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GLOBAL MARKETS RESEARCH

Greater China — Week in Review

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Highlights: China's pivot towards more stimulus

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The market reaction to the third plenum last week, unfortunately, was underwhelming as some media deemed the outcome disappointing compared to the third plenum of the 18th Central Committee in 2013.

As we wrote last week in the report, this year's third plenum of the 20th Central Committee is positioned as a continuation of the 18th Central Committee's third plenum in 2013, aiming to deepen the reforms that have not been completed in the past decade.

All the reforms are targeted to be completed within five years. This is an aggressive plan, given that most of the low-hanging fruit of the reforms has been picked in the past decade while the remaining reforms are more challenging. Completing these more challenging reforms within five years, compared to the less challenging reforms of the past decade, certainly requires at least a stable macroeconomic backdrop. Difficult reforms will face more resistance during an economic downturn as they may hurt the interests of certain privileged groups. In other words, it will be much easier to push for tough reforms with a growing pie than a shrinking pie. Therefore, we believe China will have to roll out more policy supports to ensure a stable economy.

The good news is that China's policymakers did not let the market wait for too long. Just one day after China published the decision of the third plenum, China's central bank announced on 22 July a cut to its 7-day reverse repo rate and 1-year and 5-year loan prime rates (LPR) by 10 basis points, the first rate cut in almost a year.

Three days later, on 25 July, the central bank unexpectedly conducted its second medium term lending (MLF) auction in July with the reduced interest rate of 20bps to 2.3%. With the cuts of all major interest rates last week including 7D reverse repo rate, LPR and MLF, it shows the potential pivot of PBoC towards more aggressive easing. Additionally, the cut of MLF after the cut of LPR also showed the deemphasis of the MLF rate as the key policy rate.

Elsewhere China also stepped up its fiscal policy. China's NDRC and Ministry of Finance announced on 25 July to repurpose this year's 1 trillion yuan ultra long-term bond. 300 billion will be redeployed to support the equipment upgrade and trade-in of consumer goods. For example, In the aspect of vehicle scrappage and renewal, the subsidy standards for eligible vehicles have been doubled to 20000 yuan for new energy vehicle and 15000 yuan for fuel powered vehicles.

As a result of a series of rate cuts, China's yields fell last week across the curve, led by the long-term yield. China's 30-year Treasury yield tested 2.4% again. According to China's central bank, a reduction in short-term rates does not necessarily imply that long-term yields will have more room to fall. If rate cuts

improve economic fundamentals, it could lead to an increase in medium- and long-term yields. However, the further decline in medium- and long-term yields last week indicates that the market remains uncertain about whether the recent rate cuts are strong enough to support the economy. In the short term, the market will focus on whether the central bank will start selling long-term bonds to limit the decline in long-term yields.

In a recent article, Deputy Governor of the People's Bank of China, Tao Ling, highlighted the next steps to accelerate the improvement of the central bank's system reforms. One key point is that the central bank needs to clearly define its role and establish the dual objectives of maintaining currency stability and financial stability.

The currency stability carries out two aspects including preventing the devaluation of money held by the public and maintaining the RMB exchange rate at a reasonable and balanced level. It also involves maintaining a reasonable positive real interest rate, emphasizing employment targets, appropriately monitoring asset price changes, establishing effective communication mechanisms, and increasing policy transparency.

Overall, while balancing multiple objectives, the central bank will continue to seek a balance between inflation and exchange rate stability. These multiple goals also explain the central bank's previous focus on the exchange rate.

Nevertheless, China's "buying time" strategy to stabilize the RMB over the past one year has finally paid off. The RMB rebounded last week despite rate cuts, supported by the unwinding of carry trade triggered by the sharp rally of the JPY. The path of RMB appreciation during the rate cuts may give China confidence to focus its monetary policy more on boosting domestic demand.

Offshore RMB funding cost rose notably last week, as financial institutions were reluctant to provide RMB liquidity via swap. Overnight CNH HIBOR rose to 5.76% last Wednesday, the highest level since April this year.

Hong Kong's unemployment and underemployment rates stayed flat at 3.0% and 1.2% respectively in the three-month ending June 2024. Total labour force and employed person grew by 0.1% and 0.2% respectively compared with the preceding three-month period, hence keeping the job market on the tight side. However, it was noticed that private sector job vacancy fell notably period-to-period, suggesting that the labour market may have more room to ease down the road.

