OCBC GLOBAL MARKETS RESEARCH

Greater China – Week in Review

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Highlights: early signs of restocking

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The major economic data for August, adjusted for seasonal variations, reveal significant improvements in most areas as compared to the preceding month. Noteworthy developments were observed in the sectors of industrial production, which surged by 0.5% month-on-month seasonally adjusted, and fixed asset investment, which escalated by 0.26% month-on-month seasonally adjusted.

This positive trend is underscored by three salient developments. Firstly, the manufacturing output demonstrated robust growth, particularly in the realms of equipment and high-tech manufacturing.

Secondly, August witnessed an accelerated growth in raw materials manufacturing, heralding the commencement of a new inventory cycle. We have been discussing China's destocking cycle for some time now. At last, there appears to be a glimmer of hope, a light at the end of the tunnel.

Thirdly, a significant resurgence was observed in the value-added segment of computer and communication equipment manufacturing, potentially spurred by increased inventory accumulation by corporations. Data from August indicates a recovery in the export of commodities such as integrated circuits and automatic data processing equipment, hinting an improving global semiconductor outlook.

China’s credit data also exceeded market expectation in August. A significant spike was noted in the net financing through local government bonds, reaching 1.18 trillion yuan in August, which marks an increment of 875.5 billion yuan when juxtaposed with the same period last year. This surge has considerably augmented the overall social financing, with government bonds playing a pivotal role.

Moving forward into September, it is projected that the net government bond issuance will maintain a robust position, possibly exceeding CNY 1 trillion. This suggests a strong continuation of aggregate social financing, indicating a concerted effort to fuel economic activity and foster stability in the market.

Despite the encouraging sign of stabilization, the property market continues to be the missing puzzle piece in the economic picture. Some of my friends residing in tier-1 cities have recently resumed their house hunting activities, following the relaxation of policies in China. The on-the-ground feedback indicates a rise in property viewing activities; however, most prospective buyers are not in a hurry to finalize deals due to the increasing supply of apartments post relaxation. High-frequency data corroborates this trend, showing that property sales in 30 major cities continue to be lackluster.

China’s central bank has declared a reduction in its reserve requirement ratio by 25 basis points, effective from September 15th. This strategic move is anticipated to infuse over CNY500 billion of liquidity into the financial system.

Although the one-month interval from the previous interest rate cut is somewhat shorter than the historical norm, the timing of the reserve requirement ratio cut aligns largely with expectations. We believe that the decision on the timing was primarily influenced by four factor including easing tighter interbank liquidity in September, supporting rising issuance of local government bonds, further boosting growth and mitigating the impact of capital outflows on RMB liquidity.

The primary indicator of supply and demand for foreign currency, which encompasses both spot transactions and derivatives such as forwards and options, revealed that net outflows remained substantial for the second consecutive month in August. Even though the willingness to sell foreign currency surged to 72% from 64% in July, the inclination to purchase foreign currency also saw a significant rise, moving up to 71% from 67%.

Looking ahead, we think there is still room for China to lower its RRR should capital outflow pressure remain.

Nevertheless, the cycle of reducing interest rates is approaching a culmination. The recent data indicate that China's price cycle has potentially bottomed out. Historically, central banks have exhibited a tendency to enact cuts to the interest rates during phases characterized by declining or near-bottom price cycles. Conversely, in a scenario where the price cycle is on an upward trajectory, central banks are generally reticent to introduce further rate cuts. With the latest RRR cut in place which may further support the modest rise of inflation, we think the chance of interest rate cuts may be lower.

On equity market, the most significant development over the weekend was the arrest of the principal controller of a listed company. This individual is under suspicion of manipulating the securities market and engaging in unauthorized reduction of their holdings. Arrests are typically viewed as a last resort by the market, and this action may hopefully help to restore market confidence.

As HKD liquidity tightened further, major lenders in the city would reportedly hike its HIBOR-linked mortgage cap rate by 50 basis points, piling more misery on the property market. The existing mortgage cap rate at 225bps below the HKD prime rate (P – 2.25%) , will be raised to (P – 1.75%). Based on the latest one-month HIBOR rate at 4.96%, the new mortgage rate will be touching the cap rate at around 4.125%, up from 3.625% before the adjustment.

We believe this decision was made in view of the tight HKD liquidity, as well as growing conviction for "high for longer" narrative. Aside from the increased demand for HKD asset (continuous southbound inflows) and quarter-end effect, the upcoming issuance of government green bond totaling HK$15 billion, as well as IPO prospects, are all factors contributing to the HKD liquidity tightness.

