Greater China – Week in Review

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Highlights

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The US-China tension continued to escalate last week after Trump Administration added more Chinese companies into the entity list with the battleground shifted to South China Sea.

As we mentioned before, one of the new parameters adding to the current US-China tension is Trump administration's increasing reliance on economic sanction to confront China. It is almost inevitable that we might see more Chinese companies and individuals being targeted by the Trump administration in the next two months leading to November election.

However, we think China's reaction function to the economic sanction could be different and China is unlikely to go down the path of tit-for-tat as we saw in 2018 during the trade war for two reasons. First, China may not launch large scale retaliation against the US companies as Trump's heightening deglobalization campaign ahead of November election could be the opportunity for China to market its commitment to further open its domestic market to attract foreign investors. Second, as we are only less than two and half months away from the election, China is likely to take a wait and see approach to seek more clarity from the election result.

As such, Trump's increasing economic sanction against China is more likely to be a one-way show to entertain his domestic audience. As long as China plays a patient card to avoid a tit-for-tat trap, the impact of the escalating tension on global financial market may be limited.

Nevertheless, the risk of hot-war cannot be totally ruled out given the cold war icon U2 spy plane returned to the centre stage last week. Therefore, we still need to monitor the risk of misfire in Taiwan Straits and South China Sea carefully even though Taiwan was reported to remind the pilots not to fire the first shot.

Domestically, China's industrial profit growth reaccelerated to 19.6% yoy in July, highest since June 2018, from 11.5% yoy in June. 32 out of 41 sectors reported positive profit growth in July. In the first seven months of 2020, 12 out of 41 industries achieved positive growth for profit led by computer, infocomm and electronic equipment manufacturing industry thanks to higher demand amid global pandemic. Meanwhile, China's integrated circuit industry sales revenue rose by 16.1% in the first half 2020 to CNY353.9 billion despite the rising US-China tension.

PBoC's director of monetary policy division said China will need more certain monetary policy to deal with all kinds of uncertainty. He also confirmed that China has no plan for zero interest rate, negative interest rate and QE. This means that China will continue to treasure the room for conventional monetary policy, which hints that market funding cost is likely to be around the official rate.

On currency, although the delayed review of phase one trade deal was largely a non-event, it did remove the tail risk for RMB given both sides reaffirmed their plans to honour the deal. RMB's recent appreciation is more a catch-up move, which may continue to support the pair test 6.80 range.

In **Hong Kong**, on data front, though July's exports and imports continued to drop, we see two bright spots. First, total exports to Asia grew for the second consecutive month by 0.6% yoy. This reflects the trend of regionalization which might have accelerated amid US-China tension and Covid-19 outbreak. Second, exports and imports of electrical machinery continued to increase. This suggests that Asian electronic value chain remained resilient owing to the booming high-tech industry. Taken all together, it reinforces our view that the Hong Kong could continue to play its role as the key re-export port connecting China and the rest of Asia.

On local pandemic front, as it showed signs of slowdown lately, the government partially relaxed the containment measures and may further ease the measures following the mass testing. As such, moderate recovery of the economy could be expected in 4Q. **On financial market front,** all eyes were on Nongfu Spring's hot IPO and the news that Ant Group filed for HK IPO. With large IPO crossing month-end and more IPOs coming, HKD liquidity tightened on a broad basis. Despite that, the increase in front-end rates was much milder than what we saw in 2019 as aggregate balance has more than tripled since then. Clearly, the HIBOR volatility has reduced and the HKD rates are less affected by either IPO effect or seasonal factors than before. Last week, HKMA injected another HK$5.29 billion into the interbank market to defend the currency peg. We may see more interventions in the coming months should another wave of busy IPO activity coincide with quarter-end. Aggregate balance may grow to above HK$200 billion. On the back of increasing interbank liquidity, HIBOR may come off ultimately after any brief jump once the IPO effect and seasonal factors wane.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC's director of monetary policy division said China will need more certain monetary policy to deal with all kinds of uncertainty.	▪ China's central bank has run its monetary policy under the framework of prudent with more flexibility. According to Sun Guofeng, flexibility is to ensure there is no liquidity shortage as well as no excessive liquidity. Meanwhile, he also highlighted the importance of room for conventional monetary policy again confirming that China has no plan for zero interest rate, negative interest rate and QE. This means that China will continue to treasure the room for conventional monetary policy, which hints that market funding cost is likely to be around the official rate.
▪ Nongfu Spring started public offering on 25th August and received strong response with an oversubscription rate of more than 250 times. The company plans to raise as much as HK$8.35 billion via Hong Kong IPO. ▪ Ant Group filed for Hong Kong IPO last week and reportedly will launch the IPO to raise US$10 billion in September or October. Besides, Yum China is expected to start public offering this week and the company plans to raise about US$2 billion.	▪ As Nongfu Spring's large IPO is across month-end and more IPOs are expected to come in the next months, HKD demand was largely supported. As a result, USDHKD forward swap points were paid up across the curve. Meanwhile, USDHKD spot touched the strong side of the trading band and triggered HK$5.293 billion intervention by the HKMA. As a result, aggregate balance increased to HK$193 billion. ▪ Meanwhile, HKD liquidity tightened in particular the front-end. For example, 1M HIBOR jumped from recent low of 0.226% to 0.367% while 3M HIBOR rose merely from the recent low of 0.44% to 0.47%. Still, the increase in front-end rates was much milder than what we saw in 2019 as aggregate balance has more than tripled since then. This reinforces our view that the HIBOR volatility has reduced and the HKD rates are less affected by either IPO effect or seasonal factors than before. ▪ Going forward, should there be another wave of busy IPO activity, it coupled with quarter-end effect will likely continue to boost HKD demand. In other words, USDHKD spot may keep re-testing 7.75 in the coming months and trigger further HKMA intervention. We expect aggregate balance will grow to above HK$200 billion. On the HIBOR front, the upside would be limited given the increasing interbank liquidity. Rather, after the IPO effect and seasonal factors wane, HIBOR may come off slightly. For example, 1M HIBOR may retreat towards 0.2%.
▪ Hong Kong government announced to allow dining-in at restaurants till 9pm (relaxed from the previous 6pm) as local pandemic showed signs of slowdown lately. Besides, cinemas, beauty parlors and some outdoor sports venues are allowed to re-open. Meanwhile, wearing of mask is no longer mandatory in the country parks and when doing exercises outdoors. The relaxation of containment measures is effective from 28th August.	▪ Going forward, following the mass Covid-19 testing, we expect the government will ease the containment measures gradually. With the gradual resumption of economic activities and the upcoming relief measures, the economy may regain some momentum in the last quarter of this year on assumption that there will not be virus resurgence during the period.

