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Highlights: semiconductor is the key battleground

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President Biden signed an executive order last week to improve semiconductor supply chain while the US Senate Majority Leader Schumer has directed his lawmakers to work on bill to address America's short term and long term plan to protect the semiconductor supply chain and keep America leading position in AI, 5G, quantum computing, biomedical and storage etc.

It is getting clearer that semiconductor sector will become the key battleground for US and China for long term rivalry in the next few years under Biden Administration.

Despite relatively hawkish headline, the bilateral relationship between US and China is still well on track in our view. Although Katherine Tai, Biden's top trade nominee, backed tariffs as a "legitimate tool", she made no new tariff threats. In addition, China's Customs Tariff Commission of the State Council extended tax exempt for 65 US goods by another 200 days to 16 Sep 2021.

For this week, focus will shift to China's two sessions such as government work report on 14th five-year plan for National Economic and Social Development and the long-term objectives through the Year 2035. The rising competition from the US for the supply chain will further underpin the role of innovation as a core national strategy for the next five year.

Key words such as common prosperity, carbon neutral and anti-monopoly will also attract attention from the market.

On economic data, both China's manufacturing and non-manufacturing PMI fell in February. Although it is partially due to seasonal holiday effect, the large than expected decline may warrant more investigation in the next one to two months to check whether the growth momentum has been affected by the concern about credit tightening.

PBoC's forex purchase increased slightly by CNY9.2 billion in January after the decline of CNY32.87 billion in December. PBoC's strategy to keep its balance sheet relatively stable as part of traditional monetary policy framework indicated that China's central bank is unlikely to intervene the currency market. We will continue to monitor the change of PBoC balance sheet to gauge the possible impact of capital inflows on China's domestic liquidity.

In **Hong Kong,** all eyes were on the 2021-22 Budget last Wednesday. There are several key highlights. First, over HK$120 billion counter-cyclical measures will be rolled out to meet the immediate needs, including e-consumption vouchers and Special 100% Loan Guarantee for the unemployed. Second, long-term plans are created to build a sustainable future, like supporting the financial sector, I&T sector, digitalization, green and sustainable projects as well as other infrastructure projects. Third, the government expects to keep running operating deficits till 2025-26. Fourth, to strengthen the fiscal health in the long run, the government will cut recurrent expenditure by 1% in 2022-23, reduce one-off relief measures progressively in the medium term and raise the stamp duty on stock trades from 0.1% to 0.13%, effective 1 August 2021.

As a knee-jerk reaction to the surprising stamp duty hike, Hang Seng Index, southbound flows and HKD spot fell simultaneously. The shocking news however was soon overshadowed by the inflation and tapering fears which weighed heavily on global equities. Having said that, since the global liquidity remains flush and the economy stays on the recovery track, the equity market may not see sustainable outflows while the USDHKD spot may not easily break above 7.76. This Monday, the market will closely monitor the result of the industry consultation over the Hang Seng Indexes' proposal to revamp the index by improving the representation.

On the economy front, since the 2021-22 Budget is more expansionary than expected while vaccines have been rolled out from 26 February, we hold onto our view that the economy will rebound by 4.1% on assumption that the border will reopen in 2H. However, the recovery may be uneven across sectors. Trade sector may continue to shine on the back of China's resilient growth, the external demand revival, and the growing regional trade activities amid the supply chain shift. Meanwhile, the retail and F&B sectors (benefiting from relaxation of social distancing measures and e-consumption vouchers) may recover at a faster pace than the tourism and aviation sectors.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US President Joe Biden signed an executive order calling for a 100-day review to assess vulnerabilities and areas for improvement of supply chains. ▪ Meanwhile, Katherine Tai, Biden's top trade nominee, backed tariffs as a "legitimate tool" to counter China's state-driven economic model.	▪ Other than President Biden's executive order, the US Senate Majority Leader Schumer has directed his lawmakers to work on bill to address America's short term and long term plan to protect the semiconductor supply chain and keep America leading position in AI, 5G, quantum computing, biomedical and storage etc. ▪ It is getting clearer that semiconductor sector will become the key battleground for US and China for long term rivalry in the next few years under Biden Administration. ▪ Despite relatively hawkish headline, the bilateral relationship between US and China is still well on track in our view. The White House has said that the order is not aimed at competing with China. Although Katherine said China need to live up to its commitment under the phase 1 trade deal, she made no new tariff threats and also did not specify detailed plan how she plans to enforce China to abide by trade agreement.
▪ Hong Kong: FY2020 fiscal balance came in at a deficit for the second consecutive year of a record HK$257.6 billion (9.5% of GDP), but lower than expected of about HK$300 billion.	▪ As the near-term outlook is still fraught with uncertainties and it may take some time to heal the wound from Covid-19 shock, the 2021-22 Budget remains one of the most expansionary budgets since record with fiscal balance pencilled at another deficit of HK$101.6 billion (3.6% of GDP). Also, the government expects to keep running operating deficits till 2025-26. To strengthen the fiscal health in the long run, the government will cut recurrent expenditure by 1% in 2022-23, reduce one-off relief measures progressively in the medium term and raise the stamp duty on stock trades from 0.1% to 0.13%, effective 1 August 2021. ▪ Zooming in on the 2021-22 Budget, it could be divided into two parts. First, meeting immediate needs with targeted measures including e-consumption vouchers, Special 100% Loan Guarantee for the unemployed, HK$6.6 billion for jobs creation, HK$934 million for tourism and further enhancement of Special 100% Guarantee Product for SMEs. Second, building a sustainable future with long-term plans like supporting the financial sector, I&T sector, digitalization, green and sustainable projects as well as other infrastructure projects. ▪ Since the 2021-22 Budget is more expansionary than expected while vaccines have been rolled out from 26 February, we hold onto our view that the economy will rebound by 4.1% under the base case scenario (border will reopen in 2H).
▪ Last Wednesday, following the announcement of stamp duty hike on stock trades, Hang Seng Index closed down 3% while southbound equity flows saw record outflows of HK$19.96 billion and the first outflows since 18 December 2020. Meanwhile, USDHKD spot rose to the highest since mid-January.	▪ With the first trading tax hike since 1993, market frets that this move will undermine the competitiveness of HK equity as China charges only unilateral stamp duty on A-share trades while no stamp duty is charged on US stock transaction. ▪ Nevertheless, USDHKD and USDCNH forward swap points barely moved last Wednesday. This indicates that the market players may have not speculated on any sustainable equity outflows because of the stamp duty adjustment. Since more and more biotech and new economy companies as well as the issuers of ADRs are lining up to get listed in Hong Kong, Hong

