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Greater China – Week in Review

Highlights: Signs of stabilisation in net interest margin

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Equity market rotation continued last week with China's banks outperforming. China's big five state-owned banks reported stronger-than-expected net profit growth in 3Q26, supported by signs of stabilisation in net interest margins (NIMs). Although NIMs remained compressed at 1.24%–1.36%, the prolonged margin squeeze appears to be easing as funding costs decline faster than asset yields. Successive deposit rate cuts are increasingly feeding through to banks' funding costs as higher-cost time deposits mature and are rolled over at lower rates. Meanwhile, much of the downward repricing pressure on asset yields from earlier loan prime rate (LPR) cuts and mortgage rate resets was front-loaded in 2024–25. This improving balance between funding costs and asset yields suggests that the worst of the NIM compression may be behind us, providing some relief to banks' profitability despite the persistently low interest rate environment.

China's PBOC takes another step towards a market-oriented monetary policy framework. The PBOC announced that it will conduct overnight reverse repo operations every working day from 2 November, at a fixed rate currently set at 1.25%, marking a significant step towards replacing the seven-day reverse repo rate as its main policy anchor. Meanwhile, seven-day reverse repo operations will shift to competitive-rate auctions, primarily conducted around tax-payment periods and month-end.

The move represents a structural reform rather than outright monetary easing. Although the new overnight policy anchor of 1.25% is below the existing seven-day reverse repo rate of 1.40%, the overnight rate was already in place, suggesting no immediate change in the monetary policy stance.

China's manufacturing PMI fell more sharply than expected in October, underperforming seasonal trends and slipping back into contractionary territory. The manufacturing PMI declined by 0.8 percentage points to 49.3, while the non-manufacturing PMI fell by 0.5 percentage points to 49.7, also entering contractionary territory.

The slowdown was broad-based across enterprises of different sizes, with smaller firms facing greater pressure. The manufacturing PMIs for large, medium-sized and small enterprises declined by 0.4, 1.3 and 1.4 percentage points, respectively. Only large enterprises remained in expansionary territory, highlighting the uneven nature of China's industrial recovery.

Construction activity weakened sharply, suggesting that fiscal support has yet to translate meaningfully into physical investment. The construction PMI fell by 2.3 percentage points to 48.0 in October, significantly underperforming seasonal norms. Although China completed the disbursement of RMB800bn in new policy-based financial instruments by 28 October, local government special-purpose bond issuance slowed again during the month. Looking ahead,

the key indicators to monitor will be the pace of government bond issuance, the conversion of policy funding into physical investment, and progress on the six major infrastructure networks.

Looking ahead, China's economy is expected to sustain a modest recovery through the remainder of the year, supported by the accelerated implementation of existing policy measures. While both manufacturing and non-manufacturing PMIs weakened in October, partly reflecting the fading boost from earlier holiday-related activity, business expectations remained relatively resilient. The business activity expectations indices for manufacturing, construction and services all stayed above the 50 threshold, suggesting that firms remain cautiously optimistic about the near-term outlook despite persistent demand-side pressures. The key to sustaining the recovery will be translating policy support and improving business expectations into stronger investment and domestic demand.

Key Event	
Facts	**OCBC Opinions**
▪ China's manufacturing PMI fell more sharply than expected in October, underperforming seasonal trends and slipping back into contractionary territory. The manufacturing PMI declined by 0.8 percentage points to 49.3, while the non-manufacturing PMI fell by 0.5 percentage points to 49.7, also entering contractionary territory.	▪ The broad-based deterioration suggests that China's economic recovery remains fragile, with domestic demand continuing to lag behind supply-side capacity. ▪ Both production and new orders weakened, highlighting persistent demand-side pressures. On the supply side, the manufacturing production index dropped sharply by 1.9 percentage points to 49.8, falling into contractionary territory and underperforming seasonal norms. The decline partly reflected a payback from September's stronger-than-seasonal rebound, as front-loaded production likely brought forward some manufacturing activity at the expense of October's output. ▪ On the demand side, the new orders index declined by 1.1 percentage points to 49.4. New orders underperformed seasonal trends for two consecutive months, underscoring the persistent weakness in underlying demand. External demand also softened, with the new export orders index falling by 1.3 percentage points to 48.7. ▪ Price pressures moderated but remained elevated, adding to the margin squeeze facing downstream manufacturers. The purchasing prices index for major raw materials and the output prices index fell by 4.0 and 2.3 percentage points to 56.8 and 51.7, respectively. Both indices remained above the 50 threshold, indicating that prices continued to rise, albeit at a slower pace. Elevated crude oil costs continued to weigh on downstream chemical producers, prompting some manufacturers to scale back or suspend operations. Meanwhile, subdued final demand limited firms' ability to pass higher input costs on to customers, potentially squeezing profit margins further and reinforcing the weakness in production. ▪ The slowdown was broad-based across enterprises of different sizes, with smaller firms facing greater pressure. The manufacturing PMIs for large, medium-sized and small enterprises declined by 0.4, 1.3 and 1.4 percentage points, respectively. Only large enterprises remained in expansionary territory, highlighting the uneven nature of China's industrial recovery. Nevertheless, employment conditions in the services sector continued to improve, offering a modest bright spot amid the broader slowdown. ▪ Construction activity weakened sharply, suggesting that fiscal support has yet to translate meaningfully into physical investment. The construction PMI fell by 2.3 percentage points to 48.0 in October, significantly underperforming seasonal norms. Although China completed the disbursement of RMB800bn in new policy-based financial instruments by 28 October, local government special-purpose bond issuance slowed again during the month. Meanwhile, high-frequency indicators, including asphalt plant operating rates, remained subdued, suggesting a continued lag between policy funding and

	actual project implementation. Looking ahead, the key indicators to monitor will be the pace of government bond issuance, the conversion of policy funding into physical investment, and progress on the six major infrastructure networks. ▪ Looking ahead, China's economy is expected to sustain a modest recovery through the remainder of the year, supported by the accelerated implementation of existing policy measures. While both manufacturing and non-manufacturing PMIs weakened in October, partly reflecting the fading boost from earlier holiday-related activity, business expectations remained relatively resilient. The business activity expectations indices for manufacturing, construction and services all stayed above the 50 threshold, suggesting that firms remain cautiously optimistic about the near-term outlook despite persistent demand-side pressures. The key to sustaining the recovery will be translating policy support and improving business expectations into stronger investment and domestic demand.

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