Greater China – Week in Review

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Highlights: monitoring contagion risks

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Market sentiment has been dominated by China headlines in the past week including weaker than expected August economic indicators, increasing concerns about the contagion risk from Evergrande's debt crisis as well as ongoing China's regulatory crackdown.

Share price of Evergrande continued to decline with total market cap ended the week at around HKD33 billion, less than one tenth of more than CNY300 billion net assets in company's balance sheet as of 2Q.

Evergrande has pledged to assure buyers the delivery of uncompleted projects as well as repaying all matured wealth management products. But those two pledges look increasingly contradictory given a more hostile market environment with situation deteriorated day by day.

We are not in any position to speculate the future path of the indebted company. It remains to be seen whether the current crisis is a liquidity crunch or a straw breaking camel's back which will lead to eventual insolvency of the company.

From macro perspective, two things we pay more attention to include company's off-balance sheet liability as well as possible contagion via its related financial institutions as well as suppliers. With more focus shifting to Evergrande, the size of off-balance sheet liability is likely to be uncovered gradually. Whether it will exceed the net assets of more than CNY300 billion in its balance sheet will be the key.

In addition, although Evergrande started to reduce its equity stakes in Shengjing bank, the largest city commercial bank in Northeast China, the previous tie-up may return to the spotlight during the debt restructuring process.

China's August economic indicators disappointed with consumption missed the forecast by a big margin. Nevertheless, the recent data disappointments did not change narratives about China in our view. Please refer to our report in more details.

China's domestic drive to pursue technology self-sufficiency and pause of supply chain shift due to outbreak in ASEAN may continue to offset the negative impact from China's sporadic virus outbreak and chip shortage.

The recent moderation in property market is likely to be the cause for concern. In addition, we think despite the drag on China's growth, Chinese government is unlikely to roll back its curb in property market given its goal for common prosperity and rebooting population growth. This may create downside risks to China's growth.

The outlook of China's growth in the last quarter and 2022 will probably hinge on whether infrastructure investment is able to pick up to offset the loss of momentum in property space.

On policy, monetary policy remains flexible to safeguard the stability of money market against the backdrop of increasing concerns from rising default risk. PBoC fully rolled over its maturing MLF in September and restarted its 14-day reverse repo to meet quarter end liquidity needs.

In **Hong Kong,** southbound bond connect will be launched on 24th Sep. Since onshore bonds may be sufficiently attractive at this juncture while only 41 banks, QDII and RQDII are allowed to participate in the new connect scheme, net inflows under the new connect scheme may not be so strong. Having said that, China's onshore investors may try to diversify the portfolio with offshore assets. As such, we expect some interests in the southbound bond connect. Going forward, the new connect scheme will become a new source of offshore RMB liquidity, bring in new participants to Hong Kong's bond market, provide a new channel to digest the abundant onshore USD liquidity, and promote RMB internationalization in the longer term.

On the economy front, unemployment rate for the three months to August fell to 4.7%, the lowest since 1Q 2020. Since the unemployment rate of the hardest-hit sectors is still higher than the pre-pandemic level, there is room for further decline on the back of rebounding local consumption. On a positive note, Hong Kong's Chief Executive Carrie Lam said the government is actively discussing with Mainland China in terms of conditional and gradual border reopening. However, government's Covid-19 adviser hints that zero-tolerance Covid-19 strategy may remain intact until the vaccination rate reaches 80% to 90% whereas the share of people partially vaccinated against Covid-19 only reached 58.1% as of 17th September. This suggests that the bar for border reopening remains high. As such, we expect the decline of unemployment rate to slow down and the overall jobless rate to stay above 4% in the near term.

