Greater China – Week in Review

21 June 2021

Highlights: PBoC in full control

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

RMB liquidity returned to the spotlight last week. PBoC's fully rollover of MLF early last week disappointed some market watchers as they expected more due to concerns about the falling excessive reserve.

Nevertheless, the data from central bank balance sheet showed that the expectation on the falling excessive reserve in May was wrong. PBoC balance sheet expanded by CNY460 billion to CNY32.69 trillion, first expansion since January 2021. It was mainly supported by the increase of claims on other depository institutions, which increased by CNY469.7 billion unexpectedly despite PBoC's cautious open market operation. This indicates that PBoC may provide the funding support to the real economy via relending.

From liquidity perspective, the unexpected rapid expansion of PBoC's claims on other depository institutions helped alleviate the concern about the falling excessive reserve in China's banking system.

This also demonstrated that PBoC is still in full control of liquidity even though China's liquidity pressure may heighten in the second half due to rising issuance of local government bond. The key takeaway for the market is that there is no point to overly speculate China's liquidity without proof given PBoC has mentioned clearly that it will keep liquidity reasonably stable.

On economic data, the deceleration of industry production on two-year average basis showed that China's recovery momentum may have peaked as support from external demand may have peaked due to gradual reopening of global economy.

The bright spot came from the rebound of manufacturing investment, which rose by 0.6% yoy on two-year average in the first five months. This is the first time that manufacturing investment has returned to pre-pandemic level since the outbreak of Covid-19. The recovery of manufacturing investment will help China reduce its reliance on infrastructure investment.

Despite sporadic outbreak of new delta version of the Covid-19 in Guangdong province, China's mobility on national level was less affected as a result of rapid vaccine rollout. Total travel during the 3-day dragon boat festival long weekend reached 89.13 million, back to 98.7% of pre-pandemic level. On Covid-19, China hit milestone that the country has administrated more than 1 billion doses of Covid-19 vaccines last week.

On currency, RMB retreated against the dollar following the surge of dollar index last week. However, RMB index returned to above 98 again. Historically, RMB tended to outperform its major trading peers against the backdrop of rising dollar index. This may be the case as well this time given fundamental support to RMB remained unchanged.

Chinese banks net sold foreign currencies again in May. The surplus of net sale of foreign currencies widened to US$22.8 billion in May. Willingness to sell foreign currencies increased from 61% in April to 67% in May while willingness to purchase foreign currencies also increased from 65% to 66% in May. The increase of willingness to sell and purchase foreign currencies at the same time could be a relief to regulators who have been working hard to curb RMB's one-way movement expectation.

In **Hong Kong,** unemployment rate dropped to a one-year low of 6% during the three months to May, owing to the gradual economic recovery and the well-contained local epidemic. On a positive note, Hong Kong's vaccination rate has been picking up. Meanwhile, the Consumption Voucher Scheme will be open for registration from 4 July with the first instalment to be distributed as early as 1 August. Despite the substitution effect, we expect this will help to boost local consumption especially during holidays and promotion seasons. The Financial Secretary expects the consumption voucher scheme to provide a 0.7% buffer for GDP in 2021. More notably, the government reportedly will shorten the hotel quarantine requirement to 7 days for travellers who have been fully vaccinated and passed an antibody test. All these combined may support further economic recovery and in turn boost hiring sentiments. However, some sectors that rely heavily on tourists may not see any strong recovery until the border reopens. As such, though we expect overall jobless rate to fall towards 5% or even below this level in 2H, it may remain far away from the pre-pandemic level of sub-3%.

