OCBC TREASURY RESEARCH

Greater China – Week in Review

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Highlights: China still offers high rate of return for foreign investors

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Evergrande flare-up hasn't kept Chinese market down so far. Chinese equity market ended the month of September slightly higher despite rising volatility while RMB was largely isolated from those negative headlines.

Nevertheless, the latest September manufacturing PMI confirmed multiple headwinds faced by the Chinese economy. Despite China's recovery from the impact from delta variant outbreak in August with service sectors returned to expansion territory, the dip of manufacturing PMI below 50 for the first time since pandemic showed that Chinese companies are facing multiple headwinds including the disruption from power shortage and rising raw material prices.

The breakdown of official manufacturing PMI shows that PMI from large corporates rebounded to 50.4 from 50.3 while PMI for medium sized corporates and small corporates fell to 49.7 and 47.5 respectively from 51.2 and 48.2. The divergence of sentiment between large corp and SMEs showed uneven pressures faced by the Chinese corporates. This may justify more monetary support to SMEs including further RRR cut in our view though we still see low chance of outright interest rate cut.

We sense slightly dovish tilt from PBoC 3Q monetary policy committee meeting. Although PBoC reiterated the key messages from the Politburo meeting in late July, the highlight of more supports to the real economy implies that credit policy is likely to be more supportive going forwards.

In addition, PBoC also said it will safeguard legitimate rights of housing consumers in its 3Q monetary policy committee meeting. The tone was echoed by the joint meeting host by the PBoC and banking and insurance regulator last week with major financial institutions to support steady and healthy property market. **The recent meeting fuelled the hopes that China may loosen its tight mortgage standard.** The sporadic report emerged that some cities have lowered the mortgage rates for some home buyers. We think it is possible for China to ease mortgage lending standard further but a chance of broad-based rollback of property tightening is low against the backdrop of China's pursuit of common prosperity.

The news last week that Japan's Government Pension Investment Fund (GPIF) will avoid Yuan-denominated Chinese sovereign bond may affect market's expectation on the size of capital inflows into China's bond market from this month on the inclusion of Chinese government bonds into the FTSE Russell World Government Bond Index.

Nevertheless, Chinese currency regulator SAFE remained positive on the outbreak of portfolio inflows in its latest first half Balance of Payment report. China's non-reserve financial and capital account returned to surplus again in the first half of 2021, first surplus since 2019. The steady inflows under direct investment and portfolio investment offset the outflows from alternative investment. Inflows from foreign direct investment for the first half of 2021 hit US$177 billion, highest in record for the first half of the year.

On service trade, the recent covid bought China more time to restructure its service trade. Although service trade deficit from tourism is likely to remain sizable once border restrictions eased, China's service trade deficit from transportation and intellectual property are expected to narrow as China continued to upgrade its transportation sector as well as boost innovation.

China continued to offer exciting investment opportunities for foreigners with total rate of return in the first half of 2021 stood at 6.4% much higher than 3.3% rate of return earned by China's investment in the world.

Despite strong RMB year to date, SAFE continued to encourage Chinese corporates to increase their hedge of FX exposure. Total hedge ratio rose by 7.5% in the first half of 2021 to 22.8% from that in the first half of 2020.

In Hong Kong, trade data and retail sales both recorded double-digit year-on-year growth in August. This suggests that both the strong external demand and the rebound of local consumption may have supported the economic recovery in 3Q 2021. However, we remain wary of some downside risks facing the trade sector, which include raw material shortage, elevated shipping costs, China's power crunch and the diminishing demand after the reopening- and stimulus-induced surge. Meanwhile, we note that most of the retail outlets' sales value remained well below the level of August 2018 due to the absence of visitor spending. As such, even with the distribution of another instalment of e-consumption voucher on 1st October, retail sales may not return to the pre-pandemic level amid ongoing border controls. In short, retail sales may grow 5-10% yoy this year depending on the timing of border reopening.

On the financial sector front, as market volatility may remain high amid inflation concerns and the Fed's plan to start tapering by end of this year, HKD deposits' yoy growth may have peaked and therefore HKD loan-to-deposit ratio (LDR, rebounded to 84.2% in August) may have troughed. Still, without strong loan demand, the near-term upside of both HKD LDR and local rates are expected to be limited.

Elsewhere, HKMA is studying the feasibility of expanding the use of RMB in Hong Kong stock trading. Though it may take some time for the idea to materialize, the HKMA's move reinforces two big trends. First, we may see further financial integration between Hong Kong and China especially among the Greater Bay Area going forward. Second, Hong Kong continues to play a key role in supporting RMB internationalization. As such, we expect HK's RMB deposits (+25.5% yoy to the highest since January 2016 at RMB842.7 billion) to increase further in the medium to long term.

