Highlights: Bracing for a weaker Yuan

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China's August data beat market expectation showing modest recovery of the economy. Please refer to our special report last Friday for more details about China's data. The rebound of fiscal revenue from value added tax and consumption tax also reinforced the view of the economic recovery. Nevertheless, the upbeat data are not enough to alleviate the concerns related to the resurgence of virus and fragile property market.

There is still no evidence of improving property market. The high frequency data still showed close to 30% year on year decline of property sales in 30 major cities in the first of September. In addition, the weak property market sentiment also showed profound impact on China's fiscal position. Five taxes related to property and land market shrank in August, which fell by 24.6% yoy on the aggregate level.

Nevertheless, China's real estate stocks continued to outperform due to expectations on full relaxation of home purchase restrictions in non-tier 1 cities.

Chengdu lifted its two-week lockdown in the middle of September. Even during the lockdown, residents were still allowed to go out for grocery shopping. The duration and magnitude of lockdowns were much milder than those in Shanghai and Beijing in April. This showed the change of implementation even under the same framework of dynamic zero Covid. The more flexible implementation may reduce the disruptions to growth in the coming months.

Elsewhere, China's State Council announced to roll out more stimulus measures to support manufacturing sector. China will provide additional CNY32 billion tax rebate to manufacturing companies other than deferred tax payment for additional four months.

Meanwhile, the State Council also announced additional more than CNY200 billion relending quota to support commercial banks to grant medium to long term loan to companies in manufacturing, service and social services industries as well as smaller companies in other industries to upgrade equipment in the fourth quarter at an interest rate of no more than 0.7% after 2.5% subsidiary from the central budget.

China also considered foreign trade as a strong underpinning for stable growth and employment and China will step up efforts stabilize foreign trade and foreign investments.

The latest foreign currency settlement data showed that China continued to see net inflows of foreign currency despite the RMB depreciation. In addition, China's onshore dollar deposit fell further to US$649 billion in

August from US$673.6 billion in July, lowest since March 2021. This shows there is no deposit dollarization despite RMB weakness.

However, RMB extended its loss with both onshore CNY and offshore CNH broke 7. The key catalyst last Friday was the move of the daily fixing to 6.93 after China kept its fixing around 6.91 for more than a week. This showed that there is no anchor from policy makers at the current junction.

China's counter cyclical measures such as the outsized strong RMB fixing will only slow down the depreciation pace but not changing the course without the help from the Dollar. Different from the past few rounds of RMB depreciation, the collapse of RMB forward points makes RMB short easy to hold due to positive carry. This will make China's counter cyclical measures less effective to stop RMB depreciation as what they did before.

Therefore, given the US-China rate differential is expected to widen further, the risk for the USDCNY to go higher further is high.

Hong Kong government is reportedly considering cutting the hotel quarantine and switching to a "0+7" arrangement as daily Covid caseloads show signs of stabilization. The pressure to further ease the border control measures mounted, as economic pain caused by the strict antivirus measures deepened. Over the last two year or so, Hong Kong's inbound tourism was brought to a standstill and its role as a regional hub was challenged, as a result of the quarantine requirement and shut border.

With the faltering profits and salaries tax revenue, Hong Kong may see fiscal deficits of more than HK$100 billion in the current fiscal year, almost doubling the initial estimate of HK$56.3 billion in February this year. The weaker-than-expected economic performance weighed on profits and salaries tax revenue. Aside from the decrease in taxable profits and incomes, we also noticed the decline in the number of taxpayers.

Other than the profits and salaries tax revenue, the stamp duty revenue could also fall short of expectation as turnover of stocks and transactions of residential properties declined significantly. Added to that, given the ongoing consolidation in the local property market, the land premium income should come in markedly below that of estimates.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC conducted CNY400 billion MLF with interest rate unchanged at 2.75% on 15 September, partially rolling over the maturing CNY600 billion MLF.	▪ This led to net withdrawal of CNY200 billion liquidity from the system. The partial rollover since August despite China's easing bias was mainly attributable to two factors including still flushed short end liquidity and increasing financial leverage activity. China's DR007, a market determined 7-day reverse repo rate between major financial institutions remained low at around 1.5% way below official reserve repo rate of 2%. Since April, the market rate has deviated from official rate by a notable margin due to China's easing monetary policy. However, the persistent gap for more than five months also fuelled the financial leverage. Daily overnight repo transaction volume has risen sharply from about CNY4.5 trillion in the beginning of April to more than CNY6 trillion in the past two months. This may lead to concern about financial leverage. The partial rollover of MLF sent a warning signal to her market that PBoC will continue to keep an eye on financial leverage. Given, there will be addition CNY2 trillion 1-year MLF maturing in the next four months, we expect China will continue to guide the market rate converging back to official rate via partial rollover.
▪ China's State Council unveiled additional fiscal supports to manufacturing sector and reiterated that opening-up is China's basic national policy.	▪ The meeting allowed the small and medium sized companies and sell-employed households in the manufacturing sector to defer the payment of five taxes and two fees by another four months. In addition, China will provide additional CNY32 billion tax rebate to manufacturing companies. ▪ Meanwhile, the State Council also announced additional more than CNY200 billion relending quota to support commercial banks to grant medium to long term loan to companies in manufacturing, service and social services industries as well as smaller companies in other industries to upgrade equipment in the fourth quarter at an interest rate of no more than 3.2%. The relending loan will be 1-year tenor and can be rolled over twice. In addition, 2.5% interest rate cost will be subsidized by the central budget, which will reduce the effective borrowing cost for equipment upgrade to no higher than 0.7%. ▪ The meeting also considered foreign trade as a strong underpinning for stable growth and employment and China will step up efforts stabilize foreign trade and foreign investments.
▪ Hong Kong government is reportedly considering cutting the hotel quarantine and switching to a "0+7" arrangement as daily Covid caseloads show signs of stabilization.	▪ Currently, arriving visitors are required to undergo three days of quarantine in designated hotels followed by four days of health monitoring, the so-called "3+4" arrangement. Reportedly, the government is actively considering scrapping the quarantine requirement this month, hence removing the largest obstacles for holding the international banking summit and the Rugby Sevens in coming November. ▪ The pressure to further ease the border control measures mounted, as economic pain caused by the strict antivirus measures deepened. Over the last two year or so, Hong Kong's inbound tourism was brought to a standstill and its role as a regional hub was challenged, as a result of the quarantine

