Greater China – Week in Review

17 May 2022

Highlights: China can afford more stimulus

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The Chinese economy weakened significantly in April due to Covid lockdowns in some parts of China. Both industrial production and retail sales were weaker than expectation. Investment was the only data registering growth.

Industrial productions in Covid hit Yangtze River delta region and Northeastern region fell by 14.1% yoy and 16.9% yoy respectively while industrial production in less affected central China and western China rose by 4.6% yoy and 5.6% yoy. With China gradually reopens its economy this month, we expect China's industrial production to bottom out soon.

However, despite improving situation on Covid lockdowns, consumption outlook remains weak probably due to three factors including concerns about job security, weak property market and negative wealth effect amid equity sell-off. China's surveyed jobless rate rose to 6.1% in April, close to 6.2% peak observed in February 2020 during the first wave of Covid outbreak.

In addition, short term loan to household sector fell by CNY217 billion while medium to long term loan to household sector shrank by CNY31.3 billion in April. This was the second decline of medium to long term loan to household sector this year. The deleverage in household sector reflected the weak sentiment in property market and weak job prospect.

The deterioration of property market was worse than expectation. Property sales by value and by volume in the first four month fell by 29.5% yoy and 20.9% yoy respectively. Property investment growth turned negative in the first four months. Land acquisition year to date fell by 46.5% yoy, signalling more downside risks for property investment.

Given Chinese economy is heading towards a sequential contraction in the second quarter amid free fall of property related data, China has stepped up its policy supports in the past week.

PBoC announced on 15 May to allow commercial banks to lower its floor of mortgage rate for the first-time home buyers. This is the first easing policy to support property market on the national level. The quasi targeted interest rate cut showed that China has reckoned that property market is the weakest link in Chinese economy.

We expect China to roll out more supports in the coming sessions. Although PBoC kept its MLF rate unchanged in May, we expect China to lower its LPR fixing this week due to falling banks' funding costs.

Since banks are allowed to adjust their deposit rate setting with reference to 10-year gov bond yield and 1-year LPR from April, the weighted average deposit rate for financial institutions declined by 10bps in the last week of April according to PBoC. The recent deposit rate reform cleared the obstacle that interest rate cut may hurt banks' profitability.

The pace of RMB depreciation since the second half of April was unprecedented. With RMB index falling towards 100 and China's rollout of its reopening plan, we think the pressure for further RMB weakness may be lesser. We expect RMB to consolidate around 6.80 in the near term.

Elsewhere, China's central bank said it will continue to promote the reform and opening of its financial market after the IMF increased the weighting of RMB to 12.28% from 10.92% in its SDR basket. The rise of share in SDR basket mainly reflected the increasing role of RMB in international trade and global reserve currency. However, RMB's role in global foreign exchange transaction, denominated currency in global debt and denominated currency in banks' liability remained limited.

The government cut economic growth forecast for Hong Kong this year, to 1%-2%, from the previous estimate of 2%-3.5%. Our forecast at 1.2%, was close to the lower bound of the estimates.

The government cited a series of unfavourable factors weighing on Hong Kong's economic outlook, including heightened geopolitical tension, elevated global inflation and rate hikes by major central banks. Taking into account the gradual revival of local economic activities and deteriorating export outlook, the 2022 forecast for Hong Kong economy was revised downward by around 1-1.5 percentage points. On inflation outlook, the forecast rates of underlying and headline CPI were kept at 2% and 2.1% respectively, as domestic cost pressure stayed generally mild.

On exchange rate front, the spot USDHKD breached above 7.8500 last week, the first time since 2019, triggering the weak-side convertibility undertaking. The Hong Kong Monetary Authority (HKMA) intervened and bought a total of HK$11.697 billion to defend the currency peg. We expect the currency pair to stay close to the weak side convertibility undertaking for multi-month horizon, and more intervention will come on the back of broad dollar strength.

The Macau government is reportedly mulling a series of significant changes to its proposed gaming law amendment bill, in an attempt to throw a lifeline to the local gaming industry which was hit hard by the border control and visitor drop. The government plans to allow satellite casino to operate outside the venues of the respective gaming concessionaires. Another proposal under consideration is gaming tax cut, by as much as 5 percentage point, if operators can bring in foreign players.