In **Macau,** as six casino licenses will expire next June, the government will kick start a 45-day public consultation on 15th September regarding the revision to Macau's gambling laws. The upcoming revamp of gambling laws indicates that China will tighten the grip on the sector in order to crack down on money laundering, illegal capital outflows and overseas gambling trips organized by junket operators. This may result in a further shrinking VIP segment. Since gaming sector contributes largely to both GDP and the government's tax revenue while economic diversification takes some time, Macau's economy and labour market may not easily return to the pre-pandemic level in the near term should gaming sector face mounting pressure.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ Southbound bond connect will be launched this Friday (24th September) with annual aggregate quota of RMB500 billion and daily quota of RMB20 billion. Net outflows via QDII and RQDII will not be counted into the usage of the southbound bond connect quota.	▪ Though eligible investors can invest in all currency bonds via the new connect scheme, offshore investors' strong interests in China's onshore bonds indicate that onshore bonds may be sufficiently attractive at this juncture. Also notable is that only 41 banks, QDII and RQDII are allowed to participate in the new connect scheme. As such, net inflows under the new connect scheme may not be so strong. Having said that, China's onshore investors may not only search for yield but also try to diversify the portfolio with offshore assets. As such, we expect some interests in the southbound bond connect. If offshore bonds can be used as collateral in onshore repo market, the new connect scheme may be more appealing. ▪ Going forward, the new connect scheme will become a new source of offshore RMB liquidity, bring in new participants to Hong Kong's bond market including dim sum bond market and prompt China's onshore investors to strengthen the ability of managing cross-border capital flows and foreign exchange risks. ▪ Notably, currency conversion can be done in onshore interbank market if investors want to buy offshore foreign currency bond. This means that southbound bond connect may be a new channel to digest the abundant onshore USD liquidity, in turn easing the upward pressure on RMB. In conclusion, the new connect scheme would undoubtedly be helpful to support the development of Hong Kong's bond market and promote RMB internationalization in the longer term.
▪ China concluded its 18th China-ASEAN Business and Investment Summit last Monday.	▪ The record deals worth over CNY300 billion have been signed during the expo. The total value rose by 13.7% over the previous summit, showing the increasing economic linkage between China and ASEAN.
▪ Hong Kong's Chief Executive Carrie Lam said the government is actively discussing with Mainland China in terms of conditional and gradual border reopening as Hong Kong has contained the local epidemic well. Hong Kong's top government Covid adviser said the city will not consider changing its zero-tolerance Covid-19 strategy until the vaccination rate reaches 80% to 90%.	▪ However, as of 17th September, the share of people partially vaccinated against Covid-19 only reached 58.1%. This suggests that the bar for border reopening remains high. The ongoing border controls reinforce our view that Hong Kong's economic growth in 2H21 driven mainly by local consumption and investment may not be so strong. We hold onto our view that GDP growth will print 6% in 2021.
▪ Director of Research of Hong Kong Trade Development Council, Nicholas Kwan noted that more than 40% of Hong Kong's businessmen foresaw a decrease in their Christmas sales amid surging shipping costs. Though Kwan expects exports may fall in 2H21 amid high base effect, he maintains the full-year growth forecast to be 15% amid strong exports in 1H21.	▪ Some businessmen pointed out that price of containers surged four to ten times. This together with the tight supply of raw materials propels the companies to refrain from receiving orders. On a positive note, given the resilience of Hong Kong's exports and the prospect of improving trade sector outlook, the companies may not cut jobs at this juncture. We also expect both exports and imports to see double-digit growth this year.
▪ As six casino licenses will expire next June, Macau government will kick start a 45-day public consultation on 15th September regarding the revision to Macau's gambling laws. Topics include	▪ Since 2014, China's anti-corruption campaign had hit Macau's gaming sector hard with the share of VIP gaming revenue in total gaming revenue falling to 43.9% in 3Q 2019 from record high of 74% in 2Q 2011. Recently, Covid-19 outbreak has put a

1) the number of concessions; 2) the terms of the concession; 2) tightening the restrictions on the casino companies; 4) safeguarding employees; 5) strengthen the scrutiny scheme for casino companies, junket operators and co-operators, 6) appointing government representatives to directly oversee the casino operators; 7) promoting non-gaming projects; 8) social responsibility; and 9) clarifying new criminal responsibility and administrative punishment system.	lid on international travelling together while China's crackdown on cross-border gambling has weighed heavily on Macau's junket operators. As a result, gaming revenue plunged further while the share of VIP gaming revenue in total gaming revenue also dropped further to record low of 33.5% in 2Q 2021. ▪ The upcoming revamp of gambling laws indicates that China will tighten the grip on the sector in order to crack down on money laundering, illegal capital outflows and overseas gambling trips organized by junket operators. Should gaming sector face mounting pressure, there may be four implications. First, even if border reopens fully and safely, the gaming revenue may not necessarily return to the pre-pandemic level of over MOP20 billion per month given the shrinking VIP segment. Second, Macau's GDP may not easily return to the pre-pandemic level in the near term either as it takes time for economic diversification while gaming sector contributes over 50% of GDP. Third, as gaming sector is the main employer in Macau, the labour market may take some time for full recovery as well. Fourth, as gaming sector contributes up to 80% of the government's tax revenue, the fiscal condition may find it hard to strengthen in the near term.
▪ Macau's Secretary for Economy and Finance, Lei Wai Nong said the RMB will be the trading currency in the Hengqin cooperation zone which is regarded as RMB onshore market.	▪ In other words, the cooperation between this zone and Macau will become a test ground for cross-border flows, funding, investments, settlement, etc. Lei also points out that Macau will strive to develop offshore bond market. Meanwhile, the bond issuance of Guangdong government in Macau could also help to build a benchmark yield curve of RMB bonds in the city.

