Greater China – Week in Review

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Highlights

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The positive risk sentiment supported by signing of US-China phase one trade deal, stronger than expected economic growth data and China's liquidity injection via 1-year MLF is likely to be shadowed by the forming two dark clouds this week including the deteriorating Wuhan Pneumonia situation ahead of holiday season and China's official change of attitude towards Taiwan.

Let's recap all the positive news first. On phase one trade deal, implementation risk of the phase one trade deal is slightly lower thanks to flexibility of the purchase numbers. For 2020, China only need to complete about 38% of this US$200 billion target. This will reduce the implementation risks in 2020, which will buy more time for both countries to go deeper into the structural reform. Market can move on now to shift their focus back to fundamentals and other geopolitical risks.

On economy, the small V-shape recovery of nominal GDP growth in 4Q to 9.6% signals that the economy may have stabilized. The key disappointment came from infrastructure investment, which failed to response to China's supportive policies. Given, it is almost inevitable for property investment to slow down, it is important for infrastructure investment to pick up. We think a 6% growth in 2020 is still possible.

China injected CNY300 billion liquidity via 1-year MLF on 15 January ahead of Chinese New Year holiday. However, the interest rate for 1-year MLF was kept unchanged at 3.25%. Market will watch out for the fixing rate for both 1-year and 5-year LPR this morning, which is expected to fall by 5bps.

Here are two risks we have to monitor closely In the near term. First, the possibility of human to human transmission of coronavirus in Wuhan is rising given the second wave of confirmed cases over the weekend. The upcoming human migration ahead of Chinese New Year holiday this Friday may also increase the risk of spread of virus.

Second, China's move away from the phrase "Taiwan is part of China" to "Taiwan is part of People's Republic of China" in its joint statement with Myanmar over the weekend shows that PRC government has lost patience over Taiwan's political development. This also shows that China's relationship with Taiwan may enter an unchartered territory. Although China is unlikely to use force immediately, the nature of unpredictability is likely to be one of the most important parameters in the global market this year.

In **Hong Kong**, Carrie Lam, the Chief Executive of Hong Kong, has announced the new round of relief measures amounting to about HK$ 10 billion, mainly focusing on the elderly and the low income group. The relief measures might only lend short-term supports to local economy. Whether the local economy can bottom out and rebound in the near term might highly hinge on both external factor such as the progress of trade talk and domestic factor such as the development of social unrest. ZA Bank, the first virtual bank in Hong Kong, has kicked off their operation during Dec 2019.According to HKMA, 3-4 virtual banks might begin a trail operation in the first quarter in 2020. In the near term, we expect virtual banks to have limited impact on the traditional banking system. Firstly, facing fierce competition and with global uncertainties denting loan demand, virtual banks may have to offer loans with lower rates to attract customers. The resultant concerns about compressed interest rate margin may prevent them from lifting deposit rates to an unreasonably high level. Secondly, against the backdrop of global monetary easing, we believe that the overall interest rates in HK is likely to stay low despite the competition from virtual banks. In **Macau,** average housing price dropped by 5.4% mom (or +4.2% yoy) to 105,494/ square meter in December 2019. The data showed that housing market of Macau remained under pressure despite a brief rebound observed in November. It might be affected by several unfavorable factors, including rising concerns over bleak economic outlook and negative spill-over effects from HK's social unrest. We expect that the housing market of Macau will likely continue to slow down amid the persistent headwinds. Moving forward, in terms of supply, the housing start and completion dropped by 78% yoy and 37% yoy respectively for the first eleven months of 2019, reflecting that the long-term supply remains limited. On the other hand, the housing demand is expected to be resilient amid no significant structural changes observed. Therefore, the housing market correction might be contained in the longer term.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In its joint statement issued by China and Myanmar after President Xi's visit, Myanmar said it reaffirmed one-China principle and considered Taiwan as an inalienable part of the People's Republic of China's territory.	▪ The statement sparked concerns that geopolitical risk in East Asia may rise significantly in 2020. ▪ To recap, the 1992 consensus has been the key guideline for cross-straits relationship since the end of the cold war. Under the consensus, both People's Republic of China (PRC) and Republic of China (ROC) have agreed that Taiwan is part of China. However, the consensus allows more flexibility to define "One-China" which gives both sides the different interpretation of meanings of China. ▪ The PRC government always considers 1992 consensus as a temporary measure to set aside sovereign dispute. The move away from the phrase "Taiwan is part of China" to "Taiwan is part of PRC" shows that PRC government has lost patience over Taiwan's DPP government, which has denied 1992 consensus. This also shows that China's relationship with Taiwan may enter an unchartered territory. Although China is unlikely to use force immediately, the rising uncertainty is likely to be one of the most important parameters in the global market this year.
▪ China confirmed another 136 new cases infected with coronavirus. Three cases were reported in Beijing and Guangdong province.	▪ Two patients have died so far. The fact some of the patients have not visited the seafood market in Wuhan also led to concerns about the possibility of human to human transmission. ▪ In addition, the upcoming human migration ahead of Chinese New Year holiday this Friday may also increase the risk of spread of virus. ▪ Market will continue to monitor the development of the incidents, which may affect the risk sentiment in the global market.
▪ China and US officially signed the phase one trade deal on 15 January. The deal covers the areas of intellectual property, technology transfer, agriculture, financial services and exchange rate.	▪ As a relatively low hanging fruit, intellectual property has been well covered in the agreement with 18 pages out of 96 pages were dedicated to chapter of intellectual property. However, only 3 pages covered technology transfer, which will be one of the key focuses in phase two negotiation. ▪ On agriculture purchase, the agreed additional US$200 billion purchase of US goods and services is the same as numbers mentioned by the US in early December. However, there are two positive changes. First, China will purchase additional US$32 billion agriculture products over the next two years above 2017 baseline amount. This worked out be average US$40 billion purchase of US agriculture products per annum. This is a more feasible number as compared to US$50 billion purchase mentioned by President Trump previously. Second, the additional US$200 billion purchase will not be equally split over the next two year. For 2020, China only need to complete about 38% of this US$200 billion target. Those two changes will reduce the implementation risks in 2020, which will buy more time for both countries to go deeper into the structural reform. ▪ On currency, transparency and communication are two key words, which are largely in line with market expectation. We

