Greater China – Week in Review

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Highlights: commitment to opening intact

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The Chinese government bonds outperformed its global peers by a wide margin in the first quarter of 2021 amid the sell-off. The 10-year government bond yield only went up by about 5 basis points as compared to the rise of 60-90 basis points in the UK, US and Australia. The loose correlation between Chinese government bond and its western peers and still favorable yield differential will continue to attract foreign inflows into China's bond market.

FTSE Russel announced on 29 March that it will add Chinese sovereign bonds into its global bond index with the weighting of 5.25% beginning of at the end of October 2021. The inclusion will be phased over a period of 36 months.

The longer than expected phase-in period as compared to 10 months inclusion for JP Morgan Government Bond Index Emerging Market and 20 months inclusion for Bloomberg Barclays Global Aggregate Index indicates less than expected monthly inflows, which are estimated to be around US$3.6-4 billion on average.

On currency, the recent weakness of RMB against the dollar did not stop Chinese currency regulator from further loosening its control. China expanded its pilot qualified domestic limited partner program throughout Guangdong province to facilitate outbound investment scheme. Meanwhile, SAFE also announced further relaxation to optimize the process for individuals to purchase foreign currency under the current account. We may see more measures encouraging outflows, indicating China's rising appetite for two-way movement of RMB.

In addition, PBoC official confirmed that the central bank has tested the cross-border usage of digital RMB with Hong Kong Monetary Authority. However, we think the near-term impact is very limited. We think China's digital currency was not designed to challenge the dollar's reserve currency status.

On economic data, the latest strong rebound of PMI in March confirmed that the divergence between weak PMI and strong industrial activities in January and February was mainly distorted by the resurgence of virus. China's industry sector is expected to remain the key driver to China's growth this year.

In **Hong Kong,** eyes were on HKD's weakness early last week which was attributable to broad dollar strength, RMB weakness and the widened HKD supply and demand gap. Going ahead, the elevated stock market volatility may undermine investors' interests in IPOs and curb southbound equity inflows. Meanwhile, loan demand may be muted given the lingering pandemic uncertainty, ongoing border controls and weakened IPO loan demand. In conclusion, due to the weak HKD demand, the risk remains tilted to the downside for both HKD spot and HKD rates. However, we see low probability of USDHKD spot touching 7.80 in the near term given the inactive carry trade, the still strong interests of companies in getting listed in HK, the low probability of massive outflows and the upcoming concentrated dividend payout during June to August. Should Hong Kong allow first Special Purpose Acquisition Company (SPAC) by end of this year, it may further increase the competitiveness of HK's IPO market.

On the political front, China approved HK's electoral system overhaul on 30 March. Though Hong Kong issue remains a key proxy battleground for the US-China relationship, it has not yet affected HK's financial system and therefore may not have much impact on the HK market at this juncture.

On the economy, retail sales grew for the first time in two years during February. Going ahead, retail sales may keep up with the strong yearly growth amid low base effect and receded local infections, but broad-based recovery of the retail sector may require border reopening and labour market improvement.

In **Macau,** gross gaming revenue rebounded by 13.6% mom to the highest since Covid-19 outbreak, but still 65.9% lower than the monthly average of 2019. We tip a growth of around 150% for gross gaming revenue this year on assumption that border controls will be further relaxed in 2H.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ FTSE Russel announced on 29 March that it will add Chinese sovereign bonds into its global bond index with the weighting of 5.25% beginning of at the end of October 2021. The inclusion will be phased over a period of 36 months.	▪ The weighting is in line with market expectation of 5-6%. However, the 36-month inclusion phase is longer than initially expected. In comparison, it took 10 months for Chinese government bonds to be included in the JP Morgan Government Bond Index Emerging Market (GBI-EM) and 20 months for Chinese government bonds and policy bank bonds to be included in Bloomberg Barclays Global Aggregate Index. According to the FTSE Russel, the longer than expected phase-in period probably reflected the decision for an orderly transition. ▪ Nevertheless, this also indicates that upcoming monthly inflows into China's government bonds from passive investors will be much smaller than expected. Given it is estimated that about US$2.5-3 trillion funds may track the index, this means that the inclusion will bring in additional US$4 billion per month on average.
▪ PBoC official confirmed that the central bank has tested the cross-border usage of digital RMB with Hong Kong Monetary Authority. ▪ In addition, China also accelerated the collaboration with its counterparty in Thailand and UAE to study the use of its digital currency in cross border payment with the support from BIS innovation hub.	▪ Digital Yuan is an eye-catching topic against the backdrop of US-China tension. However, we think it is unlikely to be designed to challenge dollar's reserve currency position. Instead, it will mainly help facilitate domestic payment and cross border payment more efficiently.
▪ China's currency regulator announced further relaxation to optimize the process for individuals to purchase foreign currency under the current account. ▪ In addition, SAFE also expanded its pilot qualified domestic limited partner program throughout Guangdong province to facilitate outbound investment scheme.	▪ As China is embracing the higher flexibility of RMB, the restrictions have been gradually loosened. This shows higher appetite for rising two-way movement of RMB.
▪ USDHKD spot broke above 7.77 and traded at an over one-year high. The weakness of the HKD spot may be attributable to broad dollar strength, RMB weakness and the widened HKD supply and demand gap.	▪ Going ahead, the elevated stock market volatility may undermine investors' interests in IPOs and curb southbound equity inflows. Meanwhile, loan demand may be muted given the lingering pandemic uncertainty, ongoing border controls and weakened IPO loans. ▪ In conclusion, due to weak HKD demand, the risk remains tilted to the downside for both HKD spot and short-end HKD rates. Should broad dollar index strengthen further, USDHKD spot may edge higher. ▪ However, the currency pair may not test 7.80 in the near term. First, since the Fed stresses its commitment to low rates, the HKD-USD interest rate gap may not be wide enough to prompt short HKD/long USD carry trade. Second, with companies lining up for HK IPO / secondary listing, there may still be IPO-related HKD demand should HK stock stabilize. Third, massive equity outflows are unlikely as both the Fed and PBoC are likely to keep monetary policy unchanged. Fourth, there will be concentrated dividend payout during June to August which will increase HKD demand. All these factors may also help to