In Macau, gross gaming revenue rebounded by 32.4% mom to MOP5.88 billion in September but was still 73.4% lower compared to September 2019. Moving into October, gaming sector may lose momentum again as recent virus resurgence locally may undermine the Golden Week Holiday effect.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's currency regulator published its balance of payment report for the first half of 2021.	▪ China's current account surplus remained sizable at US$122.75 billion in the first half although the share of GDP fell to 1.5% from 1.9% in 2020. Goods surplus remained resilient while service deficit remained low. Total service deficit was at US$50.5 billion, down from US$76.55 billion in the same period last year due to cross border people movement control. ▪ As vaccine inoculation rate continued to go higher, global travel is expected to reopen further. However, this is unlikely to derail China's current account balance as China's border is expected to reopen gradually due to China's zero covid strategy. In addition, the recent covid also bought China more time to restructure its service trade. Although service trade deficit from tourism is likely to remain sizable once border restrictions eased, China's service trade deficit from transportation and intellectual property are expected to narrow as China continued to upgrade its transportation sector as well as boost innovation. ▪ China's non-reserve financial and capital account returned to surplus again in the first half of 2021, first surplus since 2019. The steady inflows under direct investment and portfolio investment offset the outflows from alternative investment. ▪ Inflows from foreign direct investment for the first half of 2021 hit US$177 billion, highest in record for the first half of the year. However, foreign direct investment in China's financial sector fell by 22% yoy to US$5.9 billion. ▪ China's total outstanding of foreign assets grew by 3.7% yoy in the first half to CNY9.0278 trillion while total outstanding of liability grew by 7.4% yoy to US$7.0418 trillion. As such, China's net foreign assets fell to US$1.986 trillion. FX reserve remained the largest portion of China's foreign assets though total share fell by 1.5% signalling the redistribution of foreign assets to private sector from public sector. ▪ China continued to offer exciting investment opportunities for foreigners with total rate of return in the first half of 2021 stood at 6.4% much higher than 3.3% rate of return earned by China's investment in the world. ▪ SAFE continued to encourage Chinese corporates to increase their hedge of FX exposure. Total hedge ratio rose by 7.5% in the first half of 2021 to 22.8% from that in the first half of 2020.
▪ Although PBoC reiterated the key messages from the July Politburo meeting in 3Q monetary policy committee meeting, it highlighted it will safeguard legitimate rights of housing consumers.	▪ We sense slightly dovish tilt from PBoC 3Q monetary policy committee meeting. Although PBoC reiterated the key messages from the Politburo meeting in late July, the highlight of more supports to the real economy implies that credit policy is likely to be more supportive going forwards. ▪ In addition, PBoC also said it will safeguard legitimate rights of housing consumers in its 3Q monetary policy committee meeting. The tone was echoed by the joint meeting host by the PBoC and banking and insurance regulator last week with major financial institutions to support steady and healthy property market. The recent meeting fuelled the hopes that