	requirement and shut border. We expect more easing of antivirus measures and border control ahead, though in a gradual and cautious manner.
▪ With the faltering profits and salaries tax revenue, Hong Kong may see fiscal deficits of more than HK$100 billion in the current fiscal year, almost doubling the initial estimate of HK$56.3 billion in February this year. ▪	▪ According to the Financial Secretary Paul Chan, Hong Kong government's fiscal deficit is expected to grow to over HK$100 billion in this fiscal year, the second highest in history (second to that of HK$232.5 billion in FY2020-21), as tax revenue fell short of expectations. Without the issue of government green bonds totaling HK$35 billion, the deficit number may look even worse. As a result, government's fiscal reserves may fall further to HK$800 billion by the end of this fiscal year. ▪ The weaker-than-expected economic performance weighed on profits and salaries tax revenue. Aside from the decrease in taxable profits and incomes, we also noticed the decline in the number of taxpayers. In June, 2.47 million tax returns were sent to taxpayers, down from that of 2.77 million and 2.62 million in the previous two years. ▪ Other than the profits and salaries tax revenue, the stamp duty revenue could also fall short of expectation as turnover of stocks and transactions of residential properties declined significantly. The average daily turnover of Hong Kong stocks in the first five month of this fiscal year (April to August 2022) was 26% lower that of last year, while total transactions of residential properties also fell more than one third. Added to that, given the ongoing consolidation in the local property market, the land premium income should come in markedly below that of estimates. ▪
▪ Six existing gaming license holders and one more bidder had submitted their bids for the new 10-year concessions, to be started in 2023.	▪ The proposal submitted by the existing concessionaires were all accepted by Macau's government, while the remaining proposal was conditionally accepted. These proposals will be assessed based on plans to grow foreign client base; company's experience in operating casinos; bidder's respective investments in gaming and non-gaming projects; and its commitment to corporate social responsibility. Result are expected to be announced in November or December. ▪

Key Economic News

Facts	OCBC Opinions
▪ China continued to see net inflows of foreign currency despite the RMB depreciation. ▪ Our preferred gauge net settlement of foreign currency in spot, forward and derivative by Chinese banks on behalf of clients remained high at US$17.8 billion. ▪ China's onshore dollar deposit fell further to US$649 billion in August from US$673.6 billion in July, lowest since March 2021.	▪ In addition, willingness to sell foreign currency remained stable at 71% in August, second highest level in the past one year while willingness to purchase foreign currency also stabilized around 67% in August. ▪ The August cross border flow data reinforced our view that the recent RMB depreciation was not the result of changing demand supply matrix for foreign currency and capital outflows.
▪ China's fiscal revenue rebounded by 5.6% yoy in August, first increase since April 2022. ▪ Fiscal expenditure growth decelerated to 5.6% yoy in August from 9.9% yoy in July.	▪ In the first eight months, fiscal revenue fell by 8% yoy, but narrowing from 9.2% yoy decline from January to July. Nevertheless, after adjusting for the VAT tax rebate, China's fiscal revenue would grow by 3.7% yoy in the first eight

	months. ▪ The recovery of fiscal revenue growth was mainly attributable to three factors including improving VAT tax and consumption tax collection and strong non-tax contribution. Non-tax rose by 33.55% yoy in August. The improving consumption tax in August was in line with the mild recovery in China. ▪ Nevertheless, property market remains the key drag on fiscal revenue. Five tax items related to property and land market fell. On the aggregate level, property related taxes fell by 24.6% yoy. Given the weak demand for land by developers, property related tax may weaken further.

RMB	
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▪ Both USDCNY and USDCNH broke above 7 last week.	▪ The key catalyst last Friday was the move of the daily fixing to 6.93 after China kept its fixing around 6.91 for more than a week. This showed that there is no anchor from policy makers at the current junction. ▪ China's counter cyclical measures such as the outsized strong RMB fixing will only slow down the pace but not changing the course without the help from the Dollar. Different from the past few rounds of RMB depreciation, the collapse of RMB forward points will make RMB short easy to hold due to positive carry. This will make China's counter cyclical measures less effective to stop RMB depreciation as what they did before. ▪ Therefore, given the US-China rate differential is expected to widen further, the risk for the USDCNY to go higher further is high.

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