GBA – Business confidence continues to improve

- **Our survey-based gauge of GBA activity and sentiment confirms a broadening economic recovery**
- **Manufacturers join technology respondents as outperformers; Hong Kong remains a laggard**
- **Borrowing costs are bottoming out; respondents expect Renminbi internationalisation to accelerate**

The GBA a bellwether for China's outlook

Kelvin Lau
+852 3983 8565
Kelvin.KH.Lau@sc.com
Senior Economist, Greater China
Standard Chartered Bank (HK) Limited

Our GBA Business Confidence Index (GBAI), based on quarterly surveys of over 1,000 companies operating in the Guangdong-Hong Kong-Macau Greater Bay Area (GBA), suggests an improvement in business confidence in Q3; this is our first update since we launched the GBAI in collaboration with the Hong Kong Trade Development Council (HKTDC) in July. The GBAI's 'current performance' index for business activity rose to 42.4 in Q3-2020 from 37.0 in Q2 (50 being neutral), reflecting easing contractionary pressure. Even more encouraging is the larger jump in the corresponding 'expectations' index, to 56.2 from 47.0 prior, reflecting a swing back to expansionary territory (and consistent with our call for China's GDP growth to return to c.6.0%) in Q4, now that we have probably seen the steepest part of China's V-shaped post-COVID recovery.

A detailed breakdown also shows that the recovery is becoming more broad-based. Stronger production and sales helped lift profit expectations, while new export orders are improving alongside domestic ones. Retailers, who were more pessimistic in Q3, are expected to start catching up with manufacturers in Q4. The sub-indices for non-core mainland GBA cities were doing as well as Shenzhen and Guangzhou (the Q2 outperformers); Hong Kong, however, remains a clear laggard. Our latest GBA credit indices indicate a likely upturn in borrowing costs, confirming our view that China's monetary policy easing is nearing an end as the urgency to support growth fades. Our thematic questions showed that 42% expected the overall pace of Renminbi internationalisation to accelerate in the coming year, echoing recent signs of a stronger policy push, although only 23% planned to use Renminbi more themselves. Trade settlement redenomination is expected to lead this transformation.

Figure 1: Eight sub-components of our GBAI's business indices

	Current performance		Expectations	
	Q3	Q2	Q3	Q2
Business Index	**42.4**	37.0	**56.2**	47.0
1. Production/sales	**36.7**	27.1	**60.0**	43.1
2. New orders	**40.7**	29.4	**61.8**	50.2
3. Capacity utilisation	**40.0**	38.9	**53.5**	47.8
4. Raw material inventory	**46.4**	46.1	**50.8**	48.3
5. Prices of finished goods/services	**47.3**	41.4	**53.2**	46.4
6. Fixed asset investment	**45.3**	40.2	**55.3**	47.3
7. Financing scale	**47.3**	46.7	**55.1**	49.3
8. Profit	**35.9**	26.5	**59.9**	43.8

Source: HKTDC, Standard Chartered Research

Detailed findings of the GBAI survey for Q3-2020

A quarter ago, *our inaugural GBAI* readings suggested weak business activity in Q2, but expectations of a better Q3 with the region set to recover from COVID-19 disruptions. Our latest GBAI confirms that GBA business activity has indeed been on the mend; more importantly, the ‘expectations’ index suggests further improvement in Q4 as all sub-indices climbed above 50, a broad-based return to expansionary territory (Figure 1). Lower borrowing costs have also been a tailwind for our respondents, but the forward-looking GBAI credit indices confirm our view that China’s post-COVID monetary easing cycle is coming to an end. Industry breakdown shows that the manufacturing and technology sectors are leading the way, with a likelihood of the services sector catching up . By city, Hong Kong respondents remain the most pessimistic. Respondents also expect an acceleration in Renminbi internationalisation in the coming year, based on the responses to our thematic questions. We expand on these key findings below:

Both the ‘current performance’ and the ‘expectations’ readings for business activity have risen

- **Broad-based Q3 recovery:** The GBAI current performance index for business activity rose to 42.4 in Q3-2020 from 37.0 in Q2, reflecting easing contractionary pressure (Figure 1). All eight of its sub-indices improved q/q, led by ‘production/sales’ (+9.6pts), ‘new orders’ (+11.3pts) and ‘profit’ (+9.4pts), indicating a broad-based recovery. This is consistent with *recent official data*, most encouraging being the marked pick-up in industrial production growth to 5.6% y/y in August (from 4.8% y/y in July), matching pre-COVID levels. August manufacturing investment growth also turned positive for the first time in 2020, driven by strong industrial profit growth (over 19% y/y in July and August) and upgrading demand. The *China SMEI* – our monthly sentiment gauge for over 500 SMEs nationwide – showed an average ‘new orders’ sub-index of 56.5, versus 52.6 in Q2 and 39.5 in Q1, echoing GBAI’s finding of solid demand ahead.

