Greater China – Week in Review

Highlights: Rotation

Tommy Xie Dongming
Head of Asia Macro Research

Keung Ching (Cindy)
Hong Kong & Macau Economist

Last week, China's markets were defined by a sharp onshore-offshore divergence. A rotation out of crowded mainland AI and semiconductor names into oversold offshore internet, consumer and pharmaceutical stocks weighed on A-share indices, with the growth-heavy ChiNext and Shenzhen Component indices falling around 4–5%. In contrast, Hong Kong-listed Chinese equities rallied strongly, led by a nearly 5% gain in the Hang Seng Tech Index.

Three macro catalysts shaped the market backdrop. First, the PBOC's Q2 Monetary Policy Committee meeting reaffirmed an accommodative policy stance, reinforcing expectations of further monetary easing. Second, China's reflation momentum softened, with weaker inflation data highlighting still-subdued domestic demand. Third, renewed military action in the Middle East pushed oil prices higher, adding to uncertainty. Against this backdrop, the China Government Bond (CGB) yields drifted lower as investors priced in a more accommodative policy outlook alongside the weaker inflation readings while Chinese yuan edged modestly higher against the US dollar despite widening yield differential between the US and China.

The PBOC's Monetary Policy Committee convened its second-quarter meeting on 4 July to discuss the policy framework for the next stage. The committee called for greater coordination between incremental and existing policy measures to maximise their combined effectiveness. It also reiterated the importance of enhancing the forward-looking, flexible and targeted nature of monetary policy, while calibrating the intensity, pace and timing of policy implementation in accordance with evolving domestic and global economic and financial conditions, as well as developments in financial markets. The statement suggests policymakers remain committed to maintaining policy flexibility and stand ready to adjust the policy mix should the growth outlook or external environment change materially. This shows that easing remains on the table if growth deteriorates.

China's reflation momentum softened with both headline CPI and core CPI moderated to 1.0% YoY from 1.2% and 1.1% respectively in May. Food prices remained the main drag while contribution from energy price to China's reflation flipped as a result of sharp fall of oil prices. Meanwhile, communication equipment prices rose 0.7% MoM, marking a seventh consecutive monthly increase, likely reflecting higher memory chip costs and continued pass-through from AI-related demand.

On the producer side, PPI inflation accelerated further to 4.1% YoY, the highest reading since August 2022. On a monthly basis, however, producer prices fell for the first time after eight consecutive months of increases, reflecting the correction in commodity prices, particularly oil, base metals and gold. Even so, AI-related inflation remained resilient. Producer prices for computer and communication equipment rose 0.7% MoM, suggesting continued pricing power supported by robust AI-related demand.

Looking ahead, the contribution from energy prices is likely to diminish in the second half of the year, suggesting that the YoY peak in PPI inflation has probably passed. However, resilient pricing in AI-related industries should help cushion the pace of PPI disinflation. Headline CPI is expected to soften modestly in the third quarter, although a recovery in pork prices could provide an upside risk to consumer inflation later in the year.

On regulatory front, authorities in China and Hong Kong have announced a series of measures aimed at deepening financial market integration between the Mainland and Hong Kong, while further developing Hong Kong's fixed income and currency (FIC) markets and offshore RMB business.

Key measures include more than doubling the size of the RMB liquidity facility to RMB500 billion, exploring a tender-based mechanism for the provision of seven-day offshore RMB liquidity, and developing an electronic trading platform for the FIC market. Measures mainly aim to improve liquidity to facilitate the use of RMB and to set up a complete yield curve in the offshore market.

In addition, the annual Southbound Bond Connect quota will be increased to RMB800 billion from RMB500 billion, while efforts will be made to expand bond repo transactions using Southbound Bond Connect-eligible bonds in Hong Kong. Our rate strategist pointed out that this may push up dim sum bond issuances, which have already been active in 1H2026 compared to last year, as issuers can tap more flows from onshore. More offshore RMB bond issuances with onshore investor participation will add to the CNH liquidity pool.

Lastly, Hong Kong has commenced a trial operation of a new gold clearing system as part of its broader strategy to establish itself as a leading regional bullion trading hub.

Hong Kong's PMI (covering the manufacturing, construction, wholesale, retail and services sectors) rose for the second consecutive month to 52.0 in June (50.4 in May), with the largest increase coming from new orders sub-index (53.2 vs. 50.1 in May). Business activity and new orders both expanded at the fastest rates in four months.