	China may loosen its tight mortgage standard. The sporadic report emerged that some cities have lowered the mortgage rates for some home buyers. We think it is possible for China to ease mortgage lending standard further but a chance of broad-based rollback of property tightening is low against the backdrop of China's pursuit of common prosperity.
▪ Hong Kong's Financial Secretary Paul Chan points out that during the year after the implementation of National Security Law, Hong Kong's IPO proceeds grew by over 50% yoy to more than HK$500 billion while the average turnover of Hong Kong stock market also increased by nearly 70% to over HK$160 billion. Meanwhile, the AUM under asset and wealth management business increased by 21% yoy to about HK$35 trillion in 2020. ▪ KPMG raises the full-year IPO proceeds forecast from over HK$400bn to HK$500bn given that over 200 firms have applied for HK IPO as of end-3Q.	▪ Given US-China tensions' impact on the overseas listing of Chinese companies, it is likely for Hong Kong's IPO market to remain attractive. However, the latest response to new IPOs was rather muted probably due to the heightened regulatory risk in China and the risk-off sentiments across the globe amid inflation concerns and rising long-term government bond yields. ▪ Going forward, we hold onto our view that the financial sector will remain resilient on the back of further GBA financial integration and Hong Kong's unique advantage as the gateway to China. Having said that, we are also wary of the downside risk such as a faster than expected tightening by the Fed amid persistent inflation concerns.
▪ HKMA is studying with other regulators about the feasibility of expanding the use of RMB in Hong Kong stock trading, said the Chief Executive Eddie Yue.	▪ However, they may need some time to gauge the demand of investors and ensure the integration of stock prices denominated in different currencies. On a positive note, if this comes true, it may increase the variety of offshore RMB assets and accelerate the development of CNH derivative products as well as other offshore RMB products. Yue also pointed out that Qianhai and the Greater Bay Area will be the test field for cross-border projects with Hong Kong. ▪ Though it may take some time for the idea to materialize, the HKMA's move reinforces two big trends. First, we may see further financial integration between Hong Kong and China especially among the Greater Bay Area going forward. Second, Hong Kong continues to play a key role in supporting RMB internationalization.
▪ As two new local Covid-19 cases were reported on Sep 25 and 26, Macau's government has entered a state of immediate prevention from Sep 25 which kicks start mass Covid-19 testing and requires the proof of a negative Covid-19 test result obtained within 48 hours for departure from Macau.	▪ Meanwhile, Zhuhai city of Guangdong has tightened the rules on visitor arrivals from Macau while Hong Kong also suspended the Return2HK and Come2HK scheme for Macau residents. ▪ On a positive note, for the mass Covid-19 testing, all have been tested negative. However, Macau will only lift the state of immediate prevention if there is no more local Covid-19 case over the 14 days after the completion of mass Covid-19 testing. As such, even though hotels have been actively offering discounted room rates to try driving up the hotel occupancy rate, Mainland visitors may still be deterred by the new containment measures. If this is the case, Macau's inbound tourism and gaming sector may benefit less than previously expected from China's Golden Week Holiday.

Key Economic News

Facts	OCBC Opinions
▪ China's official manufacturing PMI fell to 49.6 in September, below the threshold line of 50 for the first time since the start of the pandemic.	▪ Despite China's recovery from the impact from delta variant outbreak in August with service sectors returned to expansion territory, the latest manufacturing PMI showed that Chinese

▪ Non-manufacturing PMI, however, rebounded to 53.2 from 47.5 with service PMI rebounded to 52.4 from 45.2.	companies are facing multiple headwinds including the disruption from power shortage and rising raw material prices. ▪ Both demand and supply moderated further in September. New orders fell to 49.3 while production fell to 49.5 from 50.90, below 50 for the first time since February 2020. The decline of production was mainly due to power shortage. ▪ In addition, the breakdown of manufacturing PMI shows that PMI from large corporates rebounded to 50.4 from 50.3 while PMI for medium sized corporates and small corporates fell to 49.7 and 47.5 respectively from 51.2 and 48.2. This showed pressures are building up from rising raw material prices. ▪ The raw material input price rebounded to 63.5 from 61.3. This implies that China's producer price index is likely to remain elevated in the coming months, which may continue to add pressures to companies' profitability in the downstream sectors.
▪ Hong Kong's exports and imports rose by 25.9% yoy and 28.1% yoy respectively in August, roughly in line with expectation.	▪ In particular, the exports to China increased by 30% yoy while the import from China also grew by 28.1% yoy. Besides, imports from all the other nine major partners showed double-digit growth with those from South Korea, Singapore and Taiwan growing at a relatively fast pace by 47.8% yoy, 38.3% yoy and 32.9% yoy respectively. Likewise, exports to Taiwan, Singapore and South Korea increased notably by 49.6% yoy, 34% yoy and 39.8% yoy respectively. By commodity, total exports and imports of "electrical machinery, apparatus and appliances, and electrical parts thereof" advanced by 34.1% yoy and 36.8% yoy respectively. ▪ Taken all together, it points to strong external demand in particular for electrical machinery and electrical parts. Due to the Delta variant outbreaks across the globe, China continued to play a role as the world's factory and in turn supported Hong Kong's re-exports especially given that China partially closed Ningbo's Zhoushan port in August. ▪ Going forward, Hong Kong's trade sector may continue to benefit from the rebounding external demand in the run-up to Christmas holiday. However, we remain wary of some downside risks including raw material shortage, elevated shipping costs, China's power crunch and the diminishing demand after the reopening- and stimulus-induced surge.
▪ Hong Kong's retail sales in value term surged 11.9% yoy in Aug, stronger than expected.	▪ Specifically, the sales value of consumer durable goods (+7% yoy), jewellery, clocks and watches (+28% yoy), goods in department stores (+7.5% yoy) and clothing, footwear and allied products (+41% yoy) all showed notable growth. This is attributable to low base effect and more importantly a combination of e-consumption vouchers, faster-than-expected improvement in labor market as well as the well-contained local epidemic. ▪ However, the e-consumption vouchers could be used for not only goods but also services and transportation. In other words, the economic benefit of the vouchers may not be fully reflected in the retail sales data. Also notable is that most of the retail outlets' sales value remained well below the level of August 2018 due to the absence of visitor spending. As such, even with the distribution of another instalment of e-