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Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC announced on 15 May to allow commercial banks to lower its floor of mortgage rate for the first time home buyers.	▪ The lower limit of mortgage rate for first time buyers will be changed to 5-year LPR minus 20bps from previously 5-year LPR. ▪ This is the first easing policy to support property market on the national level. The quasi targeted interest rate cut showed that China has reckoned that property market is the weakest link in Chinese economy.
▪ The IMF increased the weighting of RMB to 12.28% from 10.92% in its SDR basket.	▪ The rise of share in SDR basket mainly reflected the increasing role of RMB in international trade and global reserve currency. However, RMB's role in global foreign exchange transaction, denominated currency in global debt and denominated currency in banks' liability remained limited. ▪ In respond to IMF"s decision, China's central bank said it will continue to promote the reform and opening of its financial market.
▪ China kept its 1-year MLF rate unchanged in May.	▪ Despite intact of MLF rate in May, market hopes on LPR cut in May remain as there was prior example in September 2019 when China cut its LPR without lowering the MLF rate. ▪ The recent deposit rate reform which allows banks to peg their deposit rate setting with 1-year LPR and 10-year Treasury yields cleared the obstacle that interest rate cut may hurt banks' profitability. As such, we see rising chances that China may lower its LPR fixing this week to further support its economy.
▪ PBoC unveiled the details about the latest deposit rate reform in its 1Q monetary policy report.	▪ The central bank said banks now adjust their deposit rate setting with reference to 10-year gov bond yield and 1-year LPR. There are two implications here. First LPR becomes increasingly more important. It not only affect the funding costs for company also the funding costs for banks. Second, the decline of bond yields will have more direct contribution to lower the funding costs to the real economy via the transmiion mechanism from the banking sector. ▪ According to PBoC, big banks and most joint stock banks have lowered the deposit rates for 1-year and above and deposit rates for certificate of deposit since the second half of April. In the last week of April, the weighted average deposit rate for financial institutions have declined by 10bps.
▪ Hong Kong: The government cut economic growth forecast for Hong Kong this year, to 1%-2%, from the previous estimate of 2%-3.5%. Our forecast at 1.2%, was close to the lower bound of the estimates.	▪ Taking into account the gradual revival of local economic activities and deteriorating export outlook, the 2022 forecast for Hong Kong economy was revised downward by around 1-1.5 percentage points. On inflation outlook, the forecast rates of underlying and headline CPI were kept at 2% and 2.1% respectively, as domestic cost pressure stayed generally mild. ▪ Separately, Hong Kong published its finalized real GDP figure for 1Q 2022, the year-on-year change was kept at -4.0%, while its quarter-to-quarter change was revised downward from -2.9% to -3.0%. By component, private consumption expenditure, gross domestic fixed capital formation and total exports of goods recorded year-on-year decline of 5.5%, 8.4% and 4.5% respectively in real terms in the first quarter of 2022. Meanwhile, the government consumption expenditure rose by