On the financial market front, USDHKD spot edged up above 7.7600 last week due to broad dollar strength on hawkish Fed surprise. However, until we move much closer to the Fed's first rate hike, the relatively small USD-HKD yield differential may cap the downside of the HKD spot in the near term despite a strong US dollar. In the coming sessions, we may even see some short-term liquidity draining events such as busy IPO pipeline, dividend payments and half-year end lending some support to both HKD spot and front-end HKD rates. In conclusion, USDHKD spot may hover in the range of 7.7550-7.7900 while 1M HIBOR may stay below 0.2% for some time.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪	▪
▪ China's central bank fully rolled over its maturing CNY200 billion 1-year MLF keeping its interest rate unchanged for 15 months.	▪ However, the amount is slightly lower than some expected due to falling excessive reserve in June. This showed that PBoC is likely to continue its cautious stance over liquidity management to strike the delicate balance between economic recovery and containing financial risk.
▪ USDHKD spot edged up above 7.7600 last week due to broad dollar strength on hawkish Fed surprise.	▪ Though dot plots showed a median expectation of two rate hikes by end of 2023, the Fed's chair Powell noted that we should take the move "with a big grain of salt". Until we move closer to the Fed's first rate hike, USDHKD forward swap points may not show much downside. Given the relatively small USD-HKD yield differential, we also do not expect to see much downside for the HKD spot in the near term despite a strong US dollar. ▪ In the coming sessions, we may even see some short-term liquidity draining events such as busy IPO pipeline, dividend payments and half-year end lending some support to both HKD spot and front-end HKD rates. Moving into July, the dividend payments may increase while the market is expecting the launch of wealth management connect and southbound bond connect. In conclusion, we hold onto our view that USDHKD spot will hover in the range of 7.7550-7.7900 while 1M HIBOR may stay below 0.2% for some time.
▪ In 3Q 2021, Hong Kong Exchanges and Clearing Ltd will start to consult on the proposal to allow the listing of special purpose acquisition companies (SPAC) in the city.	▪ This move mainly aims to increase the competitiveness of Hong Kong's IPO market as the IPO of SPACs have been active in the US while Singapore has already started the consultation early this year. However, since the risks and benefits remain debatable, whether the listing of SPACs in Hong Kong will be allowed under various conditions remains to be seen.
▪ Hong Kong reportedly will shorten the hotel quarantine requirement to 7 days for travellers who have been fully vaccinated and passed an antibody test. This change however will not apply to visitors from places with "high-risk" such as the UK, US and Japan.	▪ However, there is no further details such as the effective date of the relaxation. Also, it may not lend much support to the hardest-hit sectors. The key for further relaxation of border controls would still be a high vaccination rate at home and abroad. On a positive note, Hong Kong's vaccination pace has been accelerating with the share of population who have received at least one dose of Covid-19 vaccine increasing by 5 percentage points over the past 15 days. Previously, it took nearly one month to see a similar increase in vaccination rate.
▪ Hong Kong announced details of the HK$5000 e-consumption vouchers.	▪ The Consumption Voucher Scheme will be open for registration from 4 July and the vouchers will be distributed in up to three instalments with the first instalment to be distributed as early as on 1 August via Octopus, Wechat Pay HK, Alipay HK or Tap & Go. The vouchers should be used at local retail, catering and service outlets (including their online platforms). ▪ The vouchers will only expire in late 2021 or early 2022 depending on the choice of the stored value facilities. As such, despite the substitution effect, we expect this will help to boost local consumption especially during holidays and promotion seasons. Meanwhile, the scheme may help to accelerate the adoption of electronic payments by the

	consumers and the merchants. The Financial Secretary expects the consumption voucher scheme to provide a 0.7% buffer for GDP in 2021.

