Greater China – Week in Review

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Highlights

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The US-China tension continued to escalate with China's largest chip maker SMIC has been the latest target after media reported US companies needed to obtain export license to supply SMIC. The impact on the company could be potentially bigger as compared to impact on Huawei as the company has not stocked up as much as Huawei did in the past two years.

Interestingly, the political motivated economic sanctions, which aim to slow down the development of China's semiconductor sector, failed to stop global financial market from being more connected. Global capital continued to flow into China's bond market with total foreign holdings of China's bond has reached CNY2.8 trillion at the end of August according to PBoC.

Meanwhile, FTSE Russell announced on 24 Sep that it will include China's government bonds into its flagship World Government Bond Index from October 2021, which is expected to bring in more than US$100 billion capital into China's bond market.

In addition, China continued to open its economy with three more free trade zones have been launched last week in capital Beijing and two central provinces Anhui and Hunan. The recent expansion of FTZs to central China's Anhui and Hunan showed China's plan to leverage on free trade zone as catalyst to further develop the less developed central China, which is also in line with China's dual circulation strategy.

Two questions have been raised and debated in the market over the past week. First, will the recent capital inflows, driven by RMB appreciation and favorable yield differential, lead to domestic asset bubbles? Second, where is the red line for PBoC to intervene the recent RMB strength?

On the first question, we are also concerned about the potential rising real interest rate in China as inflation is expected to slow down significantly in the last quarter of 2020. The rising real yield differential, which may potentially converge to nominal yield differential, could be the challenge to China's recovery and capital inflows. As such, we think China may have to guide the nominal yield lower at certain stage. We will continue to monitor the development real yield in China.

Second, we don't see any urgency for China to intervene prematurely to put a stop on RMB appreciation for two reasons. First, although RMB has broken the year high against the dollar, RMB index is still below March high. Second, there is no evidence of forming of one-way RMB appreciation expectation in the onshore market given still relatively stable hedge ratio from both exporters and importers.

In **Hong Kong,** panic move in the liquidity market associated with headlines surrounding Ant Group's big IPO led to notable increase in HIBOR. Meanwhile, HKD spot frequently touched 7.75 and prompted the strongest intervention by the HKMA so far this year. After that, the panic move started to fade. Going ahead, though Ant Group's big IPO looks set to increase the volatility in HK's money and FX market and more IPOs could be expected in the short to medium term, any increase in HKD rates is expected to be moderate and short-lived.

On the economy front, the near-term situation remains dire as August's trade data continued to decrease while the vacancy rate of Central's Grade-A offices and that of retail shops continued to rise. However, the medium-term outlook is mixed. On one hand, the recovery of office and retail property market may take some time as the government appears to have become more cautious about the pace of easing containment measures. Meanwhile, the pandemic may have long-term impact on the work arrangement and consumer behavior. On the other hand, trade sector may regain traction on the back of gradual global recovery, the rise of regionalization, the prevalence of "China+1" strategy and the resilience of Asia's electronic value chain.

Finally, Hong Kong Financial Services Development Council launched a job creation scheme for the financial services industry under the government's relief fund. This is imminent to help ease the pressure on the labor market.

