Greater China — Week in Review

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Highlights: sentiment turned sour again

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In the first half of June, China's small-cap stocks have relinquished most of their gains since late April after China unveiled additional policy supports. Investors remain cautious about the impact of the easing real estate policies, leading to conservative trading. The market's divided opinions on real estate policies primarily stem from the intermittent effect of policy relaxation on real estate sales in major cities since 2022. The latest data from May indicated further weakening in China's real estate market, with property price corrections deepening. It may take some time for demand and supply to reach a new equilibrium.

Additionally, risk sentiment has receded again due to concerns about delistings. In May 2024, the number of ST (Special Treatment) stocks increased by 52, the highest since 2018. The reasons for the new ST stocks in May 2024 are more complex, with many companies included due to internal control issues.

Despite resilient manufacturing sector and improving domestic demand, the latest May economic data failed to boost the sentiment as China's money supply growth hit the record low.

Due to the five-day Labor Day Holiday falling in May this year, two days longer than in 2023, the month-on-month increase in industrial production decelerated, while consumption growth improved. Service consumption has grown rapidly, with travel and cultural tourism remaining active. However, retail sales of automobiles were weaker than expected, declining by 4.4% YoY. The domestic car market is highly competitive, and price wars have led some consumers to adopt a wait-and-see approach.

Manufacturing has been a standout sector in the first half of this year, reflecting strong external demand for China's economy. The rising global demand for Chinese products, coupled with the global economic soft landing, highlights the increasing competitiveness and appeal of Chinese products resulting from industrial upgrades. Current production trends indicate a shift towards high-tech, smart, and green manufacturing. High-tech manufacturing has maintained double-digit growth, with its added value increasing by 10.0% YoY. In terms of fixed asset investment, manufacturing investment has grown rapidly. From January to May, manufacturing investment increased by 9.6% YoY, 5.6 percentage points higher than the growth rate of total investment, contributing 57.3% to total investment growth.

The focus, however, was primarily on money supply, with both M1 and M2 growth slowing to record lows. M2 growth decelerated to 7% YoY in May from 7.2% YoY in April, while the contraction in M1 growth widened to 4.2% YoY in May from 1.4% YoY previously. The gap between M2 and M1 widened further.

Statistically, China's M1 does not include household demand deposits and government deposits, making it more sensitive to fluctuations in corporate demand deposits. The recent sharp contraction in M1 was partially attributed to technical issues, as China's market interest rate self-regulation mechanism clamped down on high-interest deposit behavior via manual interest rate adjustments. The previous arbitrage activities, where corporations used funds from cheap bill financing to invest in high-interest deposits, were curbed. This led to a simultaneous contraction in some deposits and loans, causing M1 to decline rapidly. Meanwhile, banks faced pressure as deposits were transferred to cash management products such as wealth management products and money market funds over time, which are not captured by M1.

In addition to technical issues, the contraction in M1 was also a result of the weak property market. Historically, property sales have been an important channel for converting household demand deposits, which are not captured in M1, to corporate demand deposits, which are captured in M1. The contraction in M1 also reflects that confidence in the real economy still requires further restoration.

China's central bank kept its MLF rate unchanged again in June disappointing some investors. The liquidity injection from the MLF has declined dramatically as China's prevailing market rate has been traded below the official policy rates. Nevertheless, the recent inaction in terms of monetary policy also showed China's policy dilemma.

PBoC currently appears to favor exchange rate stability over interest rate adjustments. Although the current low inflation rate supports the case for further interest rate cuts in China, concerns about the impact of such cuts on exchange rate stability limit the central bank's ability to adjust interest rates.

Hong Kong's PMI fell to the contractionary zone in May, at 49.2, dragged by the decline in new orders and output sub-indexes. As a result of fewer new businesses, output contracted in three out of four passing months. Overall sentiment deteriorated further, while profit margin continued to shrink with rising competition and input cost. Forward looking indicators suggested that demand is likely to stay subdued in the near term.

