OCBC TREASURY RESEARCH

Greater China – Week in Review

7 June 2021

Highlights: bumpy road ahead

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Soon after China and US restarted their more regular communications on economic and trade issues following the virtual meeting between Vice Premier Liu He and US Treasury Secretary Janet Yellen, President Biden signed an executive order on 3 June to update an investment blacklist which bans US entities from investing in Chinese companies with ties to defense or surveillance technology.

The number of Chinese companies in the blacklist was expanded to 59 from previously 48 identified by Trump Administration in 2020. The expansion of the list was mainly due to the official inclusion of subsidiaries or related companies of blacklist companies.

In addition, the expansion of the scope of targeted companies beyond those with military ties to those in the surveillance technology sector indicated that the list may grow longer in future.

Nevertheless, the new blacklist will be created and maintained by the US Treasury Department instead of Department of Defense. This gives market hopes that the list could be more rational due to Treasury team's closer linkage with financial market.

The recent Covid-19 outbreak in Guangzhou, capital city of Guangdong Province, has caught attention given Guangdong's role as China's major economic and transportation hub. Guangdong's GDP has crossed CNY11 trillion in 2020, on par with that of South Korea for the first time. In addition, Guangzhou's Baiyun airport was ranked as the world's busiest airport during the pandemic in 2020.

Guangzhou tightened travel restriction further. Passengers leaving the city are required to present negative nucleic acid test results within the last 48 hours and most people are suggested not to leave the city or province on non-essential trip.

In the first week of June, Guangzhou's mobility has slowed down significantly. According to the City's transportation bureau, the number of passengers in railway hubs and highway fell by 61.7% and 78.4% respectively while passengers in Baiyun Airport also fell by 64 percent.

Nevertheless, given the city has rolled out massive testing and China's rapid vaccine inoculation pace with total 763 million doses have been administrated as of 5 June, we see low risk of any shock to our growth forecast though we will continue to monitor whether there is any spillover effect to global supply chain due to Guangdong's role as major trading hub.

China's move to stabilize currency expectation managed to bring two-way volatility back to the market last week. China's first RRR hike for foreign currency deposit sent a signal that there are enough tools in central bank's toolbox to curb RMB's one-way movement expectation even though PBoC has exited the direct intervention. For details, you may refer to our report here. We won't be surprised to see China to retap previous policy innovation in 2007 to ask banks to use foreign currency to pay RMB reserve should dollar liquidity remain excessive.

For this week, other than May inflation data and credit data, market will also watch out for the upcoming in-person China-ASEAN foreign ministers meeting, held in Chongqing from Monday to Tuesday with topic of vaccination passport could be the point of interest.

In **Hong Kong,** PMI for the private sector reached the highest since February 2014 at 52.5 in May, indicating that 1Q's strong GDP growth may sustain into 2Q. However, the frozen inbound tourism continues to weigh as retail sector failed to gain further steam in the absence of tourist spending. As a relatively high vaccination rate would be a pre-condition for safe border reopening, the public and private sectors have been active in incentivizing inoculation. We will closely monitor whether the vaccination program will pick up pace in the coming months. Should any further relaxation of containment measures allow local housing demand to strengthen and bring back external demand, we do not rule out the possibility of housing price refreshing record high this year.

On the financial market front, Angelalign Technology's public offering has received stronger response than JD Logistics. This coupled with strong response to iBond and HK-listed Chinese companies' preparation for dividend payments has boosted HKD demand. As a result, USDHKD spot dropped below 7.7600 to three-month low. Having said that, HKD rates have barely moved, probably due to the flush HKD liquidity and the lowered HKD loan-to-deposit ratio. Going ahead, HKD demand may remain relatively strong amid the upcoming half-year end, continuous dividend payments (during June to August) and potential large IPOs in June. However, until local loan demand rebounds and pushes up HKD loan-to-deposit ratio or the Fed starts to tighten policy, the gap between HKD demand and supply may persist and warrant a lower for longer HKD rates. As such, we see low probability of USDHKD spot retesting 7.75 in the near term.

