Greater China – Week in Review

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Highlights: falling expectation on imminent RRR cut

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Ahead of the release of China's 3Q GDP, the September trade, credit and inflation data unveiled last week gave us a first glimpse of the impact of recent event risks such as regulatory tightening, debt crisis in property market and power shortage etc on growth prospect. For details, you may refer to our special report <warm on the outside, cold on the inside>.

The widening gap between PPI and CPI to a fresh high in September has been one of the key focuses. in its latest press conference, PBoC expects upward pressures on PPI from the recent power shortage. However, PBoC expects PPI to peak in 4Q and go down gradually from the end of this year. It seems that PBoC shared the view with the major central banks that inflation is transitory.

China's government bonds were sold off last week after returning from the golden week holiday. The increase of government bond yields in China was mainly attributable to three factors including concerns about inflation amid global energy crisis, higher longer end yields globally and reduced expectation on imminent monetary easing. In addition, PBoC's comments in its latest press conference that current 2.95% 10-year gov bond yield is relatively low last Friday may further reinforce market expectation on higher yields.

The latest messages from PBoC press conference together with the full rollover of MLFs last Friday dialled back market expectation on imminent RRR cut. Although PBoC reckoned the challenges faced by smaller and micro companies due to margin pressures from the widening gap between PPI and CPI, PBoC focused more on other measures such as relending and capital market tools to support smaller companies. In addition, the decline of the average borrowing costs for smaller companies by 19bps in the first three quarters of 2021 may also give PBoC the room to take a wait-and-see approach. This hinted that PBoC may be in no rush to support smaller companies via another RRR cut.

PBoC is less concerned about the Evergrande debt crisis. PBoC official said the financial liabilities of Evergrade are less than one third of its total liabilities.

On positive note, PBoC and China's banking and insurance regulators have conducted sharing sessions with financial institutions at the end of September to **correct some misinterpretations** of recent credit polices to developers to avoid overreaction of financial institutions.

Nevertheless, uncertainty remains in China's property space. Although we believe China's top leadership has no appetite for the systemic risk, **what we don't know this time is where the red line is.** The ground feedback we received is that although some local governments want to relax property tightening measures due to the sharp decline of land sales, the grip from financial regulators remains tight. The tug of war between local governments and financial regulators indicates the lingering uncertainty associated with the property sector. **In addition, President Xi's reiteration for rollout of property tax in his latest opinion piece in Qiushi magazine to purse common prosperity also suggests that this time is different.**

Hong Kong was in the spotlight last week. **First,** The Hong Kong Exchange announced the MSCI China A50 connect (USD) Index futures, a broad-based benchmark index capturing mid and large cap China A share, has been approved by the CFTC in the United States. With the increasing demand for investors to build their portfolio in onshore equities, while Beijing crack down on private companies, from technology to private education, there will be increasing needs for hedging risk. **Second,** Shenzhen government has completed its roadshow to issue up to RMB 5 billion municipal government bond in Hong Kong on Oct 12. This marks as the first direct offshore debt sales by the domestic local government. Among the 3- and 5-year bonds, both of which are expected to finance the sustainability project "Sponge City" and water treatment project in accordance with the Green Finance Framework. As such, we think this may further facilitate and promote the financial cooperation between China and Hong Kong, and again highlighting Hong Kong's unique role as the gateway for international investors to access China. **Third,** on economic front, according to the ESS program of secretary, a total of HK$ 91.1 billion have been distributed under the employment support schemes. This had benefited more than 1.95 millions of employees, but 14% higher than the original budget, simply driven by the average number of beneficiaries were higher than the government expected. This emphasizes the fact that the program had successfully stabilized the job market, while with an intention of decreasing the city's unemployment rate. To sum up, supported by the government and better business sentiment, the unemployment rate fell faster than expected in the first 8 months of 2021. We expect unemployment rate to decline further albeit at a much slower pace due to the ongoing border controls. In other words, the overall jobless rate might stay above 4% in the near term.