	Kong stock market may still be attractive to investors. As such, any negative effect of the stamp duty hike is expected to be transitory at least at this juncture. ▪ Rather, the market may be more concerned about the rising bond yields. With the inflation and tapering fears taking a heavy toll on the risky assets, it is not surprising to see renewed southbound outflows and further depreciation of HKD. Having said that, since the global liquidity remains flush and the economy stays on the recovery track, the equity market may not see sustainable outflows while the USDHKD spot may not easily break above 7.76.
▪ Last Friday, it was announced that Alibaba Health, Longfor and Haidilao will be included into the Hang Seng Index from 15 March. This will increase the number of constituents in the index from 52 to 55. ▪ Last December, Hang Seng Indexes has conducted an industry consultation over the proposal to enhance the Hang Seng Index. The result will be announced on Monday (1 March).	▪ The proposed measures include 1) increasing the number of constituents to between 65 and 80; 2) removing the minimum listing history requirement for inclusion into the index; 3) lowering the weighting cap of individual constituents from 10% to 8% and raising that of the secondary-listed companies and WVRs from 5% to 8%; 4) selecting constituents by industry group and 5) maintaining about 25 constituents as Hong Kong companies. ▪ The purpose of the overhaul is to diversify the constituents and improve the representation for each industry without sacrificing the representation of local companies. ▪ Should the revamp materialize, Hang Seng Index which currently includes mainly banks and insurers will likely add more new economy companies. The resultant balanced representation may make Hang Seng Index more attractive to investors. Meanwhile, the higher probability of being included into the Hong Kong's stock benchmark may make the city a more appealing place for ADRs reshoring and for companies from different industries to go public.

Key Economic News

Facts	OCBC Opinions
▪ China's official manufacturing PMI moderated further to 50.6 in February from 51.3 in January.	▪ Both supply and demand softened in February. Production fell to 51.9 from 53.5. On demand side, new order fell to 51.9 from 53.5 while new export order slipped to 48.8 below 50 for the first time in six months. The decline of PMI was partially attributable to seasonal effect due to disruption from Chinese New Year. However, the larger than expected decline shows it may not only be the result of Chinese New Year effect. ▪ Raw material input prices remained elevated in Feb at 66.7. This signaled that China's PPI is likely to accelerate to about 1.8% yoy in Feb, highest since Nov 2018. The rapid increase of PPI is likely to create cost pressure for downstream companies. The recent rising demand for commodity underpin steel sectors with PMI in steel sector rebounded to 48.6 from 44.3. ▪ Non manufacturing PMI also slowed further to 51.4 from 52.4 partially attributable to resurgence of virus as construction PMI fell notably to 54.7 from 60.
▪ PBoC's forex purchase increased slightly by CNY9.2 billion in January after the decline of CNY32.87 billion in December.	▪ PBoC's strategy to keep its balance sheet relatively stable shows as part of traditional monetary policy framework indicated that China's central bank is unlikely to intervene the