Surveyed firms reported increase in sales amid new product launches, improved client demand and greater spending amid the World Cup. The boost to sales appeared broad-based, with demand from both mainland China and oversea markets increasing in June. On the other hand, margin pressure in downstream sectors persisted in June, while staffing levels was down for the third month.

Hong Kong's total assets under management (AUM) jumped 20% YoY to a record high of HK$42.2 trillion (US$5.4 trillion), driven by net inflow surge (+193% YoY to HK$2,065 billion), according to the SFC.

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▪ June CPI fell 0.3% MoM, a larger decline than implied by normal seasonal patterns, while headline inflation eased to 1.0% YoY from 1.2% in May.	▪ Food prices remained the main drag, falling 0.4% MoM. Pork prices declined for a fourth consecutive month, while fresh vegetable and fresh fruit prices fell 1.0% and 2.0% MoM, respectively, both exceeding their typical seasonal declines. By contrast, egg prices rose 7.0% MoM, extending gains for a third straight month, reflecting lower egg production during the summer heat as well as the earlier reduction in laying-hen capacity. ▪ Previously elevated energy and gold jewellery prices also retreated alongside the correction in global oil and gold prices. Energy became one of the main drags on headline CPI, with transport fuel prices falling 4.5% MoM. Meanwhile, the YoY increase in domestic gold jewellery prices moderated to 28.1%, further easing inflationary pressure from precious metals. ▪ Core CPI edged down to 1.0% YoY from 1.1%, while declining 0.1% MoM. Lower fuel surcharges and softer seasonal travel demand pushed tourism prices down 0.6% MoM. Meanwhile, communication equipment prices rose 0.7% MoM, marking a seventh consecutive monthly increase, likely reflecting higher memory chip costs and continued pass-through from AI-related demand. ▪ On the producer side, PPI inflation accelerated further to 4.1% YoY, the highest reading since August 2022. On a monthly basis, however, producer prices fell for the first time after eight consecutive months of increases, reflecting the correction in commodity prices, particularly oil, base metals and gold. Even so, AI-related inflation remained resilient. Producer prices for computer and communication equipment rose 0.7% MoM, suggesting continued pricing power supported by robust AI-related demand. Coal prices also strengthened, with coal mining prices rising 5.6% MoM, the largest monthly increase in four and a half years, driven by peak summer electricity demand and tighter supply following stricter mine safety inspections. ▪ Looking ahead, the contribution from energy prices is likely to diminish in the second half of the year, suggesting that the YoY peak in PPI inflation has probably passed. However, resilient pricing in AI-related industries should help cushion the pace of PPI disinflation. Headline CPI is expected to soften modestly in the third quarter, although a recovery in pork prices could provide an upside risk to consumer inflation later in the year.
▪ Hong Kong: PMI (covering the manufacturing, construction, wholesale, retail and services sectors) rose for the second consecutive month to 52.0 in June (50.4 in May), with the largest increase coming from new orders sub-index (53.2 vs. 50.1 in May). Business activity and new orders both expanded at the fastest rates	▪ Surveyed firms reported increase in sales amid new product launches, improved client demand and greater spending amid the World Cup. The boost to sales appeared broad-based, with demand from both mainland China and oversea markets increasing in June. The new orders and output sub-indexes rose to 53.2 (50.1 in May) and 52.7 (51.6 in May) in June respectively. ▪ On the other hand, margin pressure in downstream sectors persisted in June, while staffing levels was down for the third

in four months.	month. The input price sub-index fell to 55.3 (57.6 in May), but remained elevated, whereas the output price sub-index fell to 52.1 (52.8 in May).
▪ Hong Kong: Hong Kong's total assets under management (AUM) jumped 20% YoY to a record high of HK$42.2 trillion (US$5.4 trillion), driven by net inflow surge (+193% YoY to HK$2,065 billion), according to the SFC.	▪ Among the major segments, the AUM of the asset management and fund advisory business (+19% YoY), and private banking and private wealth management business (+24% YoY) both recorded impressive growth. ▪ Hong Kong's asset and wealth management business continued to serve a globally diversified investment base, with assets of non-Hong Kong investors accounting for 63% of the AUM. Meanwhile, majority of AUM were managed in Hong Kong and invested outside mainland China and Hong Kong. ▪ Earlier on, Boston Consulting Group ranked Hong Kong as the world's largest cross-boundary wealth management centre, topping Switzerland. The cross-border AUM reached US$2.95 trillion, slightly surpassing Switzerland's US$2.94 trillion. The increase was driven by growing wealth inflows from Mainland China and a strong IPO market last year.

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