In **Macau,** the government has announced to lift its measures for some of the entertainment and casino venues starting on 19th Oct after 11 consecutive days with no new confirmed cases. Meanwhile, Macau's casinos have implemented new mandate for all staff members to either subject themselves to weekly testing or show proof of vaccination. However, as Macau's 59% vaccination rate is still lagging behind, this means the "Zero case" policy shall remain in place until the city reaches up to at least 80%. Ultimately, Macau's visitor arrival and economy may find it difficult to return to the pre-pandemic level in the near term.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In its latest press conference, PBoC addressed a few questions such as Evergrande debt crisis, China's policy reaction to the Fed tapering and supports to SMEs etc.	▪ There are four key takeaways from PBoC's conference. ▪ First, PBoC is less concerned about the Evergrande debt crisis. PBoC official said the financial liabilities of Evergrade are less than one third of its total liabilities. Creditors are also relatively dispersed with limited concentration risks. As such, PBoC expects the risk of spill over is controllable. In addition, PBoC also said the knee jerk reaction of falling appetite from financial institutions for property loan could be normal despite overaction. PBoC and China's banking and insurance regulators have conducted sharing sessions with financial institutions at the end of September to correct some misinterpretations of recent polices to avoid overreaction of financial institutions. ▪ Second, on inflation, PBoC expects upward pressures on PPI from the recent power shortage. However, PBoC expects PPI to peak in 4Q and go down gradually from the end of this year. In addition, PBoC believes that passthrough from PPI to CPI is limited and CPI is expected to stay below the target range. ▪ Third, PBoC's press conference dialled back market expectation on imminent RRR cut. Although PBoC reckoned the challenges faced by smaller and micro companies due to margin pressures from the widening gap between PPI and CPI, PBoC focused more on other measures such as relending and capital market tools to support smaller companies. In addition, PBoC said the average interest rate for smaller companies fell to 4.89% at the end of September, down by 19bps from the end of 2020. This hinted that PBoC may be not in any rush to support smaller companies via another RRR cut. ▪ Fourth, PBoC's comment that current 2.95% 10-year government bond yield is relatively low may fuel some concerns that the room for the yields to go down is limited.
▪ China's head of CDC said China may consider opening its borders should it reach its vaccination target of 85% by early 2022.	▪ This hints that China may eventually depart from its zero covid strategy and learn to live with virus if covid becomes more like that of flu.
▪ The Hong Kong Exchange announced the MSCI China A50 connect (USD) Index futures, a broad-based benchmark index capturing mid and large cap China A share, has been approved by the CFTC in the United States.	▪ The launch of its first A share derivatives product will provide a more effective tool for investors to manage portfolio risk. This marks a milestone of HKEX's establishment to its China offshore equity derivatives business in Hong Kong. HKEX's MSCI China A50 connect (USD)index futures will commence trading on 18 Oct. Taken together, this will bring China closer to expand inclusion in major global indexes.
▪ The Shenzhen government has completed its roadshow to issue up to RMB 5 billion municipal government bond in Hong Kong on Oct 12.	▪ This marks as the first direct offshore debt sales by the domestic local government. The bonds will be issued under the tenors of 2,3 and 5 years. Among the 3- and 5-year bonds, both of which are expected to finance the sustainability project "Sponge City" and water treatment project in accordance with the Green Finance Framework. As such, we think this may further facilitate and promote the financial cooperation between China and Hong Kong, and again highlighting Hong Kong's unique role as the gateway for

	international investors to access China. As per market reaction, those bonds have been oversubscribed by 3.48 times, reaching a total of 19.03 billion yuan. It was also reported that institutional investors including asset management, fund houses, insurance, and others corporate accounts represented more than 34.18% with 1.709 billion yuan. That said, considering part of the bonds were issued the categories of green development, Hong Kong may continue to maintain its status to support local government financing and fill up the needs from international investors.
▪ Two rounds of the "Employment support scheme (ESS)" was launched last year in Hong Kong to those who lost their jobs or required financial support.	▪ According to the program of secretary, a total of HK$ 91.1 billion have been distributed under the employment support schemes. This had benefited more than 1.95 millions of employees, but 14% higher than the original budget, simply driven by the average number of beneficiaries were higher than the government expected. This emphasizes the fact that the program had successfully stabilized the job market, while with an intention of decreasing the city's unemployment rate. To sum up, supported by the government, the unemployment rate fell faster than expected in the first 8 months of 2021 and therefore we continue to look forward the overall jobless may continue to decline, however at a much slower pace due to the ongoing border controls. In other words, the overall jobless rate might stay above 4% in the near term.
▪ USDHKD spot traded above 7.7800, but lower than 12 October late session levels.	▪ Meanwhile, USDHKD forward swap points were came off to -45 from the previous level of around -42. Going forward, as the fed is set to start tapering by the end of this year, we see possibility that the USDHKD forward swap points may edge lower. As such, we may see t/t spot to trade in the range of 7.7774/7.7840 while a wider range of 7.7700-7.8000.