	consumption voucher on 1st October, retail sales may not return to the pre-pandemic level amid ongoing border controls. In short, retail sales may grow 5-10% yoy this year depending on the timing of border reopening.
▪ HKD loan-to-deposit ratio rebounded to 84.2% in August from 83.7% in July as HKD loans increased by 0.2% mom while HKD deposits fell by 0.3% mom.	▪ On deposits front, HKD deposits dropped by 3.3% yoy, the first time since May 2020 due to two reasons. First, as HIBOR has been hovering at decade-low, the resultant decrease in time deposit rates has led to continuous decline in HKD time deposits (-18.1% yoy). Second, the increasing volatility of the stock market may have deterred some potential investors as HKD CASA deposits growth slowed down notably from 13.9% yoy in July to 2.7% yoy in August. Since market volatility remains high amid renewed inflation concerns and rising US Treasury yields while local rates may stay low for some time, HKD deposits' yoy growth may have peaked. Still, given the busy IPO pipeline, deposits may show low single digit growth by end of this year. ▪ Total loans (-1.3% yoy in August) may see low single digit growth in 2021. First, trade finance (+17.7% yoy in July) may remain strong given the robust trade activities. Second, loans for use in HK (excluding trade finance), which dropped by 3.1% yoy amid high base effect, may rebound as loan demand may recover along with the improving economic growth outlook. Third, loans for use outside of HK, which fell for the sixth consecutive month by 0.4% yoy, may remain subdued until onshore USD rates go up and border reopening revive overseas M&A activities of Chinese firms. ▪ In conclusion, as the Fed is set to kick start the tightening cycle, HKD loan-to-deposit ratio (LDR) may have troughed. Still, without strong loan demand, the near-term upside of both HKD LDR and local rates are expected to be limited
▪ Hong Kong's RMB deposits showed double-digit growth for the 10th consecutive month and were up by 25.5% yoy to RMB842.7 billion in August, the strongest since January 2016.	▪ We see four reasons behind the strong growth. First, seasonal factors including half-year end in June and corporate tax payments in July have abated. Second, the PBoC cut RRR and took actions to keep liquidity reasonable ample. Third, southbound net outflows under stock connects moderated in August after reaching record high in July. Finally, banks in Hong Kong have raised RMB deposit rates in preparation for the launch of wealth management connect. ▪ Going forward, the resilience of RMB and the attractive RMB deposit rates may continue to support the growth of RMB deposits. Meanwhile, the further financial integration of the Greater Bay Area may also help to increase offshore RMB liquidity though the net inflows of RMB to Hong Kong under southbound bond connect and wealth management connect are expected to be moderate at this juncture.
▪ Macau's gross gaming revenue (GGR) increased by 165.9% yoy or 32.4% mom in August as travel restrictions and local containment measures have been relaxed.	▪ However, the GGR was still 73.4% lower compared to August 2019. Due to the rebound of local Covid-19 cases, the new containment measures look set to weigh on inbound tourism and gaming activities as the Golden Week Holiday effect may be undermined. As such, we further lower our full year GGR growth forecast from about 70% yoy to around 60% yoy. In this case, this year's gaming revenue may only return to about 32% of 2019's level.

▪ Macau's jobless rate dropped to 2.8% during the three months to August from 2.9% in the prior three-month period. Meanwhile, employed population and labour force participation rate both increased from the previous three-month period.	▪ By sector, the employed population of gaming sector increased year-on-year for the first time since early 2020 while that of restaurant & similar activities continued to grow notably by 10.1% yoy. Taken all together, it suggests some improvement in the labour market. However, the rebound of local Covid-19 cases and the virus resurgence in China have slowed down the recovery of both inbound tourism and gaming sector. As such, the jobless rate looks unlikely to fall below 2.5% by end of this year. ▪ In the medium term, should the gaming sector's recovery be hindered by the tightening control from China, it may take longer for the labor market to return to pre-pandemic level as gaming sector has been the largest employer in the city.

RMB	
Facts	**OCBC Opinions**
▪ RMB remained on the strong side against both dollar and its major trading partners.	▪ RMB Index briefly broke 100 riding on the broad dollar strength last week. Given still resilient fundamental support such as balance of payment inflows, we expect RMB to remain resilient. The near term will depend on the development of US-China relationship with mixed headlines circulating right now.

Treasury Research & Strategy

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