	cap the downside of front-end HKD rates. As such, though 1M HIBOR may subside towards 0.12% or even 0.1%, 0.1% may be a strong support.
▪ Hong Kong reportedly will consult on Special Purpose Acquisition Company (SPAC) listing framework in June and target allowing first SPAC listing by end of this year.	▪ SPACs normally put the IPO proceeds into a trust which will be then used to acquire a company. If the acquirement cannot be finished within two years, shareholders will get paid back. The total proceeds of SPAC listings in the US totalled US$96.4 billion year to date, more than the US$83.4 billion for 2020 as a whole. Since SPAC listing has been a main driver of the US IPO market growth, the SEC was said to look into the frenzy. Against this backdrop, Hong Kong may set tighter rules than the US in order to fill the loophole of the regulatory system (the absence of a collective action mechanism) and protect the investors. This may help to enhance the competitiveness of Hong Kong's IPO market as the stock exchanges of Singapore and Indonesia have also planned to allow SPAC listing in the near term.
▪ China approved HK's electoral system overhaul on 30 March.	▪ The number of seats in the Legislative Council (LegCo) will be expanded to 90 from 70 with the number of directly elected seats reducing to 20 from 35. Another 30 seats will be reserved for "functional constituencies" and the remaining 40 representatives appointed by the Election Committee. A new committee with fewer than 10 members will be established to vet all candidates for the elections. The member of the committee will be chosen by the Committee for Safeguarding National Security and China's national security office in Hong Kong. ▪ China's move to revamp HK's electoral system has prompted the US Department of State to sanction 24 Chinese and HK officials. However, all of them have already been sanctioned by US Department of the Treasury. This indicates that the US has not yet aggressively responded to HK issue. Since the political risk has not yet affected HK's financial system, it may not have much impact on HK market at this juncture.

Key Economic News

Facts	OCBC Opinions
▪ China's PMI rebounded in March to 51.9 from 50.6 in February.	▪ Both supply and demand rebounded strongly. Production index rose to 53.9 from 51.9 while new orders rose to 53.6 from 51.5. New export orders also rebounded to 51.2 from 48.8, back to expansion again. ▪ The strong rebound of PMI in March was mainly due to the abating concerns about the resurgence of virus before the Chinese New Year holiday. The divergence between weak PMI and strong industrial activities in January and February reflected the distortion from the resurgence of virus. ▪ Raw material input price rose to 69.4 from 66.7, highest since December 2016 reflecting the recent rally of commodity prices. This is likely to support profit in the upper stream industries. However, this will translate to higher PPI. We expect China's PPI to accelerate to about 3% yoy in March. ▪ Construction PMI rebounded strongly to 62.3 from 54.7 partially due to seasonal effect.

