OCBC TREASURY RESEARCH

Greater China – Week in Review

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Highlights

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The US-China tension continued to dominate the headline in this festive season. The New York Stock Exchange announced on 31 December 2020 that it will delist three Chinese telecommunication companies China Mobile, China Unicom and China Telecom (Hong Kong) to comply with an executive orders from the White House in November which bars US investors from investing in Chinese companies having ties to the Chinese military.

I revisited the book <dealing with China> by former US Treasury Secretary Henry Paulson over the weekend as he dedicated two chapters to share his story how he helped the IPOs of then China Telecom (Hong Kong) in 1997 and PetroChina in 2000 as head of Goldman Sachs. Coincidently, China's Oil majors could be next in line to be delisted according to media.

The list of China Telecom (Hong Kong) in both Hong Kong and New York in 1997 marked an important milestone for China's reform of its SOEs. So, it was a pity to see those names to be delisted. Nevertheless, other than sentimental value, the direct impact on companies' core business is likely to be limited given the size of ADRs in its total shares is very small and those companies have never raised the money in the US since the IPOs.

In addition, since 12 November, all three telecommunication companies' share prices have dropped by more than 16%, underperforming the benchmark. This showed that market has priced in the potential negative shock from increasing supply of shares in Hong Kong market due to delist in the US.

It raises two questions. First, who will be next? Second, will this idiosyncratic risk turn systemic risk? Given Biden Administration is expected to take office on 20 January, market may take a wait and see approach and is unlikely to jump to the conclusion that it will evolve to financial de-coupling.

On positive note, China and the European Union concluded their nearly seven years long negotiation of the investment treaty on 30 December 2020. The successful conclusion of RCEP negotiations in November and approval of post Brexit trade deal between EU and Britain and the conclusion of investment treaty between EU and China in the last week of December showed that multilateralism remains the dominant driver for the global economy despite all the noises and concerns.

On economy, despite the small retreat of December manufacturing PMI, China's growth momentum remained unchanged. We expect the Chinese economy to accelerate to around 18% yoy in the first quarter of 2021.

On currency, China announced to revise the weights for its currency basket RMB index to reflect the trade relationship in 2020. The dollar weight in RMB index has been cut to 18.79% from previously 21.59% while Euro weight has been increased to 18.15% from 17.40%. Against the backdrop of rising consensus about the extended dollar weakness in 2021, the increase of Euro weight in RMB index suggested that RMB index may be stronger slightly under the new weight than the old weight.

In **Hong Kong,** on the economy front, trade data beat market expectations in November, owing to the seasonality, China's solid economic recovery and the strong demand for electronic products. Moving into 2021, should vaccine rollout fuel a rebound of external demand, Hong Kong's trade sector may remain resilient. We expect exports and imports to both rebound about 5% in 2021. Regarding the financial market, on the very last day of 2020, seven companies kicked start public offering in Hong Kong, reflecting busy IPO pipeline. Given the flush global liquidity and the expectedly sanguine investment sentiment on optimism about economic outlook, Hong Kong's IPO market is expected to remain active. As such, though HKD rates may stay lower for longer amid the decreasing HKD loan-to-deposit ratio, the sizeable aggregate balance and the near-zero USD rates, the downside may be capped by any large/hot IPO or any additional bill issue of the HKMA. In conclusion, HKD rates may hover in the tight range in the coming year. For example, 1M HIBOR may oscillate in the range of 0.1%-0.3%. Meanwhile, HKD spot may trade in the range of 7.75-7.80.