Key Economic News

Facts	OCBC Opinions
▪ China's exports in dollar term rose by a stronger than expected 28.1% yoy in September while import growth decelerated to 17.6% weaker than expectation. ▪ As a result of strong exports, trade surplus widened further to US$66.76 billion.	▪ China's total trade hit a record high of US$544.7 billion in September. The demand from advanced economies for Chinese goods remained strong partially due to replacement demand as a result of pause of supply chain shift amid the global spread of delta variants. China's exports growth to the US accelerated to 30.56% with exports in absolute term hit a record of US$57.4 billion. In addition, China's trade surplus with the US also hit record high of US$42 billion. China's resilient exports to the US despite tariff served as a good basis for the partial removal of tariff. ▪ The deceleration of import growth was mainly attributable to base effect and rising commodity prices. China's imports of electronic integrated circuit hit a record high of US$41.36 billion, a sign of China's ongoing stock-up of chips amid global chip shortage and uncertain geopolitical relationship. However, import growth of EIC decelerated to 11.47% from 20-30% growth range for the first eight months due to relative high base last year. In addition, China's demand for crude oil and iron ore remained weak with imports of crude oil and iron ore by volume fell by 15.3% yoy and 11.9% yoy respectively in

	September probably due to elevated price.
▪ China's aggregate social financing increased by CNY2.928 trillion in September, CNY541 billion short of last September's level. As such, growth of stock of aggregate social financing decelerated to 10% yoy in September from 10.3% yoy in August, lowest since December 2015. ▪ M2 growth, however, reaccelerated slightly to 8.3% from 8.2%.	▪ Other than high base effect, the deceleration of aggregate social financing growth in September was also attributable to three factors including weaker demand for credit, softening direct financing activities due to looming credit risks in the property space and behind the curve issuance of local government special bond. ▪ New Yuan loan increased by CNY1.66 trillion in September. The weaker than expected loan creation was mainly due to slower than expected medium to long term loan expansion, which increased only by CNY1.16 trillion, CNY542 billion short of the level in September 2020. For breakdown, medium to long term loan to household sectors increased by CNY466 billion, CNY169 billion short of the level during the same period last year while medium to long term loan to corporate sector only increased by CNY694.8 billion, CNY373.2 billion short of the level in September 2020. The latest loan data showed that recent regulatory tightening across the different sectors may have dampened demand from both household sector and corporate sector for credit. ▪ On direct financing, new equity financing increased by CNY77.1 billion, down from CNY147.8 billion in August while financing from corporate bond issuance increased by 140 billion, down from CNY434 billion in August. ▪ Financing from local government bond issuance increased by CNY814.2 billion, down from 973.8 billion in August. As of end September, only 61% of local government bond issuance quota has been filled, way behind the curve. As such, we expect local government special bond issuance to accelerated in the last quarter of 2021, which is expected to lift aggregate social financing growth off lows. ▪ Despite the deceleration of aggregate social financing, M2 growth reaccelerated to 8.3% yoy from 8.2%. The divergence between aggregate social financing growth and M2 growth was probably attributable to two factors. First, the weak direct financing activities in September due to concerns about regulatory tightening, which has no impact on M2, contributed to the deceleration of social financing growth. Second,
▪ China's CPI moderated to 0.7% yoy in September from 0.8% yoy in August. ▪ PPI accelerated to 10.7% yoy from 9.5% in August.	▪ On sequential basis, CPI was flat in September as the decline of food prices continued to keep overall price in check. There is sign of transmission from rising raw material prices as well as supply side shock to end consumers as prices of cement, LNG and passenger car increased month-on-month. However, the supply side driven rise of consumer prices was offset by the falling travel related costs due to sporadic outbreak of delta variants in early September, which weighed down the costs of travel and accommodation. ▪ Looking ahead, CPI is likely to rebound in the coming months due to low base effect and signs of bottom out of pork prices. However, it is expected to stay below 2%. As such, CPI is unlikely to be the constraint for policy making in China. ▪ As PPI is more sensitive to the change of global macro backdrop such as China's dual control of energy intensity and energy consumption and global natural gas crisis, the recent

	surge of PPI reading reflected the supply side driven rising commodity prices. Given the recent reform of electricity pricing mechanism, which will further push up producer prices, PPI is expected to stay elevated in October and November. It may only retreat from December onwards due to base effect. ▪ The gap between PPI and CPI widened further to a fresh high. This implies further pressure on profitability in the downstream sectors. Although CPI is unlikely to be the constraint to policy making this year, the prolonged widening gap between PPI and CPI may argue for more policy supports to SMEs which are facing margin squeeze due to rising raw material prices. As such, we think there is the room for China to cut RRR further to support SMEs echoing their supports in early July.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY traded below 6.45 for most of time last week.	▪ RMB received the initial boost from strong trade data and was subsequently rode on broad dollar weakness. Nevertheless, there is also lack of catalyst to send the USDCNY down to 6.40. Market is still waiting for more details about possible partial removal of tariffs.

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