- **Reasons for optimism in Q4:** The GBAI expectations index for business activity saw an even bigger q/q jump, by 9.2pts to 56.2. This clear swing from below to above the neutral 50 mark – not only for the headline index but also all eight of its sub-indices – indicates a strong consensus that further improvement in economic activity is in store in the coming months, again led by ‘production/sales’ (+16.9pts), ‘new orders’ (+11.6pts) and ‘profit’ (+16.1pts). We separately also tracked expectations for ‘new export orders’, which came in at a similarly strong 60.8, reflecting improving external demand, possibly amplified by the GBA’s ability to resume operations and handle orders faster than most other manufacturing hubs around the world. While China has probably seen the steepest part of its post-COVID rebound, the latest GBAI ‘expectations’ numbers still bode well for the prospect of China’s overall GDP growth returning to and being sustained at c.6% throughout H2.

Bank and non-bank financing cost expected to rebound in the coming quarter

Figure 2: Financing costs bottoming out

Five sub-components of our GBAI’s credit indices – current vs expectations

	Current performance		Expectations	
	Q3	Q2	Q3	Q2
Credit Index	**45.9**	45.3	**52.4**	50.4
1. Bank financing cost *	**51.8**	54.9	**48.4**	53.7
2. Non-bank financing cost *	**51.7**	53.5	**48.3**	52.2
3. Banks’ attitude towards lending	**48.6**	54.8	**52.7**	51.4
4. Surplus cash	**37.4**	30.6	**57.1**	46.9
5. Receivables turnover	**40.2**	32.6	**55.3**	47.7

* Index above 50 indicates lower cost; Source: HKTDC, Standard Chartered Research

Our GBA credit indices echo the view that China is at the tail end of its monetary easing cycle

- **Credit conditions turning neutral:** Improving growth prospects dampen the expectation for more monetary policy support. The GBAI current performance index for credit rose marginally to 45.9 from 45.3 prior, mainly due to easing cash-flow stress as reflected by the surplus cash (+6.8pts) and receivables turnover (+7.6pts) sub-indices (Figure 2). They are also the main drivers for the 2.0pts increase in the GBA expectations index for credit to 52.4, reflecting the tailwinds from prior monetary policy easing. However, both the 'current performance' and the 'expectations' sub-indices for bank and non-bank borrowing costs declined, suggesting that borrowing costs had fallen at a slower pace in Q3 compared with Q2; the expectation is for financing costs to stop falling in Q4 . We expect the People's Bank of China (PBoC) to keep market liquidity ample via open-market-operations and re-lending, but the MLF rate is likely to be kept unchanged at 2.95% through end-2021, in our view.

Recovering domestic and external demand helped lift sentiment among manufacturers

- **Manufacturing sector improving fast:** It is of little surprise that, by industry, 'innovation and technology' once again scored the highest among the five designated sectors in Q3 (Figure 3). Riding on the GBA's inherent advantage as China's leading innovation hub, we see the sector receiving a further policy boost given the need for China to seek growth from within via industrial upgrading, but also to reduce its dependency on technology imports amid rising decoupling risk with the US. Equally impressive this time, however, is the 'manufacturing and trading' sub-index, which seems to have been lifted by the swift normalisation in domestic demand, as well as the gradual recovery in exports with Q2 lockdowns lifted in many economies. Manufacturing respondents reported a 6.2pts rise in 'current performance' to 43.3, and a sector-best 10.3pts to 57.2 in the 'expectations' sub-index.

- **Services sector expected to catch up:** 'Retail and wholesale', which barely rose in Q3, had the lowest 'current performance' sub-index for business activity (36.9) among the five designated sectors; its 'expectations' score, however, climbed to 50.5, beating 'professional services' (47.6) and 'financial services' (46.5). The financial sector, which outperformed in Q2, could start to see the drag from rising non-performing loans; banks' still-cautious approach towards lending to retail respondents (36.0) – alongside retailers' relatively weaker cash positions – also helped explain retailers' low current credit performance (41.7).