In **Macau,** gross gaming revenue grew to the highest since pandemic started in May. However, the recent virus resurgence in Guangdong province looks set to put a lid on a further recovery of Macau's inbound tourism and gaming activities.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ President Biden signed an executive order on 3 June to update an investment blacklist which bans US entities from investing in Chinese companies with ties to defense or surveillance technology. ▪ The ban will take effect from 2 August and US investors need to unwind their investing within 365 days from the date of listings.	▪ The number of Chinese companies in the blacklist was expanded to 59 from previously 48 identified by Trump Administration in 2020. The expansion of the list was mainly due to the official inclusion of subsidiaries or related companies of blacklist companies. In addition, the expansion of the scope of targeted companies beyond those with military ties to those in the surveillance technology sector indicated that the list may grow longer in future. So far, only two companies including Hangzhou Hikvision Digital Technology and Huawei Technologies are included. The US Treasury department is likely to give guidance later on what the scope of surveillance technology means. ▪ Nevertheless, the new blacklist will be created and maintained by the US Treasury Department under the new executive orders instead of Department of Defense. This gives market hopes that the list could be more rational due to Treasury team's knowledge about the economic issue though it sparked some concerns among the hardliners in the US about the historical close relationship between Treasury and wall street.
▪ The first China-Europe freight train bound for Netherland from Nanjing, capital city of Jiangsu Province arrived on 4 June. ▪ In addition, China's Shanxi Province launched its first direct China-Europe freight train services to France on 2 June.	▪ The trade linkage between China and Europe is expected to boom unaffected by the recent political dispute over human rights.
▪ Guangzhou, capital city of China's economic powerhouse Guangdong Province, tightened travel restriction further to curb the recent outbreak of Covid-19.	▪ According to local health commission, Guangzhou has identified 94 community cases of Covid-19 from 21 May to 5 June. Guangzhou has rolled out massive testing in the past week. Effective from noon 7 June, passengers leaving the city are required to present negative nucleic acid test results within the last 48 hours tightened from previous 72 hours from 31 May. Meanwhile, the latest window guidance from the local health commission suggested local people from government agencies, enterprise, institutions, schools and travel agencies not to leave the city or province on non-essential trip. ▪ In the first week of June, Guangzhou's mobility has slowed down significantly. According to the City's transportation bureau, the number of passengers in railway hubs and highway fell by 61.7% and 78.4% respectively while passengers in the world's busiest airport during the pandemic in 2020 Baiyun Airport also fell by 64 percent.
▪ Hong Kong Chief Executive Carrie Lam announced the launch of the "Early Vaccination for All" campaign which aims to build an immune barrier in Hong Kong by significantly increasing the vaccination rate from now until the end of August. She also hinted that the government would roll out a raft of measures and reward programmes such as vaccination leave of government employees while encouraging private companies	▪ Since the government and private companies have held and to incentivize inoculation, the share of population received at least once dose of Covid-19 vaccine has increased from 17.37% on 27 May to 19.25% on 3 Jun, reflecting a slight acceleration. Since the government pointed out that the lifting of Covid-19 restrictions would require the vaccination rate should reach 70% or above, we will closely monitor whether the campaign could effectively support the vaccination program could pick up pace in the coming months.

to support the campaign. Furthermore, Lam pointed out that vaccination is expected to be an indispensable requirement for business or leisure trips to China and other places in the future.	

Key Economic News

Facts	OCBC Opinions
▪ China's manufacturing PMI moderated slightly to 51 in May from 51.1 in April.	▪ The moderation of manufacturing PMI was mainly due to weaker demand as both new orders and new export order softened to 51.3 and 48.3 from 52 and 50.4 respectively. Production, however, continued to expand with production index rose to 52.7 from 52.2. Raw material price index continued to jump to 72.8, highest since November 2010. The higher raw material cost may squeeze manufacture's profit.
▪ HKD loan-to-deposit ratio dropped slightly from 83.3% in March to 83.2% in April as HKD deposits (-0.5% mom) fell at a milder pace than HKD loans (-0.7% mom).	▪ On loans front, excluding the IPO-related loans, total loans and advances would have grown by 0.2% mom or 2.6% yoy. Local loan demand is expected to improve gradually as local epidemic has been well contained lately. However, until containment measures are further relaxed, we may not see a significant rebound in local loan demand despite the brief impact of IPO activities. On the other hand, loans for use outside of Hong Kong (-3.2% yoy) may remain subdued due to the flush USD liquidity in the onshore market and China's curb on overseas financing. Taken all together, we expect total loans and advances to show low single-digit growth by end of this year. ▪ On deposits front, excluding the deposits created by IPO-related loans, total deposits and HKD deposits would have increased by 0.3% mom and 0.1% mom respectively. Also notable is that the year-on-year growth of total deposits and HKD deposits remained solid at 8.1% yoy and 5.7% yoy respectively. Meanwhile, HKD CASA deposits to total HKD deposits ratio rebounded from 67.1% in March to 67.8% in April. Taken all together, it points to flush liquidity. However, excluding IPO-related deposits, the year-on-year growth of total deposits or HK deposits may slow down gradually given the latest equity outflows under stock connects, the rising concerns about the Fed's early tapering and the high base effect. We expect total deposits to see low single-digit growth by end-2021. ▪ In a nutshell, until local loan demand rebounds and pushes up HKD loan-to-deposit ratio or the Fed starts to tighten policy, the gap between HKD demand and supply may persist and warrant a lower for longer HKD rates.
▪ Hong Kong: RMB deposits rose 20% yoy or 1.2% mom to RMB781.95 billion in April.	▪ First, CNH appreciated against both HKD and USD in April. Second, CNH deposits offered relatively high interest rates. These factors have supported the growth of RMB deposits. However, as Hong Kong saw net equity outflows under stock connects for the second consecutive month in April while offshore investors have remained highly interested in onshore bonds, the upside of HK's RMB deposits has been capped. ▪ Going forward, the strength and relatively high yield of RMB may allow RMB deposits to remain strong. However, whether

