OCBC TREASURY RESEARCH

Greater China – Week in Review

25 January 2021

Highlights

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

The delicate balance for RMB demand and supply matrix has been broken in December 2020 at an unprecedented pace. Chinese banks have net settled a record of US$97 billion foreign exchange via both spot and derivatives on behalf of clients. This number is 10 times higher than monthly average of US$9.4 billion net settlement of foreign exchange from January to November.

Customer's willingness to sell foreign currency jumped to 71% in December from 62% in November while customer's willingness to buy foreign currency fell to 60% in December from 65% in November.

The difference between net foreign exchange settlement on behalf of clients and net foreign exchange receivables, which is a good leading indicator for the direction of capital flows, widened to a record high of US$49.3 billion in December. This could be an early signal that rising inflows could have reshaped the demand and supply for RMB.

The surging demand for RMB is not only attributed to seasonal demand, which companies tend to pay bonus for employees before year-end. Judging by the significant rise of RMB daily trading volume, which rose to average US$43.9 billion in December from usual daily average of about US$30 billion, it may raise concern about structural change of demand for RMB against the backdrop of China's outperformance in virus containment.

In hindsight, the surging demand for RMB in December explained the recent high frequency policy fine-tunes to discourage inflow and encourage outflows.

Interestingly, despite RMB's outperformance in the second half of 2020, the foreign exchange purchase by PBoC declined unexpectedly by CNY32.87 billion in December. In 2020, forex purchase by PBoC fell by CNY757 billion. This proved that PBoC has departed from any interventionist model. Given PBoC is moving towards a more independent model, the impact of recent capital inflows on base money creation is limited.

In addition, China further tightened its containment measures for migrant workers travelling back to rural areas for the upcoming Chinese New Year. According to government estimation, this year's annual migration is likely to be 40% lower than that in 2019.

The recent resurgence of virus is likely to be a double-edged sword. Although it may dampen the holiday consumption, it may be supportive to China's industrial activities as factories may reopen earlier post CNY holiday as most migrant workers may choose to stay in the cities to earn extra money against the backdrop of strong order books.

For today, China's President Xi will a speech at the virtual World Economic Forum focusing on the central theme of rebuilding trust.

In **Hong Kong,** all eyes were on the stock market as Hang Seng Index rose to the highest since May 2019 last week, driven by strong southbound equity inflows. Going forward, the southbound equity inflows may sustain amid the sanguine sentiments of onshore investors, the robust flows into onshore mutual funds, the attractive valuation of Hong Kong stock and the strong interests in the stock of the secondary-listed firms, the traditional large names and the new economy companies of China. Should southbound equity inflows sustain, HKD liquidity may remain flushed and allow HKD rates to stay lower for longer while supporting the HKD exchange rate to trade close to the strong side of the currency peg.

In contrast to the stock market frenzy, the real economy continued to show signs of weakness as unemployment rate surged to 16-year high of 6.6% in 4Q 2020. Going ahead, with the social distancing measures remaining in place and virus concerns continuing to disrupt economic activities, the hardest-hit sectors may remain mired in the doldrums. This indicates that the labour market may remain under pressure. As such, the government is trying to strike a balance between containing virus while protecting the already crippled economy and adhering to fiscal discipline. In conclusion, as the government may launch targeted measures and gradually relax the containment measures to revive the economy, we expect the overall unemployment rate to peak above 7% in the coming months before retracing lower on the back of vaccine-induced economic recovery.

In Macau, the month-on-month growth of visitor arrivals narrowed further in December. As vaccine roll-out has been taken place only slowly and many countries/regions are still in lockdown mode, we are concerned that Macau's inbound tourism will remain subdued in 1Q or even 1H of 2021.

Key Events and Market Talk

Facts	OCBC Opinions
▪ China rolled out more measures to contain the virus for the upcoming Chinese New Year holiday.	▪ Travellers returning to hometown need to show negative nucleic acid test result within 7 days before the trips and have to undergo 14-day health monitoring at home after arrival. This stricter measure may further discourage people from travelling in the coming weeks. According to government estimation, this year's annual migration is likely to be 40% lower than that in 2019 but 10% higher than that in 2020 when Covid-19 first emerged. ▪ Given the fluid situation in some parts of China, it is possible for government to further tighten inter-provincial travel ahead of the Chinese New Year. The recent resurgence of virus is likely to be a double-edged sword. Although it may dampen the holiday consumption, it may be supportive to China's industrial activities as factories may reopen earlier post CNY holiday as most migrant workers may choose to stay in the cities to earn extra money against the backdrop of strong order books.
▪ On 21 January, Hang Seng Index rose to the highest since May 2019. Also, the turnover of Hong Kong stock market surged to the record high as of 19 January, 32.9% of which was contributed by the turnover of stock connect program. ▪ Last Friday, HKEX announced the inclusion of eligible A-shares listed on the Shanghai Stock Exchange's Sci-Tech Innovation Board and the corresponding H-shares into Stock Connect, starting 1 February 2021. For A-shares listed on Shenzhen Stock Exchange, their corresponding H-shares will be included in Southbound trading of Stock Connect as well, effective from 1 February 2021.	▪ Going forward, southbound equity inflows may sustain amid several factors. First, onshore investment sentiment has been sanguine given China's continued economic recovery and the prospect of easing US-China tension under Biden administration. Second, liquidity continues to flow into onshore mutual funds with the latest sales of a fund attracting record subscription money (over RMB200 billion). Most of the mutual funds can invest up to 50% of their equity portfolio in HK stocks. Apart from mutual funds, other onshore institutional investors like private funds, insurance and pension funds may also join the camp to pour money to Hong Kong equity. Third, the P/E ratio of Hang Seng Index is far below that of its peers while AH premium index remains much higher than the five-year average, reflecting attractive valuation. Fourth, a lot of ADRs and new economy companies are in Hong Kong's IPO pipeline and may be included in the stock connect program later. This makes Hong Kong stock market more appealing. ▪ Still, in the meantime, we remain wary of the uncertainty about US-China relationship as well as China's potential policy risks. ▪ In a nutshell, should southbound equity inflows sustain, HKD liquidity may remain flushed and allow HKD rates to stay lower for longer while supporting the HKD exchange rate to trade close to the strong side of the currency peg.

