OCBC TREASURY RESEARCH

Greater China – Week in Review

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Highlights: Uneven recovery

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China's industrial profit grew by 11.9% yoy on two-year average in March, down from 31.2% yoy two-year average growth in the first two months of 2021, signs of slowdown. China's April official PMI also softened slightly. Nevertheless, manufacturing PMI for smaller companies improved further to 50.8 from 50.4. This is line with the rebound of Caixin PMI. The divergence between Caixin PMI and official PMI showed the smaller companies were more confident in the outlook probably due to policy support.

On sectors, upper stream raw material manufacturing was the key contributor to profitability thanks to recent surge of commodity prices. In addition, equipment manufacturing and high-tech manufacturing also demonstrated a strong recovery of profit. However, most downstream players have not recovered from the pandemic with their profit were still below that in 2019.

Overall, the latest industrial profit data and PMI confirmed that China's recovery remained uneven. This was also echoed by China's top leaders at Politburo in their April meeting on 30 April. Although China's top leadership said China's recovery remained uneven, they also agreed that pressure to stabilize growth has been falling.

China is likely to use this window to push ahead with more structural reform to aim at a more sustainable long-term growth. As such, China's infrastructure investment is expected to take a backseat. This was also confirmed by the decline of construction PMI in April, which fell to 57.4 from 62.3.

Nevertheless, we think manufacturing investment will offset the weak infrastructure investment as China's policy makers shift their focus to revive manufacturing investment and private investment.

On policy, we might see a combination of easing monetary policy but tighter credit policy. China reiterated no u-turn of macro policy last week. This reinforced our view that China is unlikely to tighten its monetary policy in the second quarter. We expect China's liquidity to remain relatively stable in the money market.

However, China's highlight of responsibility of local government leadership to deal with financial risk and ongoing target at property market including the school district housing for the first time showed that China is likely to tighten its grip on credit policy.

The strong pent-up demand for travelling jammed all the major attractions nationwide during the Labor Day holiday. More than 265 million passenger trips are expected to be made. Although it is an encouraging sign for the recovery of domestic demand, it also put China's pandemic control under test again in the context of strong new wave in Asia.

On currency, RMB index returned to above 97. The rebound of RMB index against the backdrop of new wave of virus in Asia showed market's optimism in China's external demand, which is likely to benefit from the production disruption in other parts of the region.

In **Hong Kong**, all eyes will be on 1Q GDP which is due to be released today. We expect 1Q GDP to grow by over 3% yoy, mainly driven by the external demand revival and improvement of local consumption amid subsided infections. Specifically, owing to the rebounding external demand, low base effect and soaring commodity prices, trade data continued to surprise to the upside with exports and imports surging by another 26.4% yoy and 21.7% yoy respectively in March. Going forward, economic recovery may gain further steam as internal and external demand is set to grow amid the gradual relaxation of containment measures and the extension of fiscal stimulus. Domestically, last week, the government announced to kick start the air travel bubble between Hong Kong and Singapore on May 26. Meanwhile, the government announced vaccination bubbles which could allow further relaxation of social distancing measures on condition that more people get vaccinated, effective 29 April. Should vaccination program pick up pace, we could expect further loosening of containment measures. On relief measures, HKMC Insurance Limited announced to start receiving applications for the 100% Personal Loan Guarantee Scheme from 28 April for six months.

In terms of financial market, HKD loan to deposit ratio rebounded to 83.3% in March from 82.8% in February as HKD loans dropped at a milder pace than HKD deposits. Going ahead, HKD loan-to-deposit ratio may rise from recent lows along with the loan demand and therefore help to cap the downside of HIBOR. Elsewhere, southbound bond connect reportedly will be launched in early July. Any moderate southbound inflows under the new connect scheme may help to improve offshore RMB liquidity and limit the downside of HIBOR.