In **Macau,** visitor arrivals, hotel occupancy rate and hotel guests all continued to decrease in November. Gaming revenue also fell in December. This means that the recovery of Macau's inbound tourism and gaming sector was still slow. Moving into 2021, if international travel resumes thanks to vaccine rollout, both gaming and tourism sectors may gain further momentum. However, the upside of the gaming sector may remain capped by the bleak wage growth outlook and the lingering policy risk. In conclusion, though we expect gaming revenue to more than double in 2021 as compared to the level of 2020, it may not return to the pre-virus level so soon.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The New York Stock Exchange announced on 31 December 2020 that it will delist three Chinese telecommunication companies China Mobile, China Unicom and China Telecom (Hong Kong). The trading of shares of three companies will be halted from 11 January following an executive orders from the White House in November which bars US investors from investing in Chinese companies having ties to the Chinese military.	▪ The list of China Telecom (Hong Kong) in both Hong Kong and New York in 1997 marked an important milestone for China's reform of its SOEs. In his book <dealing with China>, former US Treasury Secretary Henry Paulson wrote one chapter dedicated to the IPO of then China Telecom. ▪ The delist decision was a pity. Nevertheless, given all three telecommunication companies are only listed via American Depository receipts (ADRs) and the size of ADRs in its total shares is very small, the direct impact on companies' core business is likely to be limited. ▪ In addition, since 12 November, all three telecommunication companies' share prices have dropped by more than 16%, underperforming the benchmark. This showed that market has priced in the potential negative shock from increasing supply of shares in Hong Kong market due to delist in the US. ▪ Although we think the direct impact of the delisting is limited, it raises two questions. First, who will be next? Second, will this idiosyncratic risk spread to systemic risk? According to media that China's oil majors could be the next in line. However, given Biden Administration is expected to take office on 20 January, market may take a wait and see approaching and is unlikely to jump to the conclusion that it will evolve to financial de-coupling.
▪ China and the European Union concluded their nearly seven years long negotiation of the investment treaty on 30 December 2020. But it may still take at least one more year for the treaty to take effect.	▪ The successful conclusion of RCEP negotiations in November and approval of post Brexit trade deal between EU and Britain and the conclusion of investment treaty between EU and China in the last week of December showed that multilateralism remains the dominant driver for the global economy despite all the noises and concerns. ▪ The treaty may be the setback for the incoming Biden Administration who wants to work with the EU to press China.
▪ China announced to revise the weights for its currency basket RMB index to reflect the trade relationship in 2020. The dollar weight in RMB index has been cut to 18.79% from previously 21.59% while Euro weight has been increased to 18.15% from 17.40%.	▪ This is the third revision for RMB index since 2017. Against the backdrop of rising consensus about the extended dollar weakness in 2021, the increase of Euro weight in RMB index suggested that RMB index may be stronger slightly under the new weight than the old weight.
▪ HKD rates dropped notably with 1M HIBOR down by over 240bps in 2020 amid strong capital inflows on the Fed's sharp rate cuts.	▪ Going forward, since the Fed is poised to keep rates near zero which will warrant a continuously flush liquidity in Hong Kong, we expect HKD rates to stay lower for longer. As such, as the IPO effect and year-end effect abates, HKD rates may come off further with 1M HIBOR likely re-testing recent low of 0.1%. ▪ If this is the case, whether the downtrend of HKD rates will prompt the HKMA to issue additional EFBNs will be closely watched. Any additional bill issuance by the HKMA together with the busy IPO pipeline and seasonal factors may cap the downside of both HKD rates and HKD spot. ▪ In conclusion, HKD rates may hover in the tight range in the coming year. For example, 1M HIBOR may oscillate in the range of 0.1%-0.3%. Meanwhile, HKD spot may trade in the range of 7.75-7.80.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's December PMI retreated from high of 52.1 to 51.9.	▪ Both Supply and demand moderated. New orders and new export orders fell to 53.6 and 51.3 respectively from high of 53.9 and 51.5 but still well above threshold line. PMI for smaller companies slipped back to contraction again. ▪ The biggest change came from purchasing price index which jumped to 68 from 62.6 due to rising raw material prices. This suggests that the contraction of PPI is likely to be narrowed.
▪ Hong Kong's exports and imports increased by 5.6% yoy and 5.1% yoy respectively in November, both beating expectations.	▪ Zooming in, the overseas shipments to Mainland China (+8% yoy), the US (+1.5%) and Asia as a whole (+5.7% yoy) all rebounded. This may be attributable to the increased orders ahead of year-end holidays and China's solid economic recovery. On the other hand, exports to and imports from Taiwan and Vietnam exhibited double-digit year-on-year growth. Meanwhile, the exports and imports of electrical machinery and office machines continued to grow. This indicates that Hong Kong, as a key re-export port of electronic products in Asia, continues to benefit from the supply chain shift of the electronics industry. ▪ Moving ahead, we expect exports and imports growth to accelerate given the low base effect and the expected economic recovery of developed countries on vaccine rollout. Furthermore, with China signing RCEP with the other 14 countries, regional trade activities are set to grow in the medium to long term. China's dual-circulation strategy could also help to boost the trade activities between China and the rest of the world. If this is the case, Hong Kong's trade and logistics sector may continue to flourish. We pencil in about 5% growth for both exports and imports for 2021.
▪ HKD loan-to-deposit ratio dropped further to 82.7% in November, the lowest since February 2018, as HKD loans (-14% mom) fell at a faster pace than HKD deposits (-12.6% mom). ▪ Excluding IPO effects, total loans and advances would have reduced by 1% mom while total deposits would have dropped by 1.2% mom as large firms withdrew deposits for loans repayment.	▪ During December, several hot IPOs had locked up some HKD liquidity. This may have again boosted the growth of HKD loans and deposits. Moving into 2021, as we expect the IPO market to remain active, HKD loans and deposits may grow on the back of IPO-related demand. ▪ However, excluding IPO effects, local loan demand may be sluggish given the still dire business situation and a weakening labour market, especially if the government were to unwind the one-off relief measures. Loans for use outside of Hong Kong which grew at the slowest rate in four years by 0.9% yoy in November may remain subdued as well amid the relatively flush onshore liquidity. In contrast, total deposits may continue to see resilient year-on-year growth given flush global liquidity and the relatively sanguine investment sentiments amid vaccine rollouts and the fresh stimulus of US. ▪ Since we expect HKD loans to grow at a slower pace than HKD deposits in 2021, HKD loan-to-deposit ratio may edge down further. Meanwhile, HKD CASA deposits to total HKD deposits ratio, which remained around the highest level since April 2018, may go up gradually. Taken all together, it suggests that banking system's funding cost may remain low whereas net interest margin may remain suppressed as well.