Key Economic News

Facts	OCBC Opinions
▪ China's net foreign exchange settlement in December jumped to US$66.6 billion. ▪ In addition, net foreign exchange settlement by bank on behalf of clients via all the channels including derivatives such as forward and option jumped to a record high of US$97 billion.	▪ The delicate balance for demand for RMB has been broken in December at an unprecedented pace. In hindsight, the surging demand for RMB as proven by the foreign exchange settlement data in December explained the recent high frequency policy finetunes to discourage inflow and encourage inflows.

▪ Customer's willingness to sell foreign currency increased to 71% in December from 62% in November while customer's willingness to buy foreign currency fell to 60% in December from 65% in November.	▪ Chinese banks have net settled US$97 billion foreign exchange via both spot and derivatives. This number is 10 times higher than monthly average of US$9.4 billion net settlement of foreign exchange from January to November. ▪ If we map the settlement data into the cross border foreign exchange payment and receipts data, it shows the abrupt change of capital flows in December. The difference between net foreign exchange settlement on behalf of clients and net foreign exchange receivables, which is a good leading indicator for the direction of capital flows, widened to a record high of US$49.3 billion in December. This could be an early warning signal that rising inflows could change demand for RMB, which may create more pressures for RMB appreciation. ▪ The increase of demand for RMB in December could be partially explained by seasonal demand which exporters may sell foreign currency to pay bonus to employees. Nevertheless, the magnitude of the change is clearly beyond the story of seasonality.
▪ China's forex purchase by the central bank fell unexpectedly by CNY32.87 billion.	▪ Despite RMB appreciation since the second half of 2020 and strong inflows in November and December, the decline of CNY757 billion forex purchase by PBoC in 2020 proved that PBoC has departed from any interventionist model. Given PBoC is moving towards a more independent model, the impact of recent capital inflows on base money creation is limited.
▪ Hong Kong's unemployment rate surged to 16-year high of 6.6% in 4Q 2020. While the labour force was about the same, the total employment decreased by 0.1% in 4Q 2020, from the prior period. ▪ As local pandemic situation worsens, Hong Kong government has extended the social distancing measures by another week to 27 January, strengthened the mandatory Covid-19 testing and imposed a 2-day lockdown on a small part of Kowloon.	▪ Among all the major sectors, consumption- and tourism-related sectors' jobless rate saw the largest increase of 0.5 percentage point in 4Q 2020 as compared to the prior period, followed by the transportation sector where unemployment rate rose 0.2 percentage point. The weakening of labour market was mainly due to the expiry of Employment Support Scheme in November, the fourth wave of Covid-19 which started in late November, and the stringent social distancing measures. ▪ Going ahead, with the social distancing measures remaining in place and virus concerns continuing to disrupt economic activities, the hardest-hit sectors may remain mired in the doldrums. This indicates that the labor market may remain under pressure. As such, the government is trying to strike a balance between containing virus while protecting the already crippled economy and adhering to fiscal discipline. First, the government is planning to gradually relax the social distancing measures should locally transmitted cases of Covid-19 continue to edge lower. Second, the government announced to earmark HK$2.79 billion to rescue Ocean Park and extend the repayment date of the previous bailout of HK$5.4 billion to 2059. Third, regarding the 2021/22 Budget, Hong Kong's Chief Carrie Lam noted that it is hard to roll out unemployment benefit at the juncture but may consider lowering the requirements for Working Family Allowance Scheme.

	▪ In conclusion, we expect the overall unemployment rate to peak above 7% in the coming months before retracing lower on the back of vaccine-induced economic recovery.
▪ Macau's visitor arrivals dropped for the 14th consecutive month by 78.6% yoy in December 2020 while the month-on-month growth also narrowed further from 9.3% in November to 3.6% in December. Zooming in, Mainland visitors also merely rose by 3.1% mom despite that Macau relaxed the travel restriction on foreigners from Mainland China from last December.	▪ The very slow recovery of Macau's inbound tourism may be due to two reasons. First, Mainland visitors may have not been very keen on cross-border travel given the lingering virus concerns, the sluggish labour market, and the reluctance to have Covid-19 test. Second, Macau has tightened the travel restrictions on the countries/regions including Hong Kong that have been fighting Covid-19 resurgence. ▪ Moving ahead, as vaccine roll-out has been taken place only slowly and many countries/regions are still in lockdown mode, international travel may not resume normalcy any time soon. As such, we are concerned that Macau's inbound tourism will remain subdued in 1Q or even 1H of 2021. If this is the case, the tourism-related sectors, retail sector and gaming sector may remain sluggish as well. This may in turn weigh on the labour market and the overall economy.

RMB	
Facts	**OCBC Opinions**
▪ RMB underperformed against the dollar slightly last week with the USDCNY trapped in the range of 6.45-6.50.	▪ Market continued to digest for the recent policy tweaks for macro prudential coefficient. In addition, the recent resurgence of virus in China may also cap the gain for RMB in the near term.

Treasury Research & Strategy

OCBC Greater China Research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com