	currency market. We will continue to monitor the change of PBoC balance sheet to gauge the possible impact of capital inflows on China's liquidity.
▪ China's property prices continued to trend higher in January. New residential prices increased by 0.3% mom while prices for resale property increased by 0.4% mom.	▪ Tier-1 cities continued to outperform the mid to small cities. Resale prices for property in four tier-1 cities rose by 1.3% mom in January, the fastest pace since March 21. Given the strong performance in traditional off-peak season, we think regulators will monitor the prices trend closely. Market will also watch out for the impact of new measures from Shenzhen in February on property prices.
▪ Hong Kong: exports and imports once again surprised to the upside and advanced by 44% yoy (the strongest since 1992) and 37.7% yoy (the highest since March 2010) respectively in January.	▪ There are three main reasons behind the strong trade data. First, the base effect resulted from the different timing of Lunar New Year between this year and the last. Second, the revival of external demand. Specifically, total exports to Asia grew by 49.5% yoy while exports to the US also increased by 18.7% yoy. Third, the strong electronic value chain and the buoyant demand for electronic products. Owing to the supply chain shift regarding the electronic industry, Hong Kong's exports and imports with Taiwan and Vietnam have been growing rapidly (over 60% yoy in January). ▪ Going ahead, we expect the trade sector will continue to shine on the back of the vaccine-induced demand recovery, the supply chain shift, the "China+1" strategy, China's dual circulation strategy as well as the RCEP. Strong exports of goods may also remain the main driver of Hong Kong's economic recovery this year.
▪ HKD loan to deposit ratio rose from 83.5% in last December to 83.9% in January as HKD deposits (+18.6% mom) grew at a slower pace than HKD loans (+19.2% mom). ▪ Excluding IPO effect, total deposits, HKD deposits as well as total loans and advances would have increased by 3.2% mom, 5.3% mom and 2.6% mom respectively. ▪ RMB deposits surged by 10.5% mom or 25% yoy to RMB797.7 billion in January, the strongest since February 2016.	▪ More notably, HKD CASA deposits and RMB CASA deposits both increased significantly, pointing to strong equity-related inflows. As a result, both HKD CASA deposits/HKD total deposits ratio and total CASA deposits/total deposits ratio surged to record high of 69.1% and 64.9% respectively. Nonetheless, lately, the inflation and tapering fears have caused stock market rout and spurred southbound outflows lately. If bond yields continue rising, the market volatility may remain high. As such, we do not think the strong growth of HKD and RMB deposits or the record high CASA deposits to total deposits ratio could sustain. Having said that, we still expect to see further equity-related inflows given the robust IPO pipeline, flush global liquidity as well as the improving economic growth outlook. In a nutshell, total deposits may continue to see resilient growth in 2021. ▪ On loans front, the relatively strong growth excluding IPO effect may be attributable to seasonal factor. Should the seasonal factor abate, excluding IPO effect and the loans guaranteed by the government, local loans growth may remain sluggish until local economy shows signs of stronger recovery. Loans for use outside of Hong Kong, which dropped for the first time since November 2016 by 0.1% yoy, may also remain subdued as China has tightened the limit on offshore borrowing. ▪ In conclusion, we expect the HKD loan to deposit ratio will remain below 85% in the near term. Meanwhile, the HKD CASA deposits to HKD total deposits may stay above 65%. Given the HKD supply-demand gap, short-end HKD rates may

	be well anchored to multi-year lows.
▪ Macau's visitor arrivals dropped by 15.6% mom or 80.4% yoy in January as China had discouraged travelling in an effort to fight Covid-19 resurgence.	▪ On a positive note, with the virus being well contained, travel activities have resumed in Mainland China. Also, Macau has removed the mandatory quarantine requirement on Mainland visitors who are from areas that had battled against Covid-19 lately. Adding on a low base from same period last year, we expect the growth of visitor arrivals to return to the positive territory in February for the first time since October 2019. However, stronger recovery of inbound tourism looks unlikely until travel restrictions are removed amid successful vaccine rollouts. Due to the slow recovery of the inbound tourism, gaming sector as well as the overall economy may also remain subdued in the near term.
▪ Macau: Unemployment rate remained static at 2.7% while underemployment rate dropped significantly by 0.6 percentage point to 4.4% during the three months to January. Besides, labor force participation rate rose by another 0.1 percentage point to 70.5%, as compared to 4Q 2020. During the same period, total labour force and employed population both grew by 0.1%.	▪ Taken all together, it points to a gradual improving labor market on the back of the relief measures and the city's success in containing local pandemic. However, the recovery of the labor market conditions remains uneven across industries. As local economic activities resume normalcy, the employed population of construction (+11.2% yoy), wholesale and retail trade (+2% yoy) as well as restaurants and similar activities (+1.3% yoy) all continued to grow. In contrast, the employed population of gaming and junket activities as well as the hotel and similar activities continued to drop notably by 11.2% yoy and 7.2% yoy respectively as both gaming and tourism-related sectors have remained subdued amid ongoing travel restrictions and weak external demand. ▪ Since the gaming sector and hospitality sector have together contributed to 27% of total employed population, the overall unemployment rate may stay above 2.5% in 1H as border re-opening looks unlikely until 2H.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended the week in the familiar range of 6.45-6.5 last week despite the swing of broad dollar.	▪ The USDCNH broke 6.50 briefly last Friday as a result of rebound of broad dollar following the global sell-off of risk assets last Thursday. Although RMB has been relatively quiet for the past few weeks, the resilience of RMB amid the rising volatility in the global market reinforces our favorable call for RMB.

Treasury Research & Strategy

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