Greater China – Week in Review

13 January 2020

Highlights

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Dick Yu
Dicksnyu@ocbcwh.com

China's bond market outperformed last week on the back of softer December inflation reading. CPI remained intact at 4.5% yoy while PPI fell by 0.5% yoy. CPI is still expected to test 5% in January before trending down gradually. As compared to consumer inflation, we think market should pay more attention to China's producer prices in 2020. We think there is risk for PPI to surprise on the upside for two reasons. First, China's destock cycle may be near the bottom. Second, the recent volatility in oil prices may also add to more uncertainty. As such, we are cautious about the outlook of China's rates bond in the near term. The improving economic outlook may be more supportive to China's equity market.

China reported its first casualty from the mysterious Pneumonia in Wuhan last week. Will this round of Pneumonia outbreak be the black swan risk to global market? We think probably not for three reasons. First, Chinese government has been more transparent. Second, there is no evidence of human to human transmission yet. Third, there is also no new confirmed case since 3 January. However, as we are approaching the Chinese New Year, the largest human migration during the festival season may complicate the situation. Market will continue to monitor the development of the case.

China's banking and insurance regulator said It would continue to prevent the credit from flowing into the property market to support China's slogan that housing is not for speculation. On prevention of financial risk, the CBIRC said the size of shadow banking has fell by CNY16 trillion from the peak.

On currency, China's RMB outperformed last week without clear catalyst ahead of this week's signing of phase one trade deal. RMB's outperformance last week may have reflected the improving risk sentiment thanks to signs of economic bottoming out. We expect China's fundamental to play a bigger role in RMB's movement in 2020 although the progress of trade talk is expected to continue to dominate the headline.

In **Hong Kong,** PMI rebounded to a five-month high at 42.1 in December. Nevertheless, the PMI dropped to 40.0 on average in 4Q 2019, the lowest level in more than 21 years. Amid the prolonged social unrest in December, the business activities of Hong Kong continued to take a hit. Moving forward, as local social unrest shows no sign of resolution at this juncture, the business environment of Hong Kong might remain sluggish in 4Q. In nutshell, HK's 4Q GDP might decelerate further. Paul Chan, the Financial Secretary of Hong Kong, mentioned that estimated budget deficit would not exceed HK$80 billion (3% of GDP), based on a GDP in the region of HK$2 trillion for the year to March. With multiple internal and external headwinds, the possibility of further deceleration of GDP in 4Q cannot be ruled out. Despite that, with a strong fiscal reserve amounting to HKD 1025 billion as of the end of November, we believe that government has strong capability to provide further supports to local economy if it is necessary. Last week, HKD strengthened to the strongest level since March 2017, amid overwhelming responses on Jiumaojiu IPO with more than 600x oversubscription and the return of carry trade.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's banking and insurance regulator conducted its working conference for 2020 last week.	▪ The regulator reiterated that it would encourage banks to support the growth while balancing the risk. It will continue to prevent the credit from flowing into the property market to support China's slogan that housing is not for speculation. ▪ On prevention of financial risk, the CBIRC said the size of shadow banking has fell by CNY16 trillion from the peak. Meanwhile, China has dealt with CNY2 trillion non-performing loan in 2020.
▪ A 61-year old man was reported to have died from China's mysterious Pneumonia in Wuhan on 9 January.	▪ Will this round of Pneumonia outbreak be the black swan risk to global market in the beginning of 2020? As of now, the impact on market has been limited. We think the current pneumonia outbreak could be different from the SARS period for back in 2003 for three reasons. First, Chinese government has been transparent to share the information. Second, there is no evidence of human to human transmission. Third, Since 3 January, there is no confirmed new case and there is no healthcare worker infections have been reported. ▪ However, as we are approaching Chinese New Year, the largest human migration during the festival season may complicate the situation. Market will continue to monitor the development of the case.
▪ PBoC deputy Governor Pan Gongsheng said yesterday that RMB has played a more important role to become an auto stabilizer to balance the Balance of Payment and improve China's macro flexibility.	▪ China has been more comfortable with current RMB movement. A two-way movement will be new normal for RMB going forwards. Meanwhile, Pan also expected more long term capital inflows to China's capital market including bond and equity as a result of China's opening of its domestic financial market.
▪ The financial committee of China's State Council said it plans to work out more measures to solve the funding difficulties faced by SMEs such as replenishing capital for smaller commercial banks.	▪ There will be two key tasks for China's regulators this year including how to bring down the funding costs for the real economy and how to deal with rising default risks. Smaller banks will play a bigger role in those initiatives. As such, we may see supports to smaller banks.
▪ Paul Chan, the Financial Secretary of Hong Kong, mentioned that estimated budget deficit would not exceed HK$80 billion (3% of GDP), based on a GDP in the region of HK$2 trillion for the year to March. He indicated that the level was acceptable by international standard.	▪ Affected by US-China trade war risks and ongoing social turmoil, the local economic slowdown has accelerated during the second half of 2019. Government has splashed four rounds stimulus packages to ease the economic woes. Nevertheless, those measures have hardly reversed the economic downtrend. With multiple internal and external headwinds, the possibility of further deceleration of GDP in 4Q cannot be ruled out. Despite that, with a strong fiscal reserve amounting to HKD 1025 billion as of the end of November, we believe that government has strong capability to provide further supports to local economy if it is necessary.
▪ Last week, HKD strengthened to the strongest level since March 2017.	▪ After the year-end factor, the tightness of HKD liquidity improved briefly. Specifically, one-month and three-month HIBOR retraced to 2.0825% and 2.3263% respectively on January 9. Nevertheless, as market showed overwhelming responses on Jiumaojiu IPO with more than 600x oversubscription, the front-end HKD liquidity tightened again. Specifically, one-month HIBOR recorded the largest increase in over a month, jumping by 11 bps to 2.1885%. Meanwhile, as