In **Macau,** visitor arrivals continued to increase on monthly basis amid the resumption of travel between Macau and China but continued to drop over 90% on yearly basis in August. As the travel and transport look unlikely to resume normalcy any time soon, we may only see slow recovery in inbound tourism.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China officially opened three new pilot free trade zones on 24 September in Beijing, Anhui province and Hunan province.	▪ Total number of FTZs will be expanded to 21 covering coastal area, central and western regions. The recent expansion of FTZs to central China's Anhui and Hunan showed China's plan to leverage on free trade zone as catalyst to further develop the less developed central China, which is also in line with China's dual circulation strategy. ▪ The newly established Beijing FTZ will mainly focus on boosting service trade and will be a pilot area for the digital economy and innovation centre.
▪ FTSE Russell announced on 24 Sep that it will include China's government bonds into its flagship World Government Bond Index from October 2021.	▪ The announcement was a confidence vote from a major global index provider to China's efforts to open up its financial market and boost domestic liquidity. ▪ Currently, around 2.5% Chinese onshore bond held by foreign investors, which is way below China's regional peers such as Malaysia and Indonesia. The inclusion is expected to attract more than US$100 billion into China's bond market. However, any imminent impact is limited given we are still one year away from the actual inclusion.
▪ It was reported by the media that US has asked US companies to obtain export license before shipping to China's chipmaker SMIC though there is no official announcement yet.	▪ It is still unclear under what reason, the US plans to cut the SMIC off from US exports. The impact on the company in the near term could be big as it may not stock up enough to prepare for this situation as Huawei did.
▪ Ant Group plans to raise US$17.5 billion via Hong Kong IPO which is said to come in late October. ▪ HKMA sold HK$16.87 billion to defend the currency peg last Monday, the strongest intervention so far this year. Aggregate balance rose to an over three-year high of HK$242.5 billion.	▪ The news about Ant Group's big IPO caused some panic moves in the market which boosted HKD demand and in turn made HKD spot frequently touch 7.75 and pushed HKD rates up across the curve. However, the panic moves faded gradually with HKD rates retracing lower after the HKMA's strong intervention and the money locked up by Ming Yuan Cloud's hot IPO returned to the market. ▪ In the coming sessions, we expect to see lowered volatility in HK's money and FX market pending Ant Group's big IPO. The cautiousness of market players ahead of Ant Group's IPO may cap the downside of HKD rates. However, the recent fading of panic move also reinforces our view that HKD rates will likely come off notably after the IPO effect wanes.
▪ According to Deloitte China, the number of IPOs and the total amount of proceeds reached 99 (+1% yoy) and HK$213.8 billion (+67% yoy) in Hong Kong during the first three quarters, ranking the third in the world. Meanwhile, it estimates that there will be totally 140 IPOs and HK$400 billion worth of IPO proceeds for 2020 as a whole, making Hong Kong the world's second largest IPO market.	▪ Amid the heightened US-China tensions, eight ADRs including Alibaba have chosen Hong Kong for secondary listings since late last year and raised over HK$180 billion in total. If some 30 more ADRs eligible for Hong Kong secondary listings come, they may raise about US$15bn in total in Hong Kong. On top of this, given the strong response received by the IPOs of medical companies and high-tech companies, their peers may also come to Hong Kong for IPO. In conclusion, it looks likely that IPO pipeline will remain relatively robust going forward. However, as IPO activities may translate into capital inflows, the resultant increase in aggregate balance will likely ease the IPO effect which has had caused short-term tightening of HKD liquidity during the recent years.
▪ Hong Kong Financial Services Development Council announced to launch the first job creation scheme for the financial services industry under	▪ The scheme aims to help create 1500 full-time jobs as the company in financial services industry will receive up to HK$10,000 per month for 12 months for every eligible new

the government's relief fund. The scheme involves HK$180 million and will be open for application from 30th September.	hire. As one of the four pillar industries, financial services industry contributed 6.8% of total employment and 19.8% of GDP in terms of value added in 2018. In fact, the unemployment rate of "financing, insurance, real estate, professional and business services" increased merely by 1.9 percentage points in June-August from 2019's low, as compared to the increase of 3.3 percentage points in overall unemployment rate. The relative resilience of financial services industry makes it more capable of creating new jobs. This is imminent to help ease the pressure on the labor market and support the fresh graduates and the unemployed.

