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Greater China – Week in Review

Highlights: Bumpy transition between old and new growth engines

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Last week was marked by another divergence between Hong Kong equities and mainland A-shares. Disappointing July activity data, which reinforced concerns over persistent weakness in domestic demand, weighed primarily on A-shares. Hong Kong equities, by contrast, outperformed on continued liquidity tailwinds and stronger risk appetite toward offshore Chinese assets.

On monetary policy, the PBOC kept the Loan Prime Rate unchanged for a 15th consecutive month, while resuming its 7-day reverse repo operations. On August 21, the central bank injected RMB95 billion through 7-day reverse repos via fixed-rate, quantity-based tenders, fully meeting primary dealers' demand. This followed an eight-consecutive-trading-day suspension of the 7-day operation,

This reinforces the view that the PBOC is becoming increasingly precise and flexible in managing short-term liquidity conditions. Rather than relying mechanically on daily 7-day reverse repos, the central bank is now adjusting the tenor, timing and size of its liquidity injections according to changes in market funding conditions. The earlier pause in 7-day operations, alongside the use of overnight reverse repos, suggests that the PBOC is increasingly comfortable using a broader set of instruments to fine-tune liquidity.

July data suggest that China's economic momentum remained unsettled at the start of the second half. Admittedly, temporary factors such as adverse weather likely amplified the weakness. Three typhoons made landfall in July, disrupting major manufacturing hubs along the southeast coast and probably contributing to the manufacturing PMI falling back into contraction.

However, **beyond this temporary noise, the data continue to highlight two fundamental challenges facing the Chinese economy.**

First, domestic demand, particularly consumption, remains the key drag, with a clear "policy fade" effect emerging. Retail sales growth slowed to below 1% YoY, largely reflecting payback from the earlier trade-in subsidy programme. The subsidies had front-loaded demand for durable goods such as autos and home appliances, effectively borrowing consumption from future periods. Excluding autos, however, retail sales remained relatively resilient, rising 2.7% YoY in January–July, only marginally below 2.8% in the first half.

The broader message is that the earlier policy-driven consumption impulse is fading, while household income expectations and employment conditions have yet to take over as sustainable growth drivers. The unemployment rate also rose to 5.2%, reinforcing the view that underlying household demand remains soft. In other words, policy has helped smooth consumption temporarily, but has yet to generate a self-sustaining recovery in household spending.

Second, the weakness in investment is becoming increasingly structural, with property remaining the largest drag. More concerningly, fixed-asset investment excluding real estate contracted by 3.7%, suggesting that the slowdown is no longer confined to property and has spread to infrastructure and manufacturing investment. Local governments remain constrained by debt-resolution requirements, limiting their fiscal capacity, while private-sector investment appetite remains subdued amid weaker expected returns and continued uncertainty over domestic demand.

That said, the economy is not weakening across the board; rather, the K-shaped divergence is becoming more pronounced. The AI economy and advanced manufacturing remain important sources of resilience. Investment in computer, communications and other electronic equipment manufacturing accelerated to 7.8% YoY in January–July, from 6.5% in the first half, while output growth in the sector strengthened further to 19.1% YoY. This highlights an increasingly visible split between the old economy, where property and traditional investment remain under pressure, and the new economy, where AI-related capex and high-end manufacturing continue to expand.

Overall, China remains in the middle of a difficult transition between old and new growth engines. **The issue is not the absence of new growth drivers, but rather their current scale.** AI and advanced manufacturing are expanding rapidly, but they are not yet large enough to fully offset the structural slowdown in property, traditional investment and household demand. This leaves the economy increasingly dependent on a relatively narrow set of high-growth sectors, while the broader domestic-demand recovery remains incomplete. The recent data raises the risk to our call that 2Q growth marks the trough of the year.

Inflationary pressure in Hong Kong stayed well contained so far this year. Headline CPI rose by slower pace of 1.7% YoY and 1.9% YoY respectively in July (2.0% and 1.9% respectively in June), reflecting the impact of government rate concessions during the month. Meanwhile, underlying CPI (netting out the effect of all government's one-off relief measures) increased by a steady pace of 1.9% YoY, same as previous month.

