attributed to several unfavorable factors, including negative spill-over effects from recent social unrest of HK, weaker RMB against MOP, uncertain economic outlook of Asia including China and lingering policy risks related to money laundering.	▪ Moving forward, we expect that the downtrend of gaming revenue growth might persist in the coming months. Firstly, as the social movement in HK is expected to persist, combined with stronger MOP, the negative spill-over effects might continue to cumbrance the growth of Macau's tourism and the mass-market segment of gaming industry. Secondly, economic deceleration of China and unceasing the policy risks related to money laundering might may weigh on the VIP segment
▪ Macau's unemployment rate dropped to 1.7% during the three-month period from September to November, with the employed population increasing from 387300 to 387600.	▪ Delving into details, due to the robust growth of visitor arrival in September and October, it lent supports to the gaming and hotels and restaurants sectors, in turns driving up the labor demands. Therefore, the employed population of gaming and hotels and restaurants sectors increased by 3% yoy and 0.2% yoy respectively. Nevertheless, the employed population of construction sector continued to drop for the seventh consecutive three-month period by 3.1% yoy, amid lack of new mega entertainment and infrastructure projects under construction.

	▪ Moving forward, as domestic economic outlook has been clouded by external uncertainties, the labor market of Macau might soften. Therefore, we hold onto our view that overall unemployment rate will climb gradually towards 1.9% and even 2% in 2020.

RMB	
Facts	**OCBC Opinions**
▪ RMB consolidated against both dollar and basket in the beginning of 2020 pending on the development of trade deal.	▪ The pair may depend on the news flow on trade deal as well as the development of global risk sentiment as dollar typically benefit from the rising risk off sentiment.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W