CNH liquidity tightened again, with implied CNH rates higher across the curve, more so at the front-end, after PBoC's warning against one-sided moves of yuan and announcement of RMB15 billion bill issuance. Meanwhile, the 3-month CNH HIBOR surged to five-year high last week.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The People's Bank of China (PBOC) has declared a reduction in its reserve requirement ratio by 25 basis points, effective from September 15th. This strategic move is anticipated to infuse over CNY500 billion of liquidity into the financial system.	▪ Although the one-month interval from the previous interest rate cut is somewhat shorter than the historical norm, the timing of the reserve requirement ratio cut aligns largely with expectations. We believe that the decision on the timing was primarily influenced by four factors. ▪ Firstly, there is a growing necessity to stabilize the recent erratic behavior witnessed in money market interest rates. With September expected to witness relatively constricted funding conditions, partly due to the compounded impact of the Mid-Autumn Festival, National Day, and the close of the quarter, an RRR reduction emerges as a strategic move to infuse the market with requisite funds, thereby fostering stability. Secondly, it is vital to synchronize with the impending phase of local government bond issuance, thereby motivating banks to amplify credit extension. Recent trends indicate an acceleration in the issuance of local government bonds, evidenced by the over 1.2 trillion yuan disbursed in August, and projections suggest a potential release exceeding 1 trillion yuan in September. Thirdly, an RRR cut appears to be a viable mechanism to bolster the ongoing strategies aimed at stabilizing growth. Despite the recent encouraging signs of economic stabilization and recovery – as reflected in the August data on PMI, exports, and credit indicators – it is evident that the foundations of China's economic resurgence are yet to solidify fully. Lastly, the recent escalation in capital outflows, as demonstrated by the increased demand for foreign currencies, has exerted significant pressure on the liquidity of the RMB. The central bank's strategic move to cut RRR is aimed at mitigating this impact. ▪ Looking ahead, the cycle of reducing interest rates is approaching a culmination. The recent data indicate that China's price cycle has potentially bottomed out. Historically, central banks have exhibited a tendency to enact cuts to the interest rates during phases characterized by declining or near-bottom price cycles. Conversely, in a scenario where the price cycle is on an upward trajectory, central banks are generally reticent to introduce further rate cuts. With the latest RRR cut in place which may further support the modest rise of inflation, we think the chance of interest rate cuts may be lower.
▪ Hong Kong: As HKD liquidity tightened further, major lenders in the city would reportedly hike its HIBOR-linked mortgage cap rate by 50 basis points, piling more misery on the property market. The existing mortgage cap rate at 225bps below the HKD prime rate (P – 2.25%) , will be raised to (P – 1.75%). Based on the latest one-month HIBOR rate at 4.96%, the new mortgage rate will be touching the cap rate at around 4.125%, up from 3.625% before the adjustment.	▪ We believe this decision was made in view of the tight HKD liquidity, as well as growing conviction for "higher for longer" narrative. The tightness in funding which had previously been more obvious on the front-end, are now spreading to other tenors. ▪ Aside from the increased demand for HKD asset (continuous southbound inflows) and quarter-end effect, the upcoming issuance of government green bond totaling HK$15 billion, as well as IPO prospects, are all factors contributing to the HKD liquidity tightness. Tuhu, an online car service platform based in Mainland, planned to raise HKD1.2 billion funding, rendering it the biggest IPO in Hong Kong in recent months.

▪ CNH liquidity tightened again, with implied CNH rates higher across the curve, more so at the front-end, after PBoC's warning against one-sided moves of yuan and announcement of RMB15 billion bill issuance. Meanwhile, the 3-month CNH HIBOR surged to five-year high last week.	▪ The Chinese authorities had taken actions to squeeze offshore funding in order to ward off speculation against yuan. Such policy guidance exacerbated a seasonal tightening of CNH liquidity ahead of quarter-end and the week-long Golden week holidays. As a result, the offshore CNH liquidity tightened significantly, with implied CNH rates and CNH HIBORs rising to multi-year highs. Given PBoC's upcoming issuance of government bill at RMB15 billion yuan in Hong Kong, more than the maturing amount of RMB5 billion, CNH liquidity is unlikely to ease meaningfully in periods ahead.

