

Greater China — Week in Review

08 July 2024

Highlights: China's yield control

China's central bank took its first step to curb the recent rally in China's bond market after verbal intervention failed to cool down the market. To maintain the stable operation of the bond market, the People's Bank of China (PBoC) announced 1 July that it will conduct government bond borrowing operations with selected primary dealers of open market operations in the near future. This indicates that the PBoC is prepared to sell bonds to curb the rally after borrowing from the primary dealers.

On 5 July, local media reported that financial institutions have agreed to lend out several hundred billion yuan worth of medium- and long-term government bonds. The central bank will borrow these bonds on a credit basis with no fixed maturity date and will continue to borrow and sell government bonds depending on the performance of the bond market. This move reinforced the PBoC's commitment to defend the floor of long-term bond yields. Consequently, China's 10-year and 30-year government bond yields rebounded by 7 basis points (bps) and 8.5 bps, respectively, last week.

We believe there are three main reasons why the central bank is keen on regulating ultra-long-term interest rates. Firstly, by managing ultra-long-term rates, the central bank aims to mitigate risks associated with duration mismatches in financial institutions and cool down the irrational demand for long-term assets. Secondly, the central bank may seek to manage expectations and prevent the yield curve from inverting, which could trigger concerns about the Japanification of the Chinese economy. Thirdly, by controlling long-term rates, the central bank aims to prevent the widening of the interest rate differential between China and the US, which could put additional pressure on RMB.

Although current discussions focus on the sale of bonds by the central bank, it is also possible that the PBoC could buy bonds in the future to cap rising yields. Furthermore, the purchase of bonds by the PBoC could serve as a new avenue for injecting liquidity into the system. As the role of the Medium-term Lending Facility (MLF) gradually weakens, the PBoC's buying and selling of government bonds could become a new tool for managing medium-term liquidity. Looking ahead, the market will be keenly watching for the PBoC's comfortable range for yield curve control.

The impact of the PBoC's move towards yield control on the equity market is likely to be limited. Nevertheless, sentiment remained weak ahead of the third plenum meeting due to concerns about tax issues. The divergence between global stocks and Chinese stocks last week was particularly disappointing, as global stocks reached record high levels. Strengthening tax collection and administration is a necessary measure in the context of tax system reform. However, in the short term, it may reinforce negative expectations.

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On data, early signs of a recovery in property transaction volumes have emerged since late June in 30 major cities. The 7-day rolling average transaction volume year-on-year growth turned positive for the first time since the Chinese New Year, raising hopes that property easing measures may start to bear fruit.

Additionally, the latest data showed that in the first five months of this year, China's ports handled 2.22 billion tons of foreign trade cargo, an increase of 8.9% year-on-year. The container throughput at ports exceeded 130 million TEUs (twenty-foot equivalent units), marking an 8.8% year-on-year growth. This validates the strong external demand. Meanwhile, the faster increase in the handling of goods at ports compared to the value of China's exports indicates China's contribution to global disinflation, which may help alleviate pressure on global inflation.

The European Commission has decided to impose temporary anti-subsidy tariffs on electric vehicles imported from China. The EU will impose a 37.6% tariff on SAIC Motor Corporation, 19.9% on Geely, 17.4% on BYD, an average rate of 20.8% for other cooperating manufacturers, and 37.6% for non-cooperating manufacturers. Compared to the preliminary rates disclosed on June 12, the confirmed temporary duty rates have been slightly reduced. These temporary tariffs will take effect from July 5, 2024, and can last for a maximum of four months. During this period, EU member states will vote on whether to convert these temporary tariffs into formal duties lasting five years. The EU and Chinese governments are expected to negotiate further before the next vote.

Hong Kong's total retail sales in May again surprised the market to the downside, falling by 11.5% YoY and 12.9% YoY in value and volume terms respectively. On sequential basis, total value of retail sales rebounded by 3.2% in May over the previous month, partly due to the seasonality effect. Local consumption sentiment showed no visible signs of improvement, as high interest rate environment persisted. Separately, mainland authorities announced to raise the duty-free allowance for mainland tourists to Hong Kong (from RMB5000 to RMB12,000), on top of earlier decision to include more mainland cities in the individual Travel Schemes, rendering some supports to the retail market in periods ahead.

Hong Kong's PMI dropped further to 48.2 in June, the lowest reading since September 2022, dragged by the decline in new orders and output sub-indexes. Business conditions continued to deteriorate halfway into 2024, amid sluggish demand and rising competition among businesses in the region. Businesses reported ongoing challenges of rising costs, softening domestic demand, and heightened competition. We expect business condition to improve gradually as interest rate trends lower, though PMI may stay in the contractionary zone in the near-term.

Macau's gross gaming revenue fell 12.4% month-on-month to MOP17.7 billion in June, from the post-Covid high in May. The decline however was understandable as June is typically a slow month. In the first six months of 2024, total gross gaming revenue reached MOP113.75 billion, up by 41.9% from the same period last year, but was still down by 23.9% comparing with the same period in 2019.