	there is more upside ahead may hinge on the cross-border flows. Should wealth management connect and southbound bond connect be launched as expected in July, any resultant southbound inflows may help to improve RMB liquidity and add some upward pressure onto HK's RMB deposits.
▪ Hong Kong's retail sales growth surprised on the downside at 12.1% yoy in April, partially due to the easing low base effect.	▪ On the one hand, the retail sales of "food, alcoholic drinks and tobacco" and "goods in supermarkets" dropped by 3.7% yoy and 12.7% yoy respectively while retail sales of consumer durable goods saw the year-on-year growth narrowed from 34.4% yoy in March to 12.6% yoy in April. This suggests that retail outlets that thrived during stay-at-home period last year might have lost some momentum due to the resumption of economic activities. On the other hand, the retail sales of "clothing, footwear and allied products", "jewelry watches and clocks, and valuable gifts" and "medicines and cosmetics" grew by 60.2% yoy, 93.2% yoy and 16.4% yoy respectively. These retail outlets have regained traction thanks to the rebound in local consumption amid receded local epidemic and relaxation of social distancing measures. However, these retail outlets remained far from full recovery due to the heavy reliance on tourist spending. ▪ We expect retail sales to stabilize in the next two months on the back of well-contained local epidemic and improvement in labor market while showing stronger recovery in 2H given e-consumption vouchers and the expected border reopening. If this is the case, we expect retail sales will grow by 10%-15% this year.
▪ Hong Kong's PMI for the private sector has stayed in the expansion territory for the fourth consecutive month, reaching the highest since February 2014 at 52.5 in May. Output grew at the fastest pace since February 2018 while new orders including export orders increased. Business activity also saw strong improvement. More notably, new business from Mainland China rose for the first time in three years.	▪ Taken all together, it suggests that private sector's business conditions continued to improve as further relaxation of social distancing measures has supported the resumption of economic activities and external demand has revived further. However, firms reported lower staffing levels on average, the first decline in four months. This reinforces our view that the improvement in the labor market may remain moderate. Also notable is that the PMI data showed signs that supply constraints started to add inflationary pressure. This coupled with the low base effect may push CPI growth up above 3% yoy in 3Q.
▪ Hong Kong's housing price index increased by 3.5% yoy in April to the highest since July 2019, just 1.5% away from all-time high. Housing transaction volume also grew consecutively for one year and was up by 18% yoy to 7084 deals in May. More notably, new home launch in Tai Wai has been oversubscribed by 80.6 times lately.	▪ Taken all together, it points to solid local housing demand probably due to the well-contained local epidemic, the improvement in labor market and a low-rate environment. The narrowed decline of housing rent (-1.2% yoy in April, the mildest in 19 months) may have helped revived investment demand. Also, small businessmen's needs to liquidate their assets may have eased given the improving business conditions. As such, medium to large home (100-159.9 square meters, +5.4% yoy) started to catch up to the luxurious ones in terms of year-on-year growth. On the supply side, the supply crunch remains intact as housing completions and housing starts decreased by 36.2% yoy and 88.8% yoy respectively to 3215 units and 145 units during 1Q. ▪ Moving into the rest of this year, we do not rule out the possibility of housing price refreshing record high should any further relaxation of containment measures allow local

	housing demand to strengthen and bring back external demand. Still, we remain wary of some downside risks such as virus resurgence, delays in reopening and the Fed's premature tapering. In a nutshell, we hold onto our view that housing price index will grow by up to 5% yoy as of end-2021.
▪ Macau's gross gaming revenue grew by 492.1% yoy to MOP10.4 billion in May, beating market expectations and reaching the highest since pandemic started.	▪ Owing to the pent-up travel demand of Mainlanders and the Labor Day Holiday effect, inbound tourism regained further momentum in May. This in turn boosted gambling demand. However, gross gaming revenue was still 59.8% lower than the level of May 2019. Also notable is that Macau has tightened travel restrictions on tourists from some parts of China where mini lockdowns have been imposed amid virus resurgence. Worse still, the relatively slow vaccination rate across Asia including Macau itself means that further border reopening is unlikely in the near term. Meanwhile, we remain wary of China's crackdown on cross-border gambling and the uncertainty about the renewal of gaming licenses before June 2022. ▪ In a nutshell, we expect the year-on-year growth of gaming revenue to be remarkable amid low base effect with the full-year growth likely printing over 100%. However, the recovery itself looks likely to remain moderate and may not bring the gaming sector back to the pre-pandemic levels anytime soon.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com