Key Economic News	
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▪ China's industrial profit growth reaccelerated to 19.6% yoy in July, highest since June 2018, from 11.5% yoy in June.	▪ The three consecutive months' positive growth of industrial profit has narrowed the year to date contraction of industrial profit to 8.2% yoy from a contraction 12.8% yoy in the first

	half of 2020. ▪ 32 out of 41 sectors reported positive profit growth in July. In the first seven months of 2020, 12 out of 41 industries achieved positive growth for profit led by computer, infocomm and electronic equipment manufacturing industry thanks to higher demand amid global pandemic. ▪ In addition, car manufacturing sector came back strongly with profit for the sector rose by 125.5% yoy in July as domestic road trip pushed up demand for car.
▪ China's integrated circuit industry sales revenue rose by 16.1% in the first half 2020 to CNY353.9 billion.	▪ The IC sector continued to grow at a rapid pace despite the heightening US -China tension. The sales turnover in design sector rose by 23.6% accounting for 42.1% of total revenue in the industry. ▪ Meanwhile, China's IC sector continued to be the major driver to global IC sector. According to China customs data, imports of IC in the first hit US$154.61 billion.
▪ HK's exports and imports continued to drop by 3% yoy and 3.4% yoy respectively in July.	▪ Zooming in, we see some bright spots in the trade data. First, total exports to Asia as a whole grew for the second consecutive month by 0.6% yoy. In particular, exports to Mainland China, Vietnam and Taiwan increased by 5.2% yoy, 4.4% yoy and 0.4% yoy respectively. Meanwhile, imports from Taiwan, Vietnam, Malaysia, Singapore and South Korea grew by 45% yoy, 35.2% yoy, 21.1% yoy, 13.8% yoy and 13.8% yoy respectively. This reflects the trend of regionalization which might have accelerated amid US-China tension and Covid-19 outbreak. ▪ Second, exports of electrical machinery and office machines both increased for the sixth straight month and grew by 11.1% yoy and 4.5% yoy respectively. Meanwhile, imports of electrical machinery advanced by 8.1% yoy. This suggests that Asian electronic value chain remained resilient owing to the booming high-tech industry. Taken all together, it reinforces our view that the Hong Kong could continue to play its role as the key re-export port connecting China and the rest of Asia despite that the US revoked HK's special status. ▪ That said, in the near term, the outlook of the trade sector may remain clouded by the overall subdued external and internal demand as exports and imports with other major partners continued to show sharp decline. US-China tensions could also remain a potential drag. In conclusion, we hold onto our view that exports and imports will show single-digit decrease for the second consecutive year in 2020.
▪ Macau's unemployment rate rose from 2.5% to 2.7% during May to July 2020, the highest level since 3Q 2011. During the same period, the employed population dropped to 395.4k from 401.9k amid the decrease in non-local workers living in Macau.	▪ Other than the construction sector, all major sectors showed deterioration in the unemployment. In particular, the employed population of gaming sector continued to drop by 3.3% mom while that of wholesale and retail trade (-4.5% mom) and hotels, restaurants and similar activities (-4.3% mom) retreated. This was mainly attributed to the travel restrictions which brought the gaming and tourism to an almost standstill. ▪ Moving into the coming three-month period, the jobless rate may edge up as relief measures expire gradually. On a positive note, the labor market may improve in 4Q 2020 as the worst may be over for the major sectors on the back of China's

	phased resumption of visa approvals to Macau from mid-August. However, jobless rate may not return to the pre-virus levels any time soon as full recovery remains far off for Macau's major sectors that rely heavily on in-person interaction and external demand.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended the week firmly below 6.9 pushing up RMB index as well.	▪ Although the delayed review of phase one trade deal was largely a non-event, it did remove the tail risk for RMB given both sides reaffirmed their plans to honour the deal. RMB's recent appreciation is more a catch-up move, which may continue to support the pair test 6.80 range.

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