	HIBORs have been higher than LIBORs , it provided incentives for the return of carry trade (borrowing cheaper HKD and investing in USD with higher returns). Therefore, it lent supports to HKD. ▪ Moving forward, with approaching Chinese New Year Holiday, the front-end HKD liquidity might tighten. Nevertheless, one-month and three-month HIBOR might stabilize at 2.1% and 2.3% respectively after the seasonal factor subsides. The USDHKD spot might keep the two-way movement.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's December inflation were softer than expectation. ▪ CPI rose by 4.5% yoy, weaker than consensus of 4.7% while PPI fell by 0.5%, slightly high than expectation of the decline of 0.4%.	▪ The weaker than expected consumer inflation was mainly due to the decline of pork prices. Although the high frequency wholesale pork prices showed the mile rebound of pork prices in December, the CPI component fell by 5.6% mom. This helped counter the impact of higher vegetable prices, which rose by 10.6% mom due to seasonal effect. Overall, food prices fell by 0.4% mom. ▪ Non-food prices remained relatively stable, up by 0.1% mom. Core CPI excluding food and energy rose by 1.4% yoy, unchanged from November reading. ▪ Looking ahead, CPI is expected to rise further to around 5% in January due to base effect as a result of earlier Chinese New Year festive season in 2020. However, January may mark the peak for 2020 and it is almost certain that CPI will fall significantly in February after the Chinese New Year waned. However, the deceleration of CPI will not accelerate until the second half of 2020. As such, we think China will remain cautious in its monetary policy in the first half before seeing the concrete evidence of decline of CPI. ▪ As compared to consumer inflation, we think market should pay more attention to China's producer prices in 2020. We expect PPI to return to positive reading in the beginning of 2020. We think PPI may surprise on the upside for two reasons. First, China's industry destock cycle has come to an end. We expect China's industry to restock soon thanks to improving US-China trade outlook, green shoots in the global economy and a more supportive monetary policy. This may create some upward pressure for industry goods. Second, the recent volatility in oil prices due to rising geopolitical tension in the Middle East may also complicate the outlook of PPI. ▪ To conclude, the slightly softening inflation data may help alleviate concerns on relation in China. Although we agree that CPI is near the peak soon, it is too early to lower the guard against the backdrop of possible upside surprise from PPI. As such, we think the room for further monetary easing is likely to be limited in the first quarter. We maintain our view that equity may outperform bond in the near term.
▪ China's FX reserve rose by US$12.3 billion to US$3.1079 trillion in December.	▪ The rebound of FX reserve was mainly the result of positive valuation effect due to notable dollar depreciation in December. Overall, capital flow has been balanced in 2019.

▪ HK’s PMI rebounded to a five-month high at 42.1 in December. Nevertheless, the PMI dropped to 40.0 on average in 4Q 2019, the lowest level in more than 21 years. Amid the prolonged social unrest in December, the business activities of Hong Kong continued to take a hit.	▪ Moving forward, as local social unrest shows no sign of resolution at this juncture, the business environment of Hong Kong might remain sluggish in 4Q. Despite that government has rolled out four rounds of relief measures since August, it could hardly reverse the economic downtrend. In spite of US-China first stage trade deal achieved in December 2019, the trading sentiment and Asia's electronics supply chain might need some time to restore. Therefore, the trading activities of Hong Kong might be still under pressure in the near term. In nutshell, HK’s 4Q GDP might decelerate further.
▪	▪

RMB	
Facts	**OCBC Opinions**
▪ China’s RMB outperformed both US dollar and its major trading partners ahead of signing of phase one trade deal this week. ▪ The USDCNY ended the week below 6.91 and RMB index broke 92 upwards.	▪ There is no obvious catalyst behind RMB’s sudden appreciation although there are some rumors in the market that China may get a slightly better phase one deal. Market will monitor closely the details about the phase one deal. ▪ RMB’s outperformance last week may have reflected the improving risk sentiment thanks to signs of economic bottoming out. We expect China’s fundamental to play a bigger role in RMB’s movement in 2020 although the progress of trade talk is expected to continue to dominate the headline.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W