Decline in Macau's home price fell by a faster pace despite the removal of housing cooling measures in April. On year-to-year basis, Macau's residential property price index dropped by 11.6% (-2.0% month-to-month) in three-month ending April 2024. Comparing with the high in 2018, the housing price was still down by 18.0%. Meanwhile, trading activities stayed at a subdued level as buyers and sellers stayed on the sideline. Local housing market sentiment remained fragile in the face of high mortgage rate, as Fed was likely to delay rate cut to September this year. We now tip the year-on-year decline in housing price at 4-8% for 2024.

Key events	
Facts	**OCBC Opinions**
▪ China kept its MLF rate unchanged.	▪ In the short term, the central bank is likely to continue maintaining the stability of RMB fixing, providing a beneficial anchor for Asian currencies. However, every policy has its costs. The most significant cost here is the constraint on China's monetary policy independence. The central bank currently appears to favor exchange rate stability over interest rate adjustments. Although the current low inflation rate supports the case for further interest rate cuts in China, concerns about the impact of such cuts on exchange rate stability limit the central bank's ability to adjust interest rates.

Key Economic News	
Facts	**OCBC Opinions**
▪ Due to the five-day Labor Day Holiday falling in May this year, two days longer than in 2023, the month-on-month increase in industrial production decelerated, while consumption growth improved.	▪ Manufacturing has been a standout sector in the first half of this year, reflecting strong external demand for China's economy. The rising global demand for Chinese products, coupled with the global economic soft landing, highlights the increasing competitiveness and appeal of Chinese products resulting from industrial upgrades. Current production trends indicate a shift towards high-tech, smart, and green manufacturing. ▪ High-tech manufacturing has maintained double-digit growth, with its added value increasing by 10.0% year-over-year (YoY), 4.4 percentage points higher than the overall growth average. The value added of intelligent unmanned aerial vehicle manufacturing rose by 75% YoY, and the output of new energy vehicles surged by 33.6%, demonstrating the ongoing impact of new productive forces. ▪ China's retail sales growth accelerated to 3.7% YoY in May from 2.3% YoY in April, partly due to the extended Labor Day holiday. Service consumption has grown rapidly, with travel and cultural tourism remaining active. Retail sales of catering services rose by 5% YoY in May, up from 4.4% YoY in April. However, retail sales of automobiles were weaker than expected, declining by 4.4% YoY. The domestic car market is highly competitive, and price wars have led some consumers to adopt a wait-and-see approach. Additionally, recycling prices for old home appliances and furniture are lower than consumer expectations. Current consumption-boosting policies may not be sufficiently substantial in terms of incentives and subsidy coverage, resulting in less-than-expected consumer enthusiasm. Whether consumption growth can continue to rebound will largely depend on the introduction of more substantial "real money" policies. ▪ In terms of production, among the 41 major industrial sectors, 33 achieved year-on-year growth in value added, with over 80% of sectors experiencing growth. The value added of the equipment manufacturing industry grew by 7.5% YoY, maintaining a higher growth rate than the average for all above-scale industries for ten consecutive months. This sector contributed 45.7% to the growth of all above-scale industries. ▪ In terms of fixed asset investment, manufacturing investment has grown rapidly. From January to May, manufacturing investment increased by 9.6% YoY, 5.6 percentage points higher than the growth rate of total investment, contributing 57.3% to total investment growth. Infrastructure investment grew by 5.7% YoY. However, real estate investment remained weak, with total investment declining by 10.1% YoY in the first five months, a further deterioration from the first four months.
▪ China's credit growth in May was largely in line with expectations, however, money supply growth tumbled further to record low.	▪ China's social financing increased by 2.06 trillion yuan in May, slightly above market expectations due to local government bond issuance, which accounted for 1.23 trillion yuan. On-balance-sheet new yuan loans increased by 950 billion yuan in line with expectations. However, the structure of on-balance-sheet loan growth appears weak as a significant portion of corporate loans consists of short-term bill financing. ▪ The focus was primarily on money supply, with both M1 and M2 growth slowing to record lows. M2 growth decelerated to 7% YoY