	think the impact of currency pact from the trade deal on RMB movement is limited. ▪ On financial services, China will "eliminate foreign equity limits and allow wholly U.S.-owned services suppliers to participate in the securities, fund management, and futures sectors," not later than April 2020. This is also line with China's long term strategy to open its domestic financial market.
▪ The US Treasury Department announced that China should no longer be designated as a currency manipulator now in its latest semi-annual Macroeconomic and Foreign Exchange Policies of Major Trading Partners of the US.	▪ The move is largely symbolic in our view as the label of currency manipulator has limited impact on the market so far. Nevertheless, it is a good gesture ahead of the signing of phase one trade deal tomorrow. The US's acknowledgement on China's enforceable commitments to refrain from competitive devaluation may add more positive sentiment to already appreciating RMB.
▪ China injected CNY300 billion liquidity via 1-year MLF on 15 January ahead of Chinese New Year holiday. However, the interest rate for 1-year MLF was kept unchanged at 3.25%.	▪ The injection was not a surprise in our view as the liquidity injection via RRR cut in the beginning of January, which injected about CNY800 billion, is not enough to fill in about CNY3 trillion liquidity gap due to earlier Chinese New Year holiday, heavy issuance calendar for local government bond and usual tax payment. ▪ As such, we think the liquidity injection is just part of China's counter cyclical measures to stabilize the market instead of any easing signal.
▪ Carrie Lam, the Chief Executive of Hong Kong, has announced the new round of relief measures amounting to about HK$ 10 billion, mainly focusing on the elderly and the low income group.	▪ Specifically, the plan of the HK$2 transport fare concession to those age above 65 will be extended to the age above 60. The number of mandatory leave for workers is proposed to increase from 12 days to 17days. Government will provide cash subsidization for those family waiting for public housing for more than 3 years and unemployed residents (For a maximum of three months period). The relief measures might only lend short-term supports to local economy. Whether the local economy can bottom out and rebound in the near term might highly hinge on the recovery driven by easing trade war risks and development of local uncertainty.
▪ ZA Bank, the first virtual bank in Hong Kong, has kicked off their operation during Dec 2019.According to HKMA, 3-4 virtual banks might begin a trail operation in the first quarter in 2020.	▪ In the near term, we expect virtual banks to have limited impact on the traditional banking system . Firstly, facing fierce competition and with global uncertainties denting loan demand, virtual banks may have to offer loans with lower rates to attract customers. The resultant concerns about compressed interest rate margin may prevent them from lifting deposit rates to an unreasonably high level. Secondly, the virtual banks will offer limited services at the early stage. Adding that they focus more on promoting financial inclusion, the target customers of the virtual banks may only partially overlap those of traditional banks which offers comprehensive services. Thirdly, for the older generation including individuals and entrepreneurs who are not very adapted to online services, they may still choose traditional banks. Fourthly, against the backdrop of global monetary easing, we believe that the overall interest rates in HK should show larger downside than upside risks despite the competition from virtual banks.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's credit expansion beat market expectation in December. ▪ Aggregate social financing increased by CNY2.1 trillion while total new Yuan loan expanded by CNY1.14 trillion. ▪ In addition, broad money supply growth M2 reaccelerate to 8.7%.	