	6.0% yoy, extending the 4.1% increase in the previous quarter.
▪ Hong Kong: On exchange rate front, the spot USDHKD breached above 7.8500 last week, the first time since 2019, triggering the weak-side convertibility undertaking. The HKMA intervened and bought a total of HK$11.697 billion to defend the currency peg. We expect the currency pair to stay close to the weak side convertibility undertaking for multi-month horizon, and more intervention will come on the back of broad dollar strength.	▪ When weak side convertibility undertaking is triggered, the HKMA will defend the currency peg by buying HKD and selling USD, effectively draining HKD liquidity from the interbank market. These operations have started to have an impact, with HKD IRS being paid up. While reaction in HKD rates may still not be big enough, as the Aggregate Balance (interbank liquidity) edges down to a still thick HKD326bn. The 1M/3M HIBOR-LIBOR spreads currently stay at around 60-70 bps. ▪ Given the rate spread, carry trade activities (borrowing at lower HKD rates and converting to USD to lend at higher USD rates) should remain and keep the HKD at weak side of currency band. We expect the currency pair to stay close to the weak side convertibility undertaking for multi-month horizon, and more intervention will come on the back of broad dollar strength. Meanwhile reaction in HKD rates may still not be big enough to reverse the pressure on in spot t/t at this stage. ▪ During the previous Fed tightening cycle in 2018, as a result of the FX intervention, the total aggregate balance fell by around HK$120 billion (from HK$180 billion in April 2018 to HK$54 billion in April 2019). Subsequently, the HKD rates were driven up, and the HIBOR-LIBOR spread narrowed noticeably before widening again. 1M HIBOR-LIBOR spread narrowed from around 110 bps at end-March 2018 to 10 bp at end-June 2018, while that for 3M from around 120 bps to 25 bps. ▪
▪ Macau: The Macau government is reportedly mulling a series of significant changes to its proposed gaming law amendment bill, in an attempt to throw a lifeline to the local gaming industry which was hit hard by the border control and visitor drop. The government plans to allow satellite casino to operate outside the venues of the respective gaming concessionaires. Another proposal under consideration is gaming tax cut, by as much as 5 percentage point, if operators can bring in foreign players.	▪ Macau's gaming sector continued to be battered by the travel restriction and China's Covid lockdown. Macau's gross gaming revenue in the first four months of 2022 plummeted by 36.2%, comparing with the same period in 2021. Amid the plunging revenue, the share prices of major casino operators also saw significant discount since the start of 2022 (SJM fell by 41.3% year-to-date on 13 May; Melco by 46.8%; Wynn Macau by 29.8%). ▪ The government's plan scraping the proposal requiring satellite casino operators to tie the ownership of their respective gaming floors to the gaming concessionaires, will alleviate the financial burden faced by the cash-strapped casino operators. Meanwhile, Macau government also intends to drop a proposal that any corporate entity holding a gaming concession will need to be dissolved if failed to fresh gaming rights after the expiry of the current concessions. In addition, the gaming tax cut (currently set at 40%, way above other rivaling gaming hubs) seeks to attract more foreign bettors and reduce reliance on the Chinese market. ▪ While these proposals are positive signals for the gaming sector in Macau, the path of recovery still relies heavily on the reopening of border and how soon Covid-19 can be contained in the Mainland China.

Key Economic News

Facts	OCBC Opinions

▪ The Chinese economy weakened significantly in April due to Covid lockdowns in some parts of China. ▪ Industrial production in April fell by 2.9% yoy, weaker than market expectation of 1% increase. ▪ Retail sales growth also declined by more than expected 11.1% yoy. ▪ Fixed asset investment growth decelerated to 6.8% yoy in the first four months. Nevertheless, it was slightly better than market expectation.	▪ The larger than expected contraction of industrial production in April was mainly attributable to two factors including factory shutdown in Covid-hit areas and disruption from the supply chain bottleneck. Industrial productions in Yangtze river delta region and North Eastern region fell by 14.1% yoy and 16.9% respectively. Nevertheless, industrial production in less affected central China and western China rose by 4.6% yoy and 5.6% yoy. For breakdown, the contraction of industry production was mainly driven by the 4.6% decline of manufacturing output. ▪ On domestic consumption, retail sales of goods fell by 9.7% yoy while retail sales of catering fell by 22.7% yoy due to people movement control. Of which, car sales fell by 31.6% yoy. Although online penetration continued to increase, the 5.2% yoy decline of online physical goods sales reflected the challenges from the logistics bottleneck as cities under lockdown struggled with last mile delivery. Given the lockdown has been extended into May, we expect the rebound of retail sales is likely to be gradual. Market will eye on the 618 shopping festival with hopes of return to normalcy. ▪ Fixed asset investment was on the only major indicator registering growth in April. Infrastructure investment and manufacturing investment growth decelerated to 6.5% yoy and 12.2% yoy in the first four months from 8.5% yoy and 15.6% yoy in the first quarter. Nevertheless, property investment growth contracted by 2.7% yoy in the first four months after securing a 0.7% small growth in the first quarter. ▪ Property market weakened further in April. Property sales by value and by volume in the first four month fell by 29.5% yoy and 20.9% yoy respectively. Land acquisition year to date fell by 46.5%, signalling more downside risks for property investment. ▪ Looking ahead, we expect industrial production to bottom out in the coming months as China gradually to allow factories to reopen. However, outlook of consumption remains uncertain due to the people movement control. ▪ The latest data reinforced that China will enter a sequential contraction in the second quarter.
▪ China's aggregate social financing only increased by CNY910.2 billion in April, much weaker than market consensus. The outstanding growth of aggregate social financing decelerated to 10.2% in April from 10.5% in March. ▪ New Yuan loan increased by weaker than expected CNY645.4 billion. ▪ However, broad money supply M2 growth reaccelerated to 10.5% from 9.7%.	▪ The increase of new Yuan loan was CNY823.1 billion short of that in April 2021. This was the largest gap since July 2016. The weaker than expected aggregate social financing was mainly driven by weak on-balance sheet lending due to deleverage in household sector and weak demand in corporate sector. ▪ Short term loan to household sector fell by CNY217 billion while medium to long term loan to household sector shrank by CNY31.3 billion. This was the second decline of medium to long term loan to household sector this year. The deleverage in household sector reflected the weak sentiment in property market and weak job prospect. ▪ Loan structure is extremely weak in April as on-balance sheet bill financing increased by a sizable CNY514.8 billion, accounting for 79.8% of new loan creation. This showed that banks are relying on the short-term loan to make up their balance sheet in the absence of medium to long term demand