At component level, "electricity, gas and water" and "transport" recorded sharp increases of 10.8% YoY and 5.0% YoY respectively, reflecting the lingering effects of elevated oil prices and fuel surcharges. On the other hand, inflation in the "housing" and "food" categories—together accounting for over 60% of the CPI basket—remained contained (0.5% YoY and 0.1% YoY respectively), thereby limiting the overall upside in inflation.

Separately, Hong Kong's seasonally unadjusted unemployment rate edged up to 3.8% in the May-July 2026 period from 3.7% previously, with jobless rates rising across most sectors. The number of unemployed persons rose to 145,700, although this largely coincided with an increase in the labour force to 3.793 million, as fresh graduates and school leavers entered the job market following the end of the academic year. After adjusting for seasonality, however, the unemployment rate remained unchanged at 3.7% in May-July 2026.

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Last Friday, subscription for the government's latest HKD50 billion Silver Bond issuance began, locking up sizeable capital. Demand for Silver Bonds has historically been robust. For example, the 2025 issuance attracted approximately HKD98.2 billion in subscriptions, representing an oversubscription ratio of roughly 1.8 times the final issuance size. Meanwhile, fast-fashion giant Shein reportedly aim to launch its Hong Kong IPO this week, with a target valuation of around USD26 billion.

Key Events	
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▪ On August 21, the central bank injected RMB95 billion through 7-day reverse repos via fixed-rate, quantity-based tenders, fully meeting primary dealers' demand. This followed an eight-consecutive-trading-day suspension of the 7-day operation,	▪ This reinforces the view that the PBOC is becoming increasingly precise and flexible in managing short-term liquidity conditions. Rather than relying mechanically on daily 7-day reverse repos, the central bank is now adjusting the tenor, timing and size of its liquidity injections according to changes in market funding conditions. The earlier pause in 7-day operations, alongside the use of overnight reverse repos, suggests that the PBOC is increasingly comfortable using a broader set of instruments to fine-tune liquidity.
▪ Hong Kong: Spot USDHKD climbed to a recent high of 7.8477 on 13 Aug, just 23 pips away from the weak-side Convertibility Undertaking at 7.85, before retracing lower as HKD liquidity tightened ahead of fundraising activities and dividend payments.	▪ Last Friday, subscription for the government's latest HKD50 billion Silver Bond issuance began, locking up sizeable capital. Demand for Silver Bonds has historically been robust. For example, the 2025 issuance attracted approximately HKD98.2 billion in subscriptions, representing an oversubscription ratio of roughly 1.8 times the final issuance size. Meanwhile, fast-fashion giant Shein reportedly aim to launch its Hong Kong IPO this week, with a target valuation of around USD26 billion. ▪ Beyond these interim liquidity draining events, we continue to see limited domestic catalysts which will be exerting sustained upward pressure on HIBORs. On loan front, despite the solid growth in total loans and advances so far this year, the loan-to-deposit ratio stayed near the multi-year low, at 71.48% as of end June, reflecting still-weak loan demand relative to deposit growth. ▪ Moreover, Hong Kong's housing market recovery saw some setback lately. Buyers' sentiment turned more cautious, amid the uncertain Fed policy rate trajectory and lingering macroeconomic uncertainty. The number of residential property transactions fell to 4,462 cases in July, down by around 40% as compared to the monthly average in the second quarter this year. ▪ Meanwhile, southbound inflows through Stock Connect have moderated noticeably in recent months. Net southbound purchases amounted to HKD27 billion in June and HKD63 billion in July, both below the HKD74 billion monthly average recorded during the first quarter, suggesting somewhat softer mainland investor participation.

Key Economic Data	
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▪ July data suggest that China's economic momentum remained unsettled at the start of the second half.	▪ Admittedly, temporary factors such as adverse weather likely amplified the weakness. Three typhoons made landfall in July, disrupting major manufacturing hubs along the southeast coast and probably contributing to the manufacturing PMI falling back into contraction.

