OCBC Bank

Greater China – Week in Review

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Highlights: Smaller companies need help

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China's manufacturing PMI moderated further to 49.2 in October from 49.6 in September. Both supply and demand softened in October. The decline of production was mainly the result of recent power shortage.

One of my key takeaways from the latest PMI reading is that uneven recovery remains the key challenge. Production for medium sized companies and small companies fell to 47.7 and 45.8 respectively from 48.8 and 47.7 while production for large corps rebounded to 50.1 from 49.9. In addition, new export orders for smaller companies fell sharply to 41.3 from 45.9 while new export orders for large and medium sized companies rebounded.

It is not unexpected that smaller companies tend to feel the most impact from those disruptions such as power shortage. Meanwhile, purchasing price index surged to 72.1 in October from 63.5, implying a further acceleration of PPI growth in October, which may increase by about 12.5% yoy. This means the gap between PPI and CPI will widen further in October, squeezing profit margin in the downstream sectors.

All those data called for more policy supports to SMEs. Nevertheless, it seems that China is in no urgency to repeat what it did in early July to support the SMEs via RRR cut. Instead, the focus is mainly on alternative monetary supports such as relending and fiscal support. China's State Council announced last week to defer tax payment for SMEs in the manufacturing sector.

In addition, China will also extend the exemption of corporate income tax and value added tax on bond interest gains for foreign investors investing in the onshore bond market till the end of the 14th five-year plan period. The favourable tax arrangement is expected to attract more foreign portfolio inflows.

China continued to roll out more aggressive measures to contain the event risks such as surging coal prices. China's thermal coal futures dropped to below CNY1000 per ton, almost half of the peak in the middle of October. The NDRC is also studying to set the benchmark price at CNY440 per ton as part of intervention scheme and expect more room for coal prices to correct. The heavy intervention may help alleviate the pressures faced by industrial sectors.

The US-China relationship returned to the spotlight as a result of overwhelming headline news about Taiwan and the US Federal Communication Commission's decision to revoke the license for China Telecom America's Authority to provide telecom services, overshadowing the positive development from the video call between Vice Premier Liu He and Treasury Secretary Yellen.

Nevertheless, we still think Biden Administration knows where the bottom line is for the bilateral relationship, which will cap the further escalation of the tension ahead of the virtual summit between two leaders this year. We continue to expect the partial removal of tariff by the US side.

In **Hong Kong,** Hong Kong's government announced to end the quarantine exemption for overseas and mainland travellers, sticking to its plan of "zero infection" strategy on Covid- 19. On the positive note, HKEX's Chief Executive Nicolas Aguzin said the consultation on implementing the SPACs listing mechanism will end on October 31. He believes the proposed design framework, which has a multi-layer protective mechanism would give a new listing option to market, while will further strengthen the Hong Kong status as an ideal fund raising center. On economic front, HKD loan-to-deposit ratio increased slightly from 84.2% in August to 84.7% in September as HKD loans (0.4% mom) rose at a faster pace than Hong Kong deposits (0.3% mom). More Importantly, Hong Kong's RMB deposits increased by 1.57% mom to RMB855.93 billion in September, the highest since November 2015. The increase of RMB deposits could be supported by the yield differentials, RMB appreciation and the continuous deepening connections in Stock and Bond connects. As of September 30, the average daily turnover in northbound stock connect reached to 123.2bn yuan, while the southbound also reached 46.2bn in HKD, showing a 37% yoy and 99% yoy growth respectively. Moreover, the average daily turnover in the northbound bond connect for the first three quarters reached to 26.2 bn yuan, a 33% yoy growth in 2021. Looking ahead, we expect RMB deposits to increase further supported by the recent launched wealth management connect schemes. Finally, Hong Kong's exports and imports growth both decelerated to 16.5% yoy and 21.9% yoy respectively in September. Having said that, the total trade in value term during the first nine month of 2021 was 9% higher compared to the same period of 2019. This indicates that external demand has remained resilient.

Key Events and Market Talk

Facts	OCBC Opinions
▪ China's State Council announced to defer tax payment for SMEs in the manufacturing sector. Meanwhile tax payment for coal-fired power companies and heating companies will also be deferred.	▪ The defer payment of tax for SMEs in manufacturing sector is expected to be around CNY200 billion while defer payment for coal fired power companies and heating companies is expected to be around CNY17 billion. ▪ In addition, China will also extend the exemption of corporate income tax and value added tax on bond interest gains for foreign investors investing in the onshore bond market till the end of the 14th five-year plan period. The favourable tax arrangement is expected to attract more foreign portfolio inflows.
▪ China's thermal coal futures dropped to below CNY1000 per ton, almost half of the peak in the middle of October. ▪ In addition, coal inventories have risen by 25 million tons in the past month to historic highs of more than 100 million tons.	▪ China's national economic planning agency NDRC said there is further room for coal prices to correct given the cost of coal production is significantly lower than the current spot price. ▪ In addition, the NDRC is also studying to set the benchmark price at CNY440 per ton as part of intervention scheme. ▪ The recent sharp correction of coal prices will help contain the disruption to industrial production.