	amid rising uncertainty. ▪ The divergence between aggregate social financing growth and M2 growth in April was probably due to two factors including increasing fiscal expenditure on the back of PBoC's profit transfer and large increase of household and corporate deposits as a result of weak equity sentiment.
▪ China's CPI reaccelerated to 2.1% yoy in April from 1.5% yoy in March. ▪ PPI growth decelerated further to 8% yoy from 8.3% yoy in March.	▪ On sequential basis, CPI rose by 0.4% mom, led by higher food prices and oil prices. Food prices rose by 0.9% mom after falling by 1.2% mom in March due to higher logistics costs amid people movement control and rebound of pork prices after China beefed up its pork reserve to stabilize the prices. Pork prices increased by 1.5% mom after falling by 9.3% mom in March. The drag from pork prices to CPI started to ease. Food prices became the second largest driver to April CPI after dragging down CPI for four consecutive months. ▪ China's core CPI excluding food and energy prices rose by 0.1% mom. On year-on-year reading, core CPI growth decelerated to 0.9% yoy from 1.1% yoy. ▪ Looking ahead, as a result of extended lockdown as well as elevated global oil prices, we expect food prices and transportation costs to continue to drive CPI higher. In addition, the restart of upward cycle for pork prices and rising imported inflation due to recent weakening RMB may further create uncertainty to inflation outlook. ▪ We think CPI may gradually rise towards 3% in the second half of 2022. Nevertheless, for the whole year, we expect CPI to stay below 2.5%, within government's target. This means the constraint from inflation to China's monetary policy remains limited for now.
▪ Macau's residential property weakened further, with the price index falling by 0.5% yoy as compared to a year ago in January-March 2022, extending the 0.4% decline in 4Q 2021. Comparing with the recent peak in June-September 2021, the price index fell cumulatively by 3.6%. Meanwhile, the total residential units transacted plummeted by 36.9% yoy in the first quarter, to 826 cases.	▪ In the first quarter of 2022, the residential property market in Macau weakened with falling prices and subdued trading. The market sentiment for the residential property market in Macau was dampened by the weak economic outlook, sluggish job market, heightened volatility in financial market and Fed's aggressive monetary tightening. ▪ ▪ On top of that, the strict border control and antivirus measures had prompted exits of expatriate workers since 2020, resulting in higher vacancy rate. The vacancy rate hence exerted downward pressure on the rentals and prices of residential units. The outlook for residential properties in 2022 is tilted downside, as the abovementioned downside risks are likely to weigh on the market for the rest of the year. We expect the residential property price to fall by around 4%.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY broke above 6.80 last week.	▪ The pace of RMB depreciation since the second half of April was unprecedented. With RMB index falling towards 100 and China's rollout of its reopening plan, we think the pressure for further RMB weakness may be lesser. We expect RMB to consolidate around 6.80 in the near term.

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