▪ The surge in aggregate social financing was mainly the result of accounting change as China added issuance of government bond and local government bond into the aggregate social financing on top of local government special bond, which has been included from September 2018. With the new addition, aggregate social financing has been more important in our view as it will better reflect the coordination between China's fiscal policy and China's monetary policy. ▪ Excluding the effect of accounting change, China's aggregate social financing was still on the strong side. With the green light from top policy makers to boost infrastructure investment, we expect China's social financing growth to remain strong in the first quarter of 2020.
▪ The Chinese economy grew by 6% yoy in 4Q 2019, unchanged from 3Q growth. For 2019, the Chinese economy decelerated to 6.1% yoy from 6.6% yoy in 2018, in line with market expectation. ▪ All three major economic indicators including industrial production, fixed asset investment growth and retail sales beat market expectation in December.	▪ Although real GDP remained intact at 6% yoy in 4Q, China's nominal GDP growth reaccelerated to 9.63% yoy from 7.57% yoy. The small V-shape recovery in nominal GDP reinforced our view that the Chinese economy may have stabilized in the near term thanks to trade truce and more supportive policies. ▪ Meanwhile, manufacturing has shown signs of stabilization. Manufacturing output rose by 7%, strongest since March 2019. In addition, fixed asset investment in manufacturing reaccelerated to 3.1% yoy from 2.5%. The removal of uncertainty from trade truce and China's increasing support to high tech manufacturing sectors will continue to support the manufacturing sectors. ▪ The key disappointment came from infrastructure investment, which decelerated further to 3.8% from 4% despite all the supportive measures such as green light for local government special bond as capital for infrastructure projects etc. This shows that local governments continued to face funding constraints due to breakdown of implicit guarantee and rising default risks in China.
▪ Macau's average housing price dropped by 5.4% mom (or +4.2% yoy) to 105,494/ square meter in December 2019. Approved new residential mortgage loans declined by 2.9% mom (or -4.91% yoy) to MOP3.42 billion in November 2019. Meanwhile, the housing transaction dropped by 2.88% mom (or +8.8% yoy) to 640 deals in November 2019.	▪ The data showed that housing market of Macau remained under pressure despite a brief rebound observed in November. It might be affected by several unfavorable factors, including rising concerns over bleak economic outlook and negative spill-over effects from HK's social unrest. Taking 2019 as a whole, the housing control measures continued to trim speculative demand as local home buyers holding more than one property represented only 3.06% of total local buyers. Meanwhile, first-home local buyers remained the major driving factor of the housing market, which took over 82% of total local home buyers in whole 2019. We expect that the housing market of Macau will likely continue to slow down amid the persistent headwinds. ▪ Moving forward, in terms of supply, the housing start and completion dropped by 78% yoy and 37% yoy respectively for the first eleven months of 2019, reflecting that the long-term supply remains limited. On the other hand, the housing demand is expected to be resilient amid no significant structural changes observed. Therefore, the housing market correction might be contained in the longer term.

RMB	
Facts	**OCBC Opinions**
▪ China's RMB remained resilient last week despite lack of positive surprise from the signing of phase one trade deal. The UDCNY managed to break 6.87 despite stronger broad dollar.	▪ "Buy rumor sell fact" did not happen in RMB market last week. RMB extended its rally despite a small retreat to 6.90 following the release of details about the phase one trade deal. As we argued previously, we think fundamental picture is likely to play a bigger role in RMB's movement.

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