Key Economic News

Facts	OCBC Opinions
▪ China's air passenger travels in August fell by 51.5% yoy to 22.41 million and was only about 36.6% of that recorded in August 2019 according to data from the Civil Aviation Administration of China.	▪ The decline was due to the resurgence of Covid-19 in late July and early August. Although the booking data from online travel agencies showed the number of air passenger trips will rise notably according to CAAC official, the hope for the air travel to recover in the upcoming two festivals including Mid-Autumn long weekend from 19-21 Sep and the National Day golden week from 1-7 Oct may be dampened by the recent resurgence in Fujian Province.
▪ China's industrial production growth decelerated to 5.3% yoy in August from 6.4% yoy in July. ▪ Retail sales growth slowed down significantly to 2.5% yoy in August from 8.5% yoy in July, missing forecast by a big margin. ▪ Fixed asset investment was largest in line with expectation increasing by 8.9% yoy in the first eight months of 2021.	▪ Retail sales was the weakest link in August. On two-year average, retail sales growth decelerated to 1.5% yoy from 3.6% yoy in July. The sharp deceleration of retail sales was mainly attributable to the decline of catering sales and weak car sales. Catering sales fell by 4.5% yoy in August down sharply from growth of 14.3% yoy in July, the first decline in 2021. This is not surprising given the falling mobility as a result of the sporadic delta variant outbreak across more than 15 provinces in early August. ▪ The recent sluggish car sales could be the cause for concern, This could be the result of both chip shortage and weaker consumer sentiment. Retail sales excluding car sales increased

	by 3.6% yoy, better than 2.5% headline growth. ▪ The deceleration of industrial production was partially attributable to sharp decline of car production as a result of chip shortage. Auto production fell by 12.6% yoy. On positive note, high-tech manufacturing production accelerated to 18.3% yoy in August, highest since the data was published in 2018. In addition, pharmaceutical production reaccelerated to 32.9% yoy, second highest in record. This shows that China's production is likely to continue to receive support from China's domestic drive towards technology self-sufficient and external demand due to resurgence of Covid-19 globally. ▪ Fixed asset investment was largely in line with expectation. The acceleration of manufacturing investment was offset by slower property investment and weak infrastructure investment. Fixed asset investment in manufacturing sector increased by 15.7% yoy in the first eight months. On two-year average, it grew by 3.3% yoy, up from 3.1% yoy in the first seven months. The rebound of manufacturing investment was mainly attributable to acceleration of fixed asset investment in high-tech sectors, which increased by 13.4% yoy on two-year average on the back of China's industry upgrade and pursuing tech self-sufficiency.
▪ Hong Kong's unemployment rate for the three months to August fell faster than expected for the sixth consecutive three-month period to 4.7%, the lowest since 1Q 2020. Underemployment rate also dropped by 0.2 percentage point from the preceding three-month period to 2.4%.	▪ By sector, the unemployment rate of construction sector and transportation sector decreased at a relatively rapid rate by 0.7 percentage point and 0.5 percentage point respectively from the preceding three-month period, mainly attributable to the well-contained local epidemic which allows economic activities to resume normalcy. Supported by the e-consumption voucher, the unemployment rates of the retail sector and the accommodation services sector also dropped by 0.4 and 0.5 percentage point respectively from the preceding three-month period. However, the unemployment rate of F&B services activities remained unchanged. Since the unemployment rate of the hardest-hit sectors is still higher than the pre-pandemic level, there is room for further decline on the back of rebounding local consumption. However, without border reopening, labor market's recovery is likely to be constrained. As such, we expect the decline of unemployment rate to slow down and the overall jobless rate to stay above 4% in the near term.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNH ended the week in its recent range of 6.45-6.50 despite touching intraweek low of 6.42.	▪ RMB was largely isolated from the recent negative headline news from China. Amid the rebound of dollar index last week, RMB outperformed its major trading partners with RMB index hit a high of 99.

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