	in May from 7.2% YoY in April, while the contraction in M1 growth widened to 4.2% YoY in May from 1.4% YoY previously. The gap between M2 and M1 widened further. ▪ Statistically, China's M1 does not include household demand deposits and government deposits, making it more sensitive to fluctuations in corporate demand deposits. The recent sharp contraction in M1 was partially attributed to technical issues, as China's market interest rate self-regulation mechanism clamped down on high-interest deposit behavior via manual interest rate adjustments. The previous arbitrage activities, where corporations used funds from cheap bill financing to invest in high-interest deposits, were curbed. This led to a simultaneous contraction in some deposits and loans, causing M1 to decline rapidly. Meanwhile, banks faced pressure as deposits were transferred to cash management products such as wealth management products and money market funds over time, which are not captured by M1. ▪ In addition to technical issues, the contraction in M1 was also a result of the weak property market. Historically, property sales have been an important channel for converting household demand deposits, which are not captured in M1, to corporate demand deposits, which are captured in M1. The contraction in M1 also reflects that confidence in the real economy still requires further restoration.
▪ China's consumer price index (CPI) rose by 0.3% YoY in May, unchanged from April's reading.	▪ On a MoM basis, CPI fell by 0.1% due to a weaker-than-expected decline in non-food items. Food prices stabilized in May after contracting for two consecutive months, influenced by a rebound in pork prices due to reduced pig production capacity. Additionally, prices for fresh vegetables and fruits showed stronger-than-seasonal performance, impacted by heavy rain in the southern regions affecting supply. ▪ Non-food and core CPI both decreased by 0.2% MoM, underperforming compared to the previous month. Only clothing prices showed a seasonal increase due to the introduction of new summer collections. Meanwhile, the decline in international oil prices dragged down motor fuel prices. Prices for household appliances and vehicles also fell significantly due to production capacity pressures. Additionally, a seasonal decline in travel enthusiasm after the short holiday period led to a drop in tourism prices, contributing to overall weakness in non-food prices. ▪ Looking ahead, given that pork prices continued to rise in the first half of June, this may help counteract the unfavorable base effect with food prices tending to fall sequentially in June. We expect China's CPI to accelerate slightly to around 0.5% in June. ▪ On a positive note, China's producer price index (PPI) rose by 0.2% MoM in May, marking the first sequential increase in seven months. Consequently, the YoY contraction of PPI in May narrowed sharply to 1.4% from April's 2.5%. The MoM increase in PPI was primarily driven by rising upstream raw material prices, particularly in the non-ferrous metal industry chain, influenced by increases in international non-ferrous metal prices. However, price transmission from upstream to downstream in the PPI remained weak, suggesting that the rise in commodity prices is mainly reflected in increased cost pressures for midstream and downstream industries. There is still considerable room for the current price upcycle. The MoM rate of increase will depend on demand-side drivers, with the real estate industry chain being the most elastic part of the short-term demand side.

▪ Hong Kong's PMI fell to the contractionary zone in May, at 49.2, dragged by the decline in new orders and output sub-indexes. As a result of fewer new businesses, output contracted in three out of four passing months. Overall sentiment deteriorated further, while profit margin continued to shrink with rising competition and input cost. Forward looking indicators suggested that demand is likely to stay subdued in the near term.	▪ Output and orders sub-indexes declined at the fastest rate since September 2022. Demand from mainland China and abroad fell notably. On price front, input costs rose at the slowest pace since February 2021, while output price fell for the first time in more than two years.
▪ Decline in Macau's home price fell by a faster pace despite the removal of housing cooling measures in April. On year-to-year basis, Macau's residential property price index dropped by 11.6% (-2.0% month-to-month) in three-month ending April 2024. Comparing with the high in 2018, the housing price was still down by 18.0%. Meanwhile, trading activities stayed at a subdued level as buyers and sellers stayed on the sideline.	▪ Macau's government removed all housing cooling measures in April this year. These measures include special stamp duties (for all non-resident buyers, properties resold within 24 months and buyers with at least two properties), stress test requirement and upper limit on mortgage-to-value ratio. By the removal of cooling measures, the Macau government hopes to rejuvenate the housing market. ▪ Yet, local housing market sentiment remained fragile in the face of high mortgage rate, as Fed was likely to delay rate cut to September this year. We now tip the year-on-year decline in housing price at 4-8% for 2024.

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