Key Economic News

Facts	OCBC Opinions
▪ China's central bank balance sheet expanded by CNY460 billion to CNY32.69 trillion, first expansion since January 2021.	▪ The expansion of PBoC balance sheet in May was at the fastest pace in 2021. It was mainly supported by the increase of claims on other depository institutions, which increased by CNY469.7 billion unexpectedly despite PBoC's cautious open market operation. This indicates that PBoC may provide the funding support to the real economy via relending. ▪ From liquidity perspective, the unexpected rapid expansion of PBoC's claims on other depository institutions helped alleviate the concern about the falling excessive reserve in China's banking system. ▪ This also demonstrated that PBoC is still in full control of liquidity even though China's liquidity pressure may heighten in the second half due to rising issuance of local government bond.
▪ Chinese banks net sold foreign currencies again in May. The surplus of net sale of foreign currencies widened to US$22.8 billion in May.	▪ The key gauge of market demand and supply for foreign currencies, net sale of foreign currencies by Chinese banks on behalf of clients in both spot and derivatives, widened to US$31.7 billion in May after shrinking by US$1.36 billion in April. This showed the return of demand for RMB in May. ▪ Willingness to sell foreign currencies increased from 61% in April to 67% in May while willingness to purchase foreign currencies also increased from 65% to 66% in May. ▪ The increase of willingness to sell and purchase foreign currencies at the same time could be a relief to regulators who have been working hard to curb RMB's one-way movement expectation.
▪ China's industry production in May grew by 8.8% yoy. ▪ Retail sales rose by 12.4% yoy while fixed asset investment rose by 15.4% yoy.	▪ Growth of three major economic indicators decelerated further as base effect is fading away as the Chinese economy has recovered in May 2020 following a successful containment measure. ▪ On two-year average, industry production rose by 6.6% yoy in May, down slightly from 6.8% yoy in April. Nevertheless, fixed asset investment accelerated to 4.2% in the first five months from 3.9% yoy in the first four months while retail sales growth accelerated to 4.3% in the first five months from 4.2% in the first four months. ▪ The deceleration of industry production showed that China's recovery momentum may have peaked as support from external demand may have peaked due to gradual reopening of global economy. ▪ The bright spot came from the rebound of manufacturing investment, which rose by 0.6% yoy on two-year average in the first five months. This is the first time that manufacturing investment has returned to pre-pandemic level since the outbreak of Covid-19. Infrastructure investment decelerated to 3.4% yoy on two-year average in May from 3.8% in April. This showed that manufacturing investment will play a more

	important role in driving growth in the upcoming months.
▪ Hong Kong's unemployment rate dropped further from 6.4% during February-April to 6.0% during three months to May, reaching a one-year low and beating the market expectations. During the same period, underemployment rate fell notably by 5 percentage point to 2.8%.	▪ On a more positive note, decrease in unemployment rate was seen in all sectors with construction sector (down 0.6 percentage point to 10.3%), consumption and tourism-related sectors (down 0.5 percentage point to 9.4%), as well as transportation sector (down 0.4 percentage point to 6.3%) leading the decline, owing to the gradual economic recovery and the well-contained local epidemic. ▪ Going forward, we expect the unemployment rate will continue to edge down as the accelerating vaccination rate and the upcoming e-consumption vouchers together may support further economic recovery and in turn boost hiring sentiments. ▪ However, some sectors such as aviation and tourism that rely heavily on tourists may not see any strong recovery until the border reopens while the relaxation of board controls hinges on global vaccination pace. Also notable is that total employed persons were still 172.8k below the pre-pandemic level. As such, though we expect overall jobless rate to fall towards 5% or even below this level in 2H, it may remain far away from the pre-pandemic level of sub-3%.
▪ Macau's visitor arrivals increased by 5268.3% yoy and 9% mom to 866,063 in May.	▪ The strong rebound of the tourism sector was in line with the notable growth of gaming revenue in May, mainly attributable to the Labor Day holiday. However, total visitor arrivals were still down 74.5% from May 2019. Moving into June, the recovery may have slowed down amid the virus resurgence in some parts of China including Guangdong province which resulted in a tightening of Macau's travel restrictions on tourists from these places. Notably, visitors from Guangdong province took up 58% of Macau's total Mainland visitors in May. ▪ On a positive note, owing to the mass testing and rapid vaccination rate, China's Covid-19 infections have subsided. As such, the impact on Macau's tourism and gaming sectors may be transitory. That said, unless the border fully and safely reopens, we may not see the number of visitor arrivals returning to the pre-pandemic levels.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY returned to 6.45 range last week as a result of broad dollar strength. ▪ However, RMB index also gained returning to above 98.	▪ Historically, RMB tended to outperform its major trading peers against the backdrop of rising dollar index. This may be the case as well this time given fundamental support to RMB remained unchanged.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W