In **Macau,** though gaming revenue surged by 1014.4% yoy in April, the two-year average plunged by 80.6% from April 2019. On a positive note, the gaming sector and inbound tourism may benefit from the Mainlanders’ strong travel demand during Labor Day Holiday while regaining further steam on vaccine-induced reopening in the medium term.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's politburo concluded its April meeting on 30 April setting the tone for key economic policy for the second quarter.	▪ There are five key takeaways from the meeting. ▪ First, although China's top leadership said China's recovery remained uneven, they also agreed that pressure to stabilize growth has been falling. This showed that China will use this window to push ahead with more structural reform to aim a more sustainable long-term growth. ▪ Second, China reiterated no u-turn of macro policy. This reinforced our view that China is unlikely to tighten its monetary policy. We expect China's liquidity to remain relatively stable in the money market. ▪ Third, China's top leadership highlighted the responsibility of local government leadership to deal with financial risk. This will help ensure local government's containment of credit risk will not be disrupted by possible reshuffle of local government leadership ahead of 20th Party Congress in 2022. ▪ Fourth, China's top leadership said it will further boost domestic consumption and accelerate the recovery of manufacturing investment and private investment. Although we believe China's monetary policy is likely to remain accommodative in the near term, China may shift its focus to credit policy against the backdrop of increasing credit risk. As such, growth of China's infrastructure investment may remain sluggish. Nevertheless, we think manufacturing investment will offset the weak infrastructure investment. ▪ Fifth, property market will continue to be the target of regulatory tightening. It is also the first time that China targets the school district housing to prevent speculation.
▪ Air travel bubble between Hong Kong and Singapore will be launched on 26 May. ▪ Return2HK scheme has been expanded to cover all HK residents returning from China.	▪ In terms of the air travel bubble, Hong Kong visitors should take Covid-19 test (within 72 hours before leaving) and receive two jabs of Covid-19 vaccines (14 days before visiting Singapore). For Singapore visitors, there is no requirement for inoculation before arriving Hong Kong. The travel restrictions may be tightened should the local pandemic worsen after the launch of travel bubble. ▪ Though the partial relaxation of travel restriction measures may not be a game changer for the hardest-hit sectors, it could pave way for further border reopening in the future should local pandemic remain well contained after the relaxation.
▪ Hong Kong government announced vaccination bubbles, effective 29 April.	▪ First, 6 types of businesses including pubs that have been forced to close are allowed to reopen should all staff and customers must have received at least one dose of Covid-19 vaccine. Second, restaurants could choose to operate under any of the four modes. By choosing mode A (no requirement of additional containment measures) or mode B (record of customers' information is required), the maximum number of diners would remain at 2 or 4 while the dine-in services could be provided till 6pm or 10pm. By choosing mode C (all staff must have received at least one dose of Covid-19 jab) or mode D (all staff must have received two jabs for 14 days and customers must have been vaccinated by at least one jab), the