▪ Hong Kong's RMB deposits increased 15% yoy and 5.6% mom to RMB718 billion in November, the strongest since May 2016.	▪ RMB has hovered in a tight range against the US dollar lately. The stability of RMB as well as the relatively high interest rate may have been one of the factors driving the RMB deposits growth. However, the upside of RMB deposits may be limited in the near term as seasonal factors and the strong interests in onshore RMB assets may lead to RMB outflows from Hong Kong to Mainland China. ▪ In the medium to long term, with more cross-border investment schemes being launched, we expect to see an increase in offshore RMB liquidity which is crucial to RMB internationalization.
▪ Macau's gaming revenue dropped less than expected by 65.8% yoy in December but still plunged for the second consecutive year by 79.3% yoy for 2020 as a whole.	▪ The gambling hub further loosened the travel restriction on the foreigners in Mainland China from December. Adding on low base effect, gaming revenue surprised to the upside in December. However, as Macau tightened the travel restrictions on visitors from the countries/regions other than Mainland China and Taiwan due to the virus resurgence, the gaming sector's recovery remained slow. ▪ Moving into 2021, should vaccine rollout help to contain the virus and warrant the resumption of international travel, Macau's gaming sector may gain further momentum. However, the upside may remain capped. On one hand, the weakening prospect of wage growth across the globe may drag on the recovery of the mass market segment. On the other hand, though the government denied that the digital yuan will be introduced in Macau, the lingering policy risk has hit the junket operators hard and may continue to weigh on the VIP segment. In conclusion, though we expect gaming revenue to more than double in 2021 as compared to the level of 2020, it may not return to the pre-virus level so soon.
▪ Macau's unemployment rate for the three months to November remained unchanged at 2.9%. However, the total labour force and total employed population both dropped by 0.3% mom.	▪ By sector, the labour market condition was also mixed. With the gaming and inbound tourism activities regaining some traction on the loosened border control, the employment population of gaming, retail and hotels rebounded by 1.3%, 1.6% and 0.7% respectively on monthly basis. However, the employed population of restaurants slumped by 5% mom as visitor spending and local consumption may have remained subdued amid a weak labour market, the uncertain economic outlook and the lingering virus concerns. Meanwhile, without much construction projects in the pipeline, the employed population of construction sector also continued to decrease by 3% mom. ▪ Moving ahead, as global economy is expected to recover and international travel is expected to resume on vaccine rollout in 2021, an improving economic outlook of Macau indicates that the gambling hub's unemployment rate may have peaked and may come off gradually in 2021. However, as it may take some time for the hardest-hit services sectors to heal the wound, overall unemployment rate may not return to the pre-virus level (sub 2%) anytime soon.

RMB

Facts	OCBC Opinions
▪ The USDCNY ended the year around 6.50.	▪ RMB has underperformed Euro in December, which sent the RMB index down to below 95. The increase of Euro weight in RMB index from 2021 suggested that RMB index may be stronger slightly under the new weight than the old weight.

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