Key Economic News

Facts	OCBC Opinions
▪ The contraction of China's industrial profit narrowed further to 4.4% yoy in the first eight months from the decline of 8.1% yoy in the first seven month.	▪ The recovery of industrial profit was mainly driven by strong demand for electronic products, which drove profit for computer, infocomm and electronic equipment rose by 26.1% yoy in the first eight months. ▪ In addition, auto manufacturing also showed signs of improvement with year to date profit rose for the first time by 1.5%yoy. ▪ Mining sector remained the key drag for industrial profit.
▪ Hong Kong's imports dropped for the 21st straight month by 5.7% yoy in August. Meanwhile, the decline of exports narrowed from 3% yoy in July to 2.3% yoy in August.	▪ The better-than-expected exports were mainly attributed to the re-opening of global economy. Apart from this, the frontloading of exports orders amid heightened US-China tension may be another reason as the decline of exports to the US narrowed from 20.2% yoy in July to 14.9% yoy in August. By contrast, the weaker-than-expected imports reflect subdued internal demand amid virus resurgence. ▪ On a positive note, we continue to see signs of regionalization as exports to Taiwan and Vietnam rose by 1.6% yoy and 11.5% yoy respectively while the imports from these two regions surged by 20.8% yoy and 13.6% yoy respectively. The resilience of Asia's electronic value chain remains as another bright spot as exports of electrical machinery increased by 4.8% yoy while import of telecommunications rose by 2.4% yoy. ▪ In conclusion, in the near term, the virus resurgence across the globe and the persistent pandemic uncertainty may continue to dent domestic and external demand. Also, the low base effect will fade in late this year. As such, we expect exports and imports growth to remain in the negative territory in the coming months. However, in the longer term, we expect Hong Kong's trade sector to regain traction on the rise of regionalization and the prevailing "China+1" strategy.
▪ According to JLL Hong Kong, the transaction volume of Grade-A offices in the rental market rebounded by 10% mom whereas the rents dropped by 1.7% mom in August.	▪ This suggests that the decrease in the rents may have somehow revived the demand. In Central, the rents of Grade-A offices dropped 2.5% mom while the vacancy rate rose to the highest since December 2005 of 6% in August. With the latest virus resurgence in Europe and the lack of further strong stimulus sparking renewed concerns about economic outlook,

	business sentiment will likely remain muted. The flexible work arrangement and the cost control may also prompt companies to choose cheaper and smaller offices which may not necessarily locate in the CBD. We hold onto our view that the office property market may not return to pre-virus levels anytime soon.
▪ According to Centaline Commercial's latest report, the transaction volume of commercial properties (including office, industrial and retail properties) jumped by 18.9% to 446 deals in one month after the HKMA raised the LTV ratio caps for mortgage loans on such properties from 20th August. ▪ The government extended the existing containment measures by 7 days to 1st October.	▪ Among all, retail property showed the strongest growth of 41% to 110 deals. The rebound could also be attributed to the price concession by landlord. However, like the office property market, retail property market also saw continuous decline in rental and price as well as high vacancy rate. As the government has become much more cautious about the pace of easing containment measures in anticipation of a potential fourth wave of Covid-19, we expect the retail and office property market to remain under pressure.
▪ Macau's visitor arrivals increased for the fourth straight month on monthly basis by 206.9% to 227,113 in August. Mainland visitors, who took up 88.4% of total visitors, rose by 202.1% mom on the resumption of visa approvals to Macau by Zhuhai and the rest of Guangdong in mid-August and late August respectively.	▪ Lately, the daily average of visitor arrivals from Guangdong increased to about 15,000. This indicates that the gambling hub's inbound tourism will regain more traction in the coming months especially with the rest of China resuming the visa approvals from 23rd September. ▪ However, on yearly basis, visitor arrivals fell by over 90% for the seventh consecutive month by 93.7%. This suggests that the resumption of travel between Macau and Mainland China may not take the tourism back to the pre-virus level (about 100,000 visitor arrivals per day) any time soon as tedious procedures required to get access to Macau may deter some potential visitors. In addition, the transportation between Macau and Mainland China may not resume normalcy given the persistent pandemic uncertainty.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY returned to above 6.80 as a rebound of dollar index.	▪ Since the beginning of September, dollar index has rebounded by more than 2.5%, however, RMB managed to gain about 0.35% against the dollar month to date. ▪ Market may have turned neutral on this pair after a massive rally of dollar index last week with the pair may be traded in the range of 6.8-6.85 in the near term pending on the direction of dollar index.

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