▪ Hong Kong's retail sales increased 30% yoy in February, ending 24 consecutive months of declines. ▪ After netting out the base effect associated with the different timing of Lunar New Year holidays, retail sales grew by 2.7% yoy during the first two months. This may be partially attributable to the low base as Covid-19 outbreak started in late last January. ▪ Online sales which accounted for 6.1% of total retail sales in February increased by 74.5% yoy during the first two months of this year. ▪ The BioNTech Covid vaccination will be resumed on Monday.	▪ Zooming in, during the first two months, the sales of consumer durable goods (+28.1% yoy), commodities in department stores (+4.1% yoy), clothing, footwear and allied products (+7.5% yoy) as well as jewllery, watches and clocks and valuable gifts (+3.2% yoy) all increased. However, the sales of medicines and cosmetics (-23.1% yoy) and alcoholic drinks and tobacco (-61.7% yoy) both dropped notably during the same period, reflecting the lingering impact of border controls and social distancing measures. ▪ Going forward, the retail sector's performance may be divided. On the one hand, for the retail outlets targeting local consumers, the outlook is improving owing to the expectedly gradual relaxation of social distancing measures and the upcoming e-consumption vouchers. However, the near-term upside may be capped by the elevated unemployment. On the other hand, for the retail outlets targeting tourists, the outlook remains bleak as the slow vaccine rollout at home and abroad means that border reopening is unlikely in the near term. Whether the lifting of border control measures will warrant a strong recovery in both inbound tourism and retail sector remains uncertain given the weak labor market across the globe and the diminishing interests of some Mainlanders in visiting Hong Kong post 2019 social unrest. ▪ In conclusion, we expect retail sales to grow around 15% yoy this year, which however will still be lower than the level of 2019. Given the prevalence of online shopping, the road to recovery may be bumpier for the retail shop market.
▪ HKD loan to deposit ratio fell from 83.9% in January to 82.8% in February as HKD loans (-13% mom) fell at a faster pace than HKD deposits (-11.8% mom).	▪ The sharp decrease in loans and deposits was partially due to the slowdown in IPO activities. Excluding IPO loans, total loans and advances would have dropped by 0.9% mom in February, due to large loan repayments and subdued local loan demand amid lingering uncertainty about economic growth outlook. On the other hand, loans for use outside of Hong Kong only showed mild growth of 0.6% mom or 0.8% yoy in February due to the flush USD liquidity in the onshore market, the subdued overseas M&A activities and China's curb on offshore borrowing. Going ahead, loan growth may remain sluggish until the economy shows stronger recovery. We tip a low single-digit growth in total loans and advances (+3.2% yoy in February) this year. ▪ On the deposits front, excluding deposits created by the IPO-related loans, HKD deposits would have decreased by 2.7% mom as equity-related inflows have slowed down notably post Lunar New Year holiday and corporate customers have withdrawn deposits for large loan repayments. However, we do not see much downside in HKD deposits as massive outflows look unlikely against the backdrop of flushed global liquidity and the IPO pipeline remains busy. This year, both HKD CASA deposits (+38.2% yoy in February) and HKD total deposits (+10.5% yoy in February) may see moderate growth with HKD CASA deposits to HKD total deposits ratio (dropped slightly to 68.1% in February) staying above 65% in the near term. Meanwhile, HKD loan to deposit ratio may stay below 85% in the coming months. Given the wide HKD supply-

	demand gap, HKD rates may be anchored to multi-year lows. As such, banks' net interest margin may remain compressed in the near term.
▪ Hong Kong's RMB deposits dropped by 4.6% mom to RMB761 billion in February.	▪ Since southbound equity inflows slowed down notably post Lunar New Year holiday, RMB deposits retreated. On a positive note, given a stable RMB and the attractive yield of RMB assets, we see limited downside of RMB deposits in Hong Kong. However, further increases look unlikely either until China allows more freely cross-border flows such as launching southbound bond connect, wealth management connect, cross-border RMB cash pooling, etc.
▪ Macau's gross gaming revenue increased for the second consecutive month by 58% yoy to MOP8.3 billion in March, the highest since Covid-19 outbreak. On monthly basis, the gaming revenue also rebounded by 13.6%.	▪ The rebound was mainly attributable to the relaxation of control measures on some Mainland visitors and those on the gaming centers. Having said that, gaming revenue for March was still 65.9% lower than the monthly average of 2019. On the one hand, Mainland visitors have been deterred by the time-consuming visa application process, the requirement of Covid-19 tests and the lingering virus concerns. On the other hand, the travel restrictions on visitors from countries/regions other than Mainland China remain stringent. In conclusion, even though we may see significant year-on-year growth in gaming revenue during the rest of the year, it would mainly be a result of low base effect. Any strong recovery looks unlikely until border reopens on a broad basis hopefully in the second half of this year. We tip a growth of around 150% for gross gaming revenue this year. ▪ Elsewhere, since China has tightened the grip on overseas gambling to crack down on money laundering, junket operators have been hit hard. This may hinder the revival of high-roller demand even if the border reopens. The expiry of gaming licenses in June 2022 is another uncertainty needed to be closely monitored.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY broke 6.55 last week. The pair was traded in a new range of 6.55-6.6.	▪ Again, the weakness was mainly the result of stronger broad dollar. RMB index continued to hover around 97 level despite the initial retreat in early week. China's rising appetite for two-way movement of RMB indicates room for further correction of RMB against the dollar should dollar index extend its recent gain globally.

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