Key Economic News

Facts	OCBC Opinions
▪ China's credit data exceeded market expectation in August. ▪ The outstanding of aggregate financing growth reaccelerated to 9% yoy in August from 8.9% yoy in July. ▪ Total new Yuan loan increased by CNY1.36 trillion, above market expectation. ▪ However, broad money supply M2 slowed down to 10.6% from 10.7%.	▪ The latest data indicate a mixed picture of the Chinese credit market. While there has been an appreciable uptake in new Yuan loans, surpassing initial forecasts, the overall credit structure has demonstrated slight signs of weakening, as evidenced by an uptick in bill issuance. ▪ In August, the medium to long-term loans extended to the household sector marked an increase, amounting to CNY 160.2 billion. This figure, however, is substantially lower when compared to the data from August of the previous year, with a shortfall of CNY 105.6 billion. Despite the government initiating additional property easing measures in August, the household sector has been somewhat slow to respond. Consequently, there hasn't been a discernible resurgence in mortgage loans, which indicates a cautious sentiment among potential homeowners, possibly waiting to gauge the full impact of the easing measures before committing to new loans. ▪ A significant spike was noted in the net financing through local government bonds, reaching 1.18 trillion yuan in August, which marks an increment of 875.5 billion yuan when juxtaposed with the same period last year. This surge has considerably augmented the overall social financing, with government bonds playing a pivotal role. Notwithstanding this, the pace of fiscal spending has not kept up, remaining relatively subdued in August. This was exemplified by a marginal decrease in fiscal deposits by 88 billion yuan, a figure significantly dwarfed by the 2,484 billion yuan dip witnessed during the same period last year, contributing to a slight deceleration in China's M2 growth. ▪ Moving forward into September, it is projected that the net government bond issuance will maintain a robust position, possibly exceeding CNY 1 trillion. This suggests a strong continuation of aggregate social financing, indicating a concerted effort to fuel economic activity and foster stability in the market.
▪ China's industrial production accelerated to 4.5% yoy in August from 3.7% yoy in July. ▪ Retail sales beat market expectation of 3% by a wide margin up by 4.6%. ▪ Fixed asset investment decelerated to 3.2% yoy in the first eight month from 3.4% yoy in the first seven month.	▪ The major economic data for August, adjusted for seasonal variations, reveal significant improvements in most areas as compared to the preceding month. Noteworthy developments were observed in the sectors of industrial production, which surged by 0.5% month-on-month seasonally adjusted, and fixed asset investment, which escalated by 0.26% month-on-month seasonally adjusted.

▪ China's surveyed unemployment rate eased to 5.2% in August from 5.3% in July.	▪ This positive trend is underscored by three salient developments: ▪ Firstly, resurgence in manufacturing activities: The manufacturing output demonstrated robust growth, particularly in the realms of equipment and high-tech manufacturing. The former witnessed a rise of 5.4%, a stark contrast to the 3.3% growth observed in July, thereby signaling a shift from a deterrent to a catalyst in the overall industrial production landscape. Meanwhile, high-tech manufacturing ascended by 2.9%, marking a 2.2 percentage point growth from the previous month. Furthermore, policies fostering the transformation and upgrading of the manufacturing sector seem to have galvanized the industry, with a notable 11.2% increase in high-tech manufacturing investments recorded in the initial eight months of the year. ▪ Secondly, acceleration in raw material manufacturing: August witnessed an accelerated growth in raw materials manufacturing, heralding the commencement of a new inventory cycle. The National Bureau of Statistics reports a 10.4% uptick in the value-added of this sector, a pace 1.6 percentage points faster than July. Particularly, the sub-sectors of chemical raw materials and ferrous metal smelting exhibited an impressive growth, exceeding the average with rates of 14.8% and 14.5%, respectively. ▪ Lastly, recovery in the semiconductor related sector: A significant resurgence was observed in the value-added segment of computer and communication equipment manufacturing, potentially spurred by increased inventory accumulation by corporations. Data from August indicates a recovery in the export of commodities such as integrated circuits and automatic data processing equipment, hinting at a potential surge in related industries should the global semiconductor downcycle reach its bottom.
▪ Demand for foreign currencies remained high in August with Chinese banks net purchased US$10.3 billions worth of foreign currency.	▪ The primary indicator of supply and demand for foreign currency, which encompasses both spot transactions and derivatives such as forwards and options, revealed that net outflows remained substantial for the second consecutive month in August. Even though the willingness to sell foreign currency surged to 72% from 64% in July, the inclination to purchase foreign currency also saw a significant rise, moving up to 71% from 67%.

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