Key events	
Facts	OCBC Opinions
<ul style="list-style-type: none"> China's central bank took its first step to curb the recent rally in China's bond market after verbal intervention failed to cool down the market. In June, China's long-end bond yields fell by 9-15 basis points across the 10 to 30-year curve due to safe-haven demand. To maintain the stable operation of the bond market, the People's Bank of China (PBOC) announced 1 July that it will conduct government bond borrowing operations with selected primary dealers of open market operations in the near future. 	<ul style="list-style-type: none"> This indicates that the PBOC is prepared to sell bonds to curb the rally after borrowing from the primary dealers. On Friday, local media reported that financial institutions have agreed to lend out several hundred billion yuan worth of medium- and long-term government bonds. The central bank will borrow these bonds on a credit basis with no fixed maturity date and will continue to borrow and sell government bonds depending on the performance of the bond market. This move reinforced the PBoC's commitment to defend the floor of long-term bond yields. Consequently, China's 10-year and 30-year government bond yields rebounded by 7 basis points (bps) and 8.5 bps, respectively, last week. We believe there are three main reasons why the central bank is keen on regulating ultra-long-term interest rates. Firstly, by managing ultra-long-term rates, the central bank aims to mitigate risks associated with duration mismatches in financial institutions and cool down the irrational demand for long-term assets. Secondly, the central bank may seek to manage expectations and prevent the yield curve from inverting, which could trigger concerns about the Japanification of the Chinese economy. Thirdly, by controlling long-term rates, the central bank aims to prevent the widening of the interest rate differential between China and the US, which could put additional pressure on the renminbi. Although current discussions focus on the sale of bonds by the central bank, it is also possible that the PBoC could buy bonds in the future to cap rising yields. Furthermore, the purchase of bonds by the PBoC could serve as a new avenue for injecting liquidity into the system. As the role of the Medium-term Lending Facility (MLF) gradually weakens, the PBoC's buying and selling of government bonds could become a new tool for managing medium-term liquidity. Looking ahead, the market will be keenly watching for the PBoC's comfortable range for yield curve control.

Key Economic News	
Facts	OCBC Opinions
<ul style="list-style-type: none"> The latest data showed that in the first five months of this year, China's ports handled 2.22 billion tons of foreign trade cargo, an increase of 8.9% year-on-year. The container throughput at ports exceeded 130 million TEUs (twenty-foot equivalent units), marking an 8.8% year-on-year growth. 	<ul style="list-style-type: none"> This validates the strong external demand. Meanwhile, the faster increase in the handling of goods at ports compared to the value of China's exports indicates China's contribution to global disinflation, which may help alleviate pressure on global inflation.
<ul style="list-style-type: none"> Hong Kong's total retail sales in May again surprised the market to the downside, falling by 11.5% YoY and 12.9% YoY in value and volume terms respectively. On sequential basis, total value of retail sales rebounded by 3.2% in May over the previous month, partly due to the seasonality effect. 	<ul style="list-style-type: none"> Local consumption sentiment showed no visible signs of improvement, as high interest rate environment persisted. Delaying consumption is extremely common in a high interest rate environment, in particular for non-essential purchases. Sales of non-essential items, including "consumer durable" (-12.4% YoY in the first five months this year), "department stores" (-13.3% YoY) and "jewellery, watches and clocks" (-10.5% YoY) all saw notable declines so far this year. Separately, mainland authorities announced to raise the duty-free allowance for mainland tourists to Hong Kong (from RMB5000 to RMB12,000), on top of earlier decision to include more mainland cities in the individual Travel Schemes, rendering some supports to the retail market in periods ahead.
<ul style="list-style-type: none"> Hong Kong's PMI dropped further to 48.2 in June, the lowest reading since September 2022, dragged by the decline in new orders and output sub-indexes. Business conditions continued to deteriorate halfway into 2024, amid sluggish demand and rising competition among businesses in the region. 	<ul style="list-style-type: none"> Businesses reported ongoing challenges of rising costs, softening domestic demand, and heightened competition. Nonetheless, the level of pessimism eased notably, with some firms increasing their purchasing activities in the hope of demand recovery down the road. We expect business condition to improve gradually as interest rate trends lower, though PMI may stay in the contractionary zone in the near-term.
<ul style="list-style-type: none"> Macau's gross gaming revenue fell 12.4% month-on-month to MOP17.7 billion in June, from the post-Covid high in May. The decline however was understandable as June is typically a slow month. In the first six months of 2024, total gross gaming revenue reached MOP113.75 billion, up by 41.9% from the same period last year, but was still down by 23.9% comparing with the same period in 2019. 	<ul style="list-style-type: none"> The recovery in gaming sector had been largely mass and premium mass segment led since the removal of all covid measures. However, it was noticed that the pace of growth for the VIP segment had picked up lately. The share of VIP segment had steadied and even bounced back somewhat to 25.1% in the first quarter this year. It showed that the VIP segment may be finding some success tapping into overseas high-roller market and adopting to the new regulatory environment. That said, further crackdown on cross-boundary illegal money exchanges and loan sharks will likely post drag on the gaming sector.

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