Hong Kong's inflationary pressure stayed mild, with the CPI increasing at a slightly faster pace of 1.5% YoY in May 2024 (vs. 1.2% in April). The pick-up in inflation was largely due to scaling back of electricity charges subsidies by the government during the month. Netting out the effect of government's one-off relief measures, the underlying CPI rose by 1.0% in June, same as that in May. In view of the still-weak consumption sentiment and steady rent, we have again revised downward the full year inflation forecast from 2.3% to 1.9% for 2024.

Key events	
Facts	**OCBC Opinions**
▪ On 25 July, the central bank unexpectedly conducted its second medium term lending (MLF) auction in July with the reduced interest rate of 20bps to 2.3%.	▪ There are two surprises from this action. First, it is the first time since November 2020 that PBoC conducted MLF twice in a single month. Second, it is also the first time that the rate cut of MLF is after the cut of Loan Prime Rate (LPR) since MLF became the key policy rate from 2019. With the cuts of all major interest rates this week including 7D reverse repo rate, LPR and MLF, it shows the potential pivot of PBoC towards more aggressive easing. Additionally, the cut of MLF after the cut of LPR also showed the deemphasis of the MLF rate as the key policy rate. In future, the transmission of China’s monetary policy is likely from short term 7-day rates to LPR rather than previously MLF to LPR.
▪ China’s NDRC and Ministry of Finance announced on 25 July to repurpose this year’s 1 trillion yuan ultra long-term bond. 300 billion will be redeployed to support the equipment upgrade and trade-in of consumer goods.	▪ For example, In the aspect of vehicle scrappage and renewal, the subsidy standards for eligible vehicles have been doubled to 20000 yuan for new energy vehicle and 15000 yuan for fuel powered vehicles. ▪ The equipment upgrade and trade-in of consumer goods are not a panacea for solving China's structural problems. However, they serve as short-term solutions that can buy China more time to rebalance its economy. Historical evidence supports the effectiveness of these measures, as seen in the previous round of trade-in programs for household appliances.
▪ In a recent article, Deputy Governor of the People's Bank of China, Tao Ling, highlighted the next steps to accelerate the improvement of the central bank's system reforms. One key point is that the central bank needs to clearly define its role and establish the dual objectives of maintaining currency stability and financial stability.	▪ The currency stability carries out two aspects including preventing the devaluation of money held by the public and maintaining the RMB exchange rate at a reasonable and balanced level. It also involves maintaining a reasonable positive real interest rate, emphasizing employment targets, appropriately monitoring asset price changes, establishing effective communication mechanisms, and increasing policy transparency. ▪ Overall, while balancing multiple objectives, the central bank will continue to seek a balance between inflation and exchange rate stability. These multiple goals also explain the central bank's previous focus on the exchange rate.

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong's merchandise exports and imports continued to grow, though at decelerated pace of 10.7% and 9.0% respectively in June (14.8% YoY and 9.6% YoY respectively in March). Trade deficit rose sharply to HK$55.7 billion in April, from that of HK$12.1 billion in the previous month.	▪ Within the total, exports to mainland China increased in the slowest pace in four months, by 11.9% YoY, while exports to US rose sharply by 40.6% YoY, probably due to some forms of front-running of Chinese exports ahead of presidential election in US. Analyze by commodity, increases were recorded in most of the commodity groups, except for "non-metallic mineral manufactures" (-10.6% YoY), and "non-ferrous metals" (-22.8% YoY). ▪ Moving into the second half of 2024, growth of merchandise exports is likely to slow further, amid higher base last year, softening external demand and China's growing trade friction with the West.
▪ Hong Kong's inflationary pressure stayed mild, with the CPI increasing at a slightly faster pace of 1.5% YoY in May 2024 (vs. 1.2% in April). The pick-up in inflation was largely due to scaling back of electricity charges subsidies by the government during the month. Netting out the effect of government's one-off relief measures, the underlying CPI rose by 1.0% in June, same as that in May.	▪ On month-to-month basis, the largest contribution to price pressure came from "electricity, gas and water" component (16.6% MoM), followed by "alcoholic drinks and tobacco" (-1.4% MoM), while the largest drag came from "clothing and footwear" component (-1.7% MoM). On the other hand, private housing rental were still steady, keeping the price pressure broadly in check. ▪ In the first half this year, composite CPI rose by an average 1.6% over a year earlier, while underlying CPI rose by a milder 1.0%. In view of the still-weak consumption sentiment and steady rent, we have again revised downward the full year inflation forecast from 2.3% to 1.9% for 2024.

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