# Greater China – Week in Review

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## Highlights

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The latest addition to the evolving US-China tension is that Trump Administration is considering whether to add China's largest chip maker Semiconductor Manufacturing International Corporation (SMIC) into Commerce department's entity list. The Trump Administration has increasingly leveraged on economic sanctions and entity list to confront China despite the possible collective damage to the US companies.

Instead of going down the path of tit-for-tat, the rapid escalation of tension seems to have been the catalyst driving China to accelerate its open of its financial market to counter the impact of rising US-China tension. China's Vice Chairman of security regulator Fang Xinghai said that there is great potential to attract foreign capital into China's equity market. Fang also announced that the regulator plans to expand the eligible securities for stock connect between Hong Kong and China. Meanwhile, China also plans to expand product offering in future market to give foreign investors more risk management tools.

China's central bank deputy governor said that the negative list for foreign investment in financial sector has been fully eliminated. This means that more foreign financial institutions will enter China's market in an orderly manner.

On economic data, the latest August PMI from both manufacturing and non-manufacturing perspective confirmed China's recovery as subcomponent of new orders and new export orders showed consistent improvement despite headline manufacturing PMI softened slightly.

In **Hong Kong**, retail sales dropped for the eighteenth straight month but beat expectations in July, mainly due to low base effect and the strong sales of food and essentials during the stay-home period. Likewise, though PMI fell for the second consecutive month from 44.5 in July to 44.0 in August amid virus resurgence, the decline was much milder as compared to early this year. This reinforces our view that economic contraction will remain deep in 3Q but may narrow from 1H, especially given the receding local pandemic and the gradual easing of containment measures. Elsewhere, HKMA and HKMC Insurance Limited extended the measures to support principal moratorium. This may help to ease the cash flow pressures of the SMEs especially in the hardest-hit sectors and in turn alleviate the pressure on the labor market.

On financial market front, HKMA sold totally HK$13.3 billion last week to defend the currency peg. We expect to see more interventions going forward as HKD could remain strong on a new wave of IPO activities including Ant Group's US$10bn IPO around mid-October as well as the quarter-end effect. On top of that, as the Fed paves way for low-rate era, we expect to see more foreign investors hunt for yield in HK given the HKD-USD interest rate gap. On the back of increasing interbank liquidity, HKD rates are expected to come off once the short-term factors abate.

On banking sector front, total deposits may grow further with another wave of hot IPOs, upbeat sentiment and capital inflows. By contrast, excluding IPO loans, total loans growth is expected to remain muted amid subdued consumer and business sentiments and banks' cautiousness. As such, HKD LDR may fall from July's 85% towards 80% and in turn add downward pressure to the HKD rates in the near term.

| Key Events and Market Talk | |
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| **Facts** | **OCBC Opinions** |
| ▪ China's top financial regulators reiterated China's commitment to further open up its financial market to attract more foreign investors at an international finance forum during the ongoing China International Fair for Trade in Services. | ▪ China's Vice Chairman of security regulator Fang Xinghai said that there is great potential to attract foreign capital into China's equity market. The inflows of long term capital from foreign investors may also cap China's equity market volatility. In addition, Fang also announced that the regulator plans to expand the eligible securities for stock connect between Hong Kong and China. Meanwhile, China also plans to expand product offering in future market to give foreign investors more risk management tools.<br>▪ China's central bank deputy governor said that the negative list for foreign investment in financial sector has been fully eliminated. This means that more foreign financial institutions will enter China's market in an orderly manner. Meanwhile, he also said that more than 70 central banks globally have added RMB into their foreign exchange reserve. As of end July, financial assets held by foreign institutions and individuals has reached CNY7.74 trillion up by 37% yoy. |
| ▪ Trump Administration is considering whether to add China's largest chip maker Semiconductor Manufacturing International Corporation (SMIC) into Commerce department's entity list. | ▪ The move to considering imposing export control to SMIC marks the further escalation of US-China tech war although it may cause collective damage to the US companies such as Qualcomm. |
| ▪ HKD liquidity remained relatively tight as the money locked up for Nongfu Spring's IPO is not yet released to the market while Yum China started public offering last Tuesday to raise as much as HK$19.6 billion. 1M HIBOR rose to the highest since early July at 0.45% before retracing lower to 0.42% last Friday.<br>▪ Due to the strong HKD demand and broad dollar weakness, USDHKD spot touched 7.75 and prompted the HKMA to sell another HK$13.3 billion to defend the currency peg. | ▪ In the near term, HKD is expected to remain strong due to a new wave of IPO activities including Ant Group's US$10bn IPO around mid-October as well as the quarter-end effect. In the medium term, as the Fed paves way for low-rate era, we expect to see more investors hunt for yield given the HKD-USD interest rate gap. Meanwhile, the US-China tensions could prompt more ADRs to launch HK secondary listings and in turn lure more equity inflows. Taken all together, USDHKD spot may continue to touch 7.75 from time to time going forward and therefore aggregate balance may grow further. On the back of increasing interbank liquidity, HKD rates are expected to come off once the short-term factors abate. |
| ▪ The HKMA announced to extend the Pre-approved Principal Payment Holiday Scheme for six months to April 2021 and defer all loan principal payments of eligible customers falling due between November 2020 and April 2021 by six months.<br>▪ HKMC Insurance Limited announced to extend the application period for principal moratorium for the 80% and 90% Guarantee Produce under the SME Financing Guarantee Scheme by 6 months to 31st March 2021 and increase the maximum duration of principal moratorium from 12 to 18 months. | ▪ According to the HKMA, at the end of July 2020, banks had granted over 43,000 applications for loan tenor extension and other forms of relief, totaling over HK$530 billion. Due to the virus resurgence, the move of the HKMA and the HKMC Insurance Limited is imminent to ease the mounting cash flow pressures of the SMEs especially those in the hardest-hit sectors. This may also help to alleviate the pressure on the labor market as SMEs have employed about 45% of all workforce in the private sector. |
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| Key Economic News | |
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| ▪ China's official manufacturing PMI softened slightly in August to 51 from 51.5 in July. | ▪ Despite the weaker headline reading in August due to moderation of production, the underlying breakdown is |