Key Economic News

Facts	OCBC Opinions
▪ China's industrial profit grew by 44.7% yoy in the first three quarters. On two-year average adjusting for the pandemic effect, China's industrial profit rose by 18.8%.	▪ Industrial profit in upper stream sectors remained strong due to rising raw material prices. Profit in mining sectors more than doubled in the third quarter. Profit in coal industries rose by 272% yoy due to surging coal prices. Profit for consumer goods manufacturing rose at a steady pace of 12% on two-year average in 3Q thanks to improving demand. ▪ Profit for 29 sectors out of 41 sectors has returned to pre-pandemic level. Profit in high-tech manufacturing sector continue to lead the growth.
▪ China's manufacturing PMI moderated further to 49.2 in October from 49.6 in September. ▪ Non-manufacturing PMI fell by 0.8 to 52.4, but still above threshold line.	▪ Both supply and demand softened in October. Production of manufacturing PMI fell to 48.4 from 49.5 while new order fell to 48.8 from 49.3. ▪ The decline of production was mainly the result of recent power shortage. However, the impact is uneven as SMEs were most hit by those disruptions. Production for medium sized companies and small companies fell to 47.7 and 45.8 respectively from 48.8 and 47.7 while production for large corps actually rebounded to 50.1 from 49.9. ▪ New export orders rebounded by 0.4 to 46.6. However, only large and medium sized corps benefited from the improving external demand while new export orders for smaller companies fell sharply to 41.3 from 45.9. ▪ Purchasing price index surged to 72.1 from 63.5, implying a further acceleration of PPI growth in October, which may increase by about 12.5%. This means the gap between PPI and CPI will widen further in October, further squeezing profit margin in the downstream sectors. ▪ In addition, business expectation deteriorated further in October. Although the 53.6 reading remains above the threshold line, the rapid decline of 2.8 points, largest since pandemic, could be the cause of concern.

▪ Hong Kong's exports and imports growth both decelerated to 16.5% yoy and 21.9% yoy respectively in September.	▪ The total trade in value term during the first nine month of 2021 was 9% higher compared to the same period of 2019. In particular, total exports to Asia as a whole grew by 16.5% yoy with those to all major Asian trading partners seeing double-digit growth. Likewise, imports from all other eight major partners all showed double digit growth as well expect Malaysia and Thailand. Overall, this indicates that external demand has remained resilient. ▪ In near term, we see the growth in exports and imports may continue to climb, but at a slower pace, likely due to the combination of supply chain bottlenecks and the threat of the more infectious variants, which may partially offsetting the upside growth from the external demand from global economic recovery. As such, we remain our views that expects and imports may grow by about 20% this year.
▪ HKD loan-to-deposit ratio increased slightly from 84.2% in August to 84.7% in September as HKD loans (0.4% mom) grew at a faster pace than Hong Kong deposits (0.3% mom).	▪ On loans front, excluding the IPO-related loans, total loans and advances have grown by 0.4% mom mainly due to increase of loans for use in Hong Kong and loans for use outside Hong Kong, both of which went up by 0.4% and 0.3% respectively. We think there are two main reasons behind this. First, trade finance (+25.3% yoy in Sept) rose for the fifth consecutive month, implying strong trade activities. Second, approved new mortgage loans rose by double- digit for the eleventh consecutive month in September, driven by the robust demand from the housing market. However, looking into the data in a border range, loans for use in Hong Kong decreased by 3.6% in 3Q 2021 compared to 5.7% growth in the previous quarter. According to the HKMA, the subdued in local loan demand was led by weak loans to stockbrokers. On the other hand, although loans for use outside of Hong Kong increased by 2.0% in 3Q 2021 versus growth of 0.8% in 2Q 2021, but we believe the growth will remain capped in the near term amid 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, even so the HKD deposits increased by 0.3% mom, the year-on-year growth of total deposits and HKD deposits both dropped by 1.9% yoy and 2.2% yoy respectively, driven by the high base effect from the large scale of IPO activities in the same period of 2020. Meanwhile, HKD CASA deposits to total HKD deposits ratio rebounded from 69.1% in August to 69.2% in September. Finally, all of this points to flush global liquidity. But still, we think the total deposits and HKD deposits may show a moderate growth by the end of this year, which factored in the high base effect from the busy IPO pipeline last year. We expect total deposits to see low single-digit growth by end-2021. ▪ In conclusion, we expect HKD loan to deposit to stay below 85% in the near term, which may allow short end HKD rate to remain low for some time.
▪ Hong Kong's RMB deposits increased by 1.57% mom to RMB855.93 billion in September, the highest since November 2015.	▪ The increase of RMB deposits could be supported by the yield differentials, RMB appreciation and the continuous deepening connections in Stock and Bond connects. As of September 30,

	the average daily turnover in northbound stock connect reached to 123.2bn yuan, while the southbound also reached 46.2bn in HKD, showing a 37% yoy and 99% yoy growth respectively. Moreover, the average daily turnover in the northbound bond connect for the first three quarters reached to 26.2 bn yuan, a 33% yoy growth in 2021. Looking ahead, we expect RMB deposits may increase further supported by the recent launched wealth management connect schemes and prompt net inflows from China to Hong Kong.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY consolidated below 6.40 last week after a clean break two weeks ago.	▪ The flushed dollar liquidity in the onshore market and strong FX fundamental such as sizable goods trade surplus and persistent portfolio inflows are likely to further underpin RMB in the near term.

Treasury Research & Strategy

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