	maximum number of diners could increase to 6 or 8 and the dine-in services could be provided till 12am or 2am. ▪ As of 29 April, only about 12% of Hong Kong population has received at least one jab. Whether the new measures will incentivize inoculation remains to be seen. Should vaccination program pick up pace and allow local infections to remain well contained, we may see further relaxation of social distancing measures and border control measures.
▪ HKMC Insurance Limited announced to start receiving applications for the 100% Personal Loan Guarantee Scheme from 28 April for six months.	▪ Hong Kong permanent residents who have been unemployed for at least two months at the time of loan application could apply for loans with a fixed rate of 1% per annum and the maximum amount being six times the average monthly income during January 2020 to February 2021, or HK$80,000, whichever is the lower. The maximum repayment period is six years, with an option of principal moratorium for the first 12 months. Also notable is that there will be full refund of the interest paid after the loan is fully repaid on time. ▪ This supportive measure may help to ease the financial burden of the unemployed and in the meantime ease the imminent bad debt risk facing banks. Meanwhile, it may help to support local consumption which has been dragged down by labor market slack. More importantly, the provision of full refund of the interest paid may incentivize the unemployed to actively search for a new job in order to repay the loans.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's industrial profit surged by 137% yoy in the first quarter of 2021.	▪ After adjusting for pandemic induced base effect, China's industrial profit grew by 22.6% yoy on two-year average in the first quarter. Zooming into March, industrial profit grew by 11.9% yoy on two-year average based on our estimation, down from 31.2% yoy two-year average growth in the first two months of 2021, signs of slowdown. The deceleration of industrial profit in March was in line with cooling industry output in March as initial counter-seasonal boost from travel restriction during the Chinese New Year holiday has faded. ▪ On sectors, upper stream raw material manufacturing was the key contributor to profitability thanks to recent surge of commodity prices, accounting for 46.9% profit growth in the first quarter. Profit from raw material manufacturing surged by 434% in the first quarter. On two-year average basis, profit rose by 40.7%, higher than headline 22.6% yoy growth. ▪ In addition to upper stream sectors, equipment manufacturing and high-tech manufacturing also demonstrated a strong recovery of profit, which grew by 24.1% yoy and 36.8% yoy on two-year average. ▪ However, most down stream players have not recovered from the pandemic.
▪ China's April PMI weakened slightly to 51.1 from 51.9 in March, but above the threshold line of 50 for the 14th consecutive month. ▪ However, Caixin PMI rebounded to 51.9 from 50.6.	▪ The decline in April was broad based with the exception that manufacturing PMI for smaller companies improved further to 50.8 from 50.4. This is line with the rebound of Caixin PMI. The improving sentiment in smaller companies thanks to policy support was encouraging.

	▪ In addition, the decline of raw material input prices may ease the pressure on PPI slightly. ▪ China's construction PMI fell notably to 57.4 from 62.3 probably due to slower rollout of infrastructure investment.
▪ Hong Kong's trade data surprised to the upside with exports and imports surging by another 26.4% yoy and 21.7% yoy respectively in March.	▪ Zooming in, total exports to Asia and the US increased by 27.9% yoy and 8.2% yoy respectively. This confirms the revival of external demand probably due to the vaccine rollout and the extension of fiscal stimulus measures. Meanwhile, imports from top ten trading partners all saw double-digit yearly growth in March with imports from Mainland China growing by 20.2% yoy respectively. This may be partially due to low base effect and soaring commodity prices. More importantly, the rosy data reinforces the fact that regional trade activities continue to expand which may help to weather the impact of potential de-globalization in the medium to long term. ▪ On the other hand, Hong Kong as a key re-export port continue to benefit from the electronic supply chain diversification. Specifically, overseas shipments to Taiwan, Korea and Vietnam growing by 51% yoy, 29.2% yoy and 23.7% yoy respectively. Meanwhile, imports from Vietnam, Taiwan and Korea also rose by 39.5% yoy, 34.9% yoy and 21.8% yoy respectively. By commodity, exports and imports of electrical machinery, telecommunications equipment and office machines as a whole grew by 29.2% yoy and 26.6% yoy respectively. ▪ Going forward, we expect internal and external demand to strengthen further along with the gradual relaxation of containment measures. This may fuel further growth of Hong Kong's trade activities. Still, we remain wary of potential downside risks in the near term including the supply chain bottleneck, lingering pandemic uncertainty and the uneven vaccination pace across the globe.
▪ HKD loan-to-deposit ratio rebounded to 83.3% in March from 82.8% in February as HKD loans fell by 1.3% mom while HKD deposits dropped by 1.8% mom.	▪ Excluding the IPO-related loans, total loans and advances increased by a mild 0.7% mom in March, probably due to the improving business conditions and the receding local pandemic which together may have revived local loan demand. Elsewhere, loans for use outside of Hong Kong remained subdued and dropped 0.6% yoy as overseas loan demand of onshore Chinese companies may have eased due to flush onshore USD liquidity and China's curb on offshore borrowing. Going ahead, we expect loan demand to improve gradually should local economy recovery further on vaccine-supported border reopening. This coupled with low base last year may warrant a low single-digit growth in total loans and advances by end of this year. ▪ On deposits front, excluding the deposits created by IPO-related loans, total deposits and HKD deposits declined by 0.2% mom and 0.4% mom, led by a sharp decrease in HKD CASA deposits (accounted for 67.1% of total HKD deposits) partially due to net outflows from Hong Kong to Mainland China under stock connects. Still, both HKD deposits and total deposits locked in a strong year-on-year growth of 9.2% yoy and 6.6% yoy. Given the flush liquidity across the globe amid major central banks' dovish stance, massive capital inflows