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| | encouraging. The improvement of demand continued with new order rose for five consecutive months to 52 from 51.7. In addition, new export order also rose for four consecutive months to 49.1, highest in 2020. Meanwhile, employment index also improved marginally to 49.4 but still below the threshold line 50. Overall, we think China's August manufacturing PMI confirmed the recovery, although it is still an uneven recovery with smaller companies are still facing the stress. |
| ▪ Hong Kong's PMI fell for the second consecutive month from 44.5 in July to 44.0 in August, indicating austere business conditions of the private sector amid virus resurgence. | ▪ Zooming in, the sub-index of business activity, output and new orders all declined as local consumer and business sentiment was hit hard again by the renewed virus concerns and strict containment measures. On a positive note, the decline of PMI was milder as compared to early this year, probably owing to relief measures, the re-opening of global economy and China's steady recovery. Taken all together, it reinforces our view that economic contraction will remain deep in 3Q due to the third wave of Covid-19 but may narrow from the first half of this year. Likewise, though unemployment rate will likely go up after a brief decrease during May-July, the pace of increase may be moderate. However, the outlook of economy and labor market remains sluggish as the government hinted that the size of the fresh relief funds may be smaller than the previous round due to the ballooning budget deficit. We expect PMI to rebound but stay below 50 in the coming months. |
| ▪ HKD loan-to-deposit ratio decreased by 1.4 percentage points mom to the lowest since May 2018 at 85% in July as HKD deposits rose by 4.2% mom while HKD loans grew by 2.6% mom. | ▪ On loans front, total loans and advances rose by 1.7% mom, led by the loans for use in HK (excluding trade finance) which grew by 2.6% mom or 8.7% yoy. That said, excluding IPO loans, total loans and advances would have increase only by 0.1% mom. In other words, local loan demand may have remained weak amid virus resurgence. On the other hand, loans for use outside of HK increased by 0.1% mom or 6.4% yoy given the shifting of PBOC's monetary stance which made onshore financing relatively costly.<br>▪ On deposits front, total deposits grew by 6.3% yoy (the strongest since April 2018) or 2.7% mom in July. Excluding deposits growth driven by IPO activities, total deposits and HKD deposits would have grown by 1.5% and 1.8% on monthly basis respectively, which is still strong due to the strong equity inflows in July and the continuously upbeat investment sentiments. In particular, HKD CASA deposits also surged by 10.8% mom. By contrast, HKD time deposits tumbled for the seventh consecutive month by 5% mom amid decreasing time deposits rate. As a result, the share of HKD CASA deposits in total HKD deposits rose to 61.9%, the highest since June 2018.<br>▪ Moving ahead, another wave of hot IPOs is set to keep spurring loans and deposits growth. That said, as consumer and business sentiments remain subdued and banks remain cautious, we expect total loans and advances (+7.4% yoy) to show single-digit growth this year. In contrast, total deposits especially HKD CASA deposits may continue to see relatively strong growth amid the upbeat sentiment and expected |