- However, beyond this temporary noise, the data continue to highlight two fundamental challenges facing the Chinese economy.
- First, domestic demand, particularly consumption, remains the key drag, with a clear "policy fade" effect emerging. Retail sales growth slowed to below 1% YoY, largely reflecting payback from the earlier trade-in subsidy programme. The subsidies had front-loaded demand for durable goods such as autos and home appliances, effectively borrowing consumption from future periods. Excluding autos, however, retail sales remained relatively resilient, rising 2.7% YoY in January–July, only marginally below 2.8% in the first half.
- The broader message is that the earlier policy-driven consumption impulse is fading, while household income expectations and employment conditions have yet to take over as sustainable growth drivers. The unemployment rate also rose to 5.2%, reinforcing the view that underlying household demand remains soft. In other words, policy has helped smooth consumption temporarily, but has yet to generate a self-sustaining recovery in household spending.
- Second, the weakness in investment is becoming increasingly structural, with property remaining the largest drag. More concerningly, fixed-asset investment excluding real estate contracted by 3.7%, suggesting that the slowdown is no longer confined to property and has spread to infrastructure and manufacturing investment. Local governments remain constrained by debt-resolution requirements, limiting their fiscal capacity, while private-sector investment appetite remains subdued amid weaker expected returns and continued uncertainty over domestic demand.
- That said, the economy is not weakening across the board; rather, the K-shaped divergence is becoming more pronounced. The AI economy and advanced manufacturing remain important sources of resilience. Investment in computer, communications and other electronic equipment manufacturing accelerated to 7.8% YoY in January–July, from 6.5% in the first half, while output growth in the sector strengthened further to 19.1% YoY. This highlights an increasingly visible split between the old economy, where property and traditional investment remain under pressure, and the new economy, where AI-related capex and high-end manufacturing continue to expand.
- Overall, China remains in the middle of a difficult transition between old and new growth engines. The issue is not the absence of new growth drivers, but rather their current scale. AI and advanced manufacturing are expanding rapidly, but they are not yet large enough to fully offset the structural slowdown in property, traditional investment and household demand. This leaves the economy increasingly dependent on a relatively narrow set of high-growth sectors, while the broader domestic-demand recovery remains incomplete. The recent data raises the risk to our call that 2Q growth marks the trough of the year.

▪ Hong Kong: Inflationary pressure stayed well contained so far this year. Headline CPI rose by slower pace of 1.7% YoY and 1.9% YoY respectively in July (2.0% and 1.9% respectively in June), reflecting the impact of government rate concessions during the month. Meanwhile, underlying CPI (netting out the effect of all government's one-off relief measures) increased by a steady pace of 1.9% YoY, same as previous month.	▪ At component level, "electricity, gas and water" and "transport" recorded sharp increases of 10.8% YoY and 5.0% YoY respectively, reflecting the lingering effects of elevated oil prices and fuel surcharges. ▪ On the other hand, inflation in the "housing" and "food" categories—together accounting for over 60% of the CPI basket—remained contained (0.5% YoY and 0.1% YoY respectively), thereby limiting the overall upside in inflation. ▪ We expect the overall inflationary pressure to remain tamed for the rest of the year, on the back of the higher base a year ago, as well as limited pass-through from higher oil prices.
▪ Hong Kong: The seasonally unadjusted unemployment rate edged up to 3.8% in the May-July 2026 period from 3.7% previously, with jobless rates rising across most sectors. The number of unemployed persons rose to 145,700, although this largely coincided with an increase in the labour force to 3.793 million, as fresh graduates and school leavers entered the job market following the end of the academic year. After adjusting for seasonality, however, the unemployment rate remained unchanged at 3.7% in May-July 2026.	▪ Further increase in underemployment rate to 1.7% in May-July, from 1.6% in April-June, adding to the evidence that the labour market is slowly weakening. On the other hand, labour participation rate edged up by 0.1 percentage point to 56.3%, albeit still close to record low at 56.1%, amid ongoing structural challenges. ▪ Comparing the three-month ending July period with the three-month ending June, unemployment rates rose marginally across most sectors, with the exception of "construction", and "public administration, social and personal services" sectors. ▪ We hold onto the view that labour market slack may widen modestly in periods ahead, as hiring sentiment remained cautious.
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