	were not yet seen. Going ahead, as IPO pipeline remains busy while net inflows from Mainland China look likely under the upcoming southbound bond inflows, we expect total deposits to keep showing moderate growth this year. ▪ In conclusion, HKD loan-to-deposit ratio may rebound along with the loan demand and therefore help to cap the downside of HIBOR.
▪ Hong Kong's RMB deposits surged by 22% yoy or rose 1.5% mom to RMB772.5 billion in March. ▪ Southbound bond connect reportedly will be launched in early July and be managed in a closed-loop system.	▪ The increase in RMB deposits may be attributable to the stability and relatively high yield of RMB. Another reason may be foreigners' net selling of Chinese government bond which helped offset the net outflows from HK to China under stock connect. Going ahead, since it looks unlikely for southbound equity inflows to repeat the strength seen in January in the near term, RMB deposits in HK may not have much upside. ▪ The upcoming southbound bond connect may be a new source of offshore RMB liquidity. However, the new connect scheme may bring in only moderate southbound inflows in the beginning given the expectedly limited choices of bonds under the connect schemes and the still attractive yield of onshore bonds. Still, moderate southbound inflows may help to improve offshore RMB liquidity and cap the downside of HIBOR.
▪ Macau's gaming revenue surged by 1014.4% yoy but grew only 1.1% mom to MOP8.4 billion in April. If taking the average of the gaming revenue for last April and this April to net out the base effect, it was still 80.6% lower than the gaming revenue for April 2019.	▪ This indicates that the gaming sector is still far from full recovery amid the ongoing border control measures. Another factor hindering the sector's recovery has been China's tightened grip on cross-border gambling as the PBoC held a working conference on cracking down on the governance of cross-border gambling "fund chain". On a positive note, the gaming sector and inbound tourism may benefit from the Mainlanders' strong travel demand during Labor Day Holiday while regaining further steam on vaccine-induced reopening in the medium term. In a nutshell, we hold onto our view that gaming revenue will grow by about 150% yoy this year.
▪ Macau's unemployment rate remained static at 2.9% while underemployment rate rose by 0.3 percentage point to 4.8% in 1Q from the preceding three-month period. Worse still, the labor force participation rate fell to 69.9%, a level last seen in late 2019.	▪ By sector, the employed population of gaming and junket activities rose for the second consecutive three-month period by 1.2% and the year-on-year decline narrowed to -10.9% in 1Q. Meanwhile, the employed population of hotel, restaurant and similar activities rose 2% yoy. In contrast, the employed population of construction sector and retail sector retreated by 6.3% yoy and 11.2% yoy respectively. In a nutshell, with the gradual recovery of inbound tourism and gaming sector, the relevant industries' employment may improve moderately. This together with the fresh rounds of relief measures may support the retail sector and its employment. However, as there are few large construction projects in the pipeline, construction sector's hiring sentiments may remain subdued. As such, we expect unemployment rate remain elevated in 1H and may fall below 2.5% in 2H 2021.

RMB	
Facts	**OCBC Opinions**

▪ RMB extended its gain last week against both dollar and its major trading partners.	▪ RMB index returned to above 97. The rebound of RMB index against the backdrop of new wave of virus in Asia showed market's optimism in China's external demand, which is likely to benefit from the production disruption in other parts of the region.

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