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| | equity inflows on the back of global flushed liquidity. As such, HKD LDR may fall further towards 80% while the share of HKD CASA deposits in total HKD deposits may rise further towards 65% in the short to medium term. Though this suggests easing funding pressure on banks (composite interest rate fell to the lowest since May 2018 of 0.53% in July), it may also lead to compressed net-interest-margin in the near term. |
| ▪ RMB deposits rebounded by 2.9% mom to RMB658.3 billion in July. | ▪ There may be three reasons behind the rebound. First, though foreign investors' holding of Chinese onshore bonds marked record monthly growth in July, it might be insufficient offset by the equity outflows during the month as a whole amid authorities' crack down on speculative trade in stock market. Second, the shift of PBOC's monetary stance led to tight offshore RMB liquidity and pushed up RMB deposit rates in HK. Third, half-year end effect abated. Going forward, we expect HK's RMB deposits to hover above HK$600 billion and with limited upside as offshore RMB rate remains relatively attractive whereas foreign investors also remain enthusiastic about onshore RMB assets. |
| ▪ Hong Kong's retail sales surprised on the upside with the decline narrowing further from 24.8% yoy in June to 23.1% yoy in July, mainly due to low base effect.<br>▪ Visitor arrivals dropped by more than 90% yoy for the sixth consecutive month by 99.6% yoy in July. | ▪ The better-than-expected retail sales may also be attributed to the strong growth in the sales of commodities in supermarkets (+26.5% yoy), meat (+15% yoy) and fresh fruits and vegetables (+19% yoy) amid increasing preference to stay at home due to virus resurgence. However, the decrease in sales of commodities in department stores deepened to 28.8% yoy from June's -7% yoy amid strict containment measures and renewed virus concerns. Worse still, sales of other retail outlets fell notably. In particular, sales of jewelry, clocks and valuable goods (-53.7% yoy), clothing, footwear and allied products (-44.1% yoy) as well as medicine and cosmetics (-50.9% yoy) continued to drop significantly amid a near-standstill inbound tourism.<br>▪ Moving into the coming months, given the low base effect, we expect the decline of retail sales to keep narrowing. Besides, with the government gradually easing the containment measures amid receding local pandemic, retail sector may regain some momentum. However, as several waves of Covid-19 took a heavy toll on the labor market and the relief measures expire gradually, retail sector may not see any strong recovery. As such, despite the relaxation of control measures on non-residential property market, the retail shop market may remain sluggish, especially given the increasing prevalence of online shopping. |
| ▪ Hong Kong's CCL index which tracks the secondary housing price dropped for the second consecutive week by 0.72% on a weekly basis to the lowest since May as of 30th August. Housing transaction volume dropped for the second consecutive month by 28.9% mom to 4358 units in August.<br>▪ 7047 units of subsidized housing will be available for application from 10th September. | ▪ The retreat in housing market could be attributed to several unfavorable factors. First, subdued investment demand given the low rental yield. Housing rental index fell for the 10th consecutive month by 8.7% yoy in July as travel restrictions banned the entry of migrant workers and foreign students and in turn dented demand in the housing rental market. Second, homeowners under huge cash flow pressure such as businessowners appeared to have increasingly sold their residential properties at deep discounted price. Third, the softening labor market outlook and renewed virus concerns dented housing demand. |

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| | ▪ Going forward, once the local pandemic recedes and the containment measures are eased, we expect to see moderate rebound in the housing market given the supportive measures, lowered interest rates, the prospect of tight housing supply and the pent-up demand from the less affected higher-income group. However, the upside may remain capped by the unfavorable factors mentioned above. Also, some potential demand may be diverted by the subsidized housing. In conclusion, we expect housing price index (+1.5% YTD in July) to drop up to 5% yoy by end of this year. |
| ▪ Macau's gross gaming revenue dropped by over 90% yoy for the fifth consecutive month by 94.5% yoy to MOP1.33 billion in August despite the travel bubble formed between Mainland China and Macau from mid-July.<br>▪ In cooperation with Tencent, Alibaba and Air Macau, Macau's government unveiled a promotional campaign covering flight tickets, accommodation, and spending at local shops for Mainland visitors on 1st September. | ▪ On a positive note, with visa approvals to Macau resumed for the residents of Guangdong and those of the rest of China respectively from late August and late September, we expect gaming revenue to rebound in the coming months. The pent-up traveling demand of Mainlanders, the National Day Holiday effect and Macau government's promotional campaign could provide impetus for both tourism and gaming sectors as well.<br>▪ However, there could still be several factors hindering the recovery of the gaming sectors. First, China's slowdown and softening labor market may dent casual gambling demand and make the pent-up traveling demand unsustainable. Second, before an effective vaccine is widely available, access to Macau and the gaming center may still be subject to conditions while the transportation between Macau and Mainland China may not resume normalcy. Third, as China tightens the grip on capital outflows to crack down on overseas money-laundering, tight liquidity in Macau may constrain the rebound in VIP segment's revenue.<br>▪ In conclusion, though we expect gaming sector to regain momentum in the coming months, full recovery is still far off. We hold onto our view that gaming revenue will drop over 50% yoy this year. |

| RMB | |
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| **Facts** | **OCBC Opinions** |
| ▪ The USDCNY continued to consolidate in 6.80-6.85 range. | ▪ The pair tested the low 6.82 but failed to break. Nevertheless, despite the rebound of dollar index in the later part of last week as a result of rising risk-off sentiment due to tech stocks sell-off, the USDCNY stood firmly below 6.85. We think 6.85 could be the near-term resistance for the pair. Should dollar weaken further, we think the pair may break 6.80 eventually. |

# Treasury Research & Strategy

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