- **Hong Kong continues to lag:** Hong Kong was the only city sub-index that saw its current performance reading for business activity falling in Q3, probably reflecting renewed disruption from a third wave of COVID infections (Figure 4). All other city sub-indices for current performance rebounded above 40, with the non-core mainland cities catching up to Shenzhen and Guangzhou, which were outperformers in Q2. In terms of expectations, Hong Kong was once again the

Figure 3: GBAI's industry sub-indices

	Business (current)		Business (expect'n)		Credit (current)		Credit (expect'n)	
	Q3	Q2	Q3	Q2	Q3	Q2	Q3	Q2
Manufacturing and trading	**43.3**	37.1	**57.2**	46.9	**46.5**	45.5	**52.8**	50.6
Retail and wholesale	**36.9**	36.0	**50.5**	46.1	**41.7**	43.3	**49.1**	48.5
Financial services	**38.9**	35.5	**46.5**	49.7	**44.9**	48.1	**51.1**	48.7
Professional services	**38.4**	37.9	**47.6**	45.9	**45.2**	45.0	**48.4**	46.7
Innovation and technology	**46.9**	40.1	**68.0**	59.9	**48.9**	46.0	**59.1**	60.7

Source: HKTDC, Standard Chartered Research

odd one out, recording a mere 38.0; Shenzhen, on the other hand, stood out by climbing above 60 (62.7), head-and-shoulders above other mainland GBA cities who were also all back in expansionary territory.

Renminbi trade settlement most likely to reaccelerate as China renews its policy push

- **Renminbi internationalisation back in the spotlight:** Our thematic questions this time around focused on GBA respondents' views on Renminbi internationalisation. *We recently noted clear policy signals* that China is making a renewed push towards Renminbi internationalisation, possibly fuelled by the rising risk of financial decoupling with the US. Noting the strong motivation for China to prepare for – and limit any fallout from – a potential disruption of access to USD liquidity and clearing, we expect a reacceleration of two-way capital account opening and redenomination of trade and investment. The GBA, an aspiring megacity cluster that thrives on promoting cross-border integration, especially with Hong Kong, is one of China's designated testing grounds for financial liberalisation; our respondents therefore should give us valuable insights on how fast and far this renewed Renminbi internationalisation push can go from a genuine user perspective.

  46% of respondents said their business would benefit more from Renminbi internationalisation by operating in the GBA compared with other mainland cities/regions; the top three reasons cited were 'stronger policy support' (22.0%), 'sizeable international trade' (20.8%) and 'closer ties with Hong Kong' (13.4%) (Figure 5). Moreover, 42% expected the overall pace of Renminbi internationalisation to accelerate in the coming year (Figure 6). Responses to "do you plan to use more Renminbi for your cross-border and/or offshore activity in the coming year", were less encouraging, with only 23% saying that they would (Figure 7); the top three reasons cited were 'wider acceptance among their clients', 'strong directional view on the Renminbi outlook' and 'currency diversification to hedge risk'.

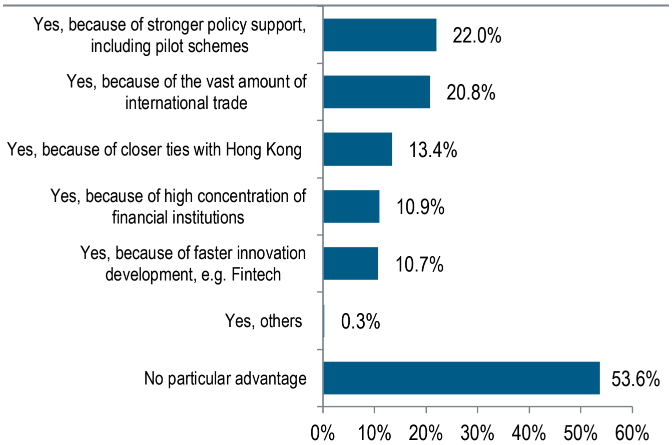
  66% of respondents said they were already using Renminbi trade settlement, and 45% said they planned to start using/increase usage, both way above other Renminbi products like cross-border cash pooling, investment and capital raising (Figures 9 and 10). Currently only 3.1% of respondents said they have offshore Renminbi (CNH) holdings; but among those that do, CNH accounts for a material 26% of their total holdings on average (Figure 8). This, together with our respondents' generally large USD holdings (38% of respondents said they do, accounting for a significant 45% of their total holdings on average), reflects plenty of room for further Renminbi redenomination, even if the transition is likely to be gradual.

Figure 4: GBAI's city sub-indices

	Business (current)		Business (expect'n)		Credit (current)		Credit (expect'n)	
	Q3	Q2	Q3	Q2	Q3	Q2	Q3	Q2
Hong Kong	**29.6**	30.3	**38.0**	35.4	**41.9**	40.8	**45.9**	43.1
Guangzhou	**44.3**	37.4	**56.2**	51.4	**48.6**	46.0	**49.9**	53.2
Shenzhen	**44.2**	41.2	**62.7**	51.2	**46.2**	47.7	**56.0**	52.3
Foshan	**43.7**	34.3	**58.8**	46.6	**44.5**	48.5	**52.5**	54.4
Dongguan	**42.6**	31.5	**59.5**	43.0	**46.1**	41.5	**55.5**	48.2
Macao and other cities	**49.3**	37.7	**55.0**	47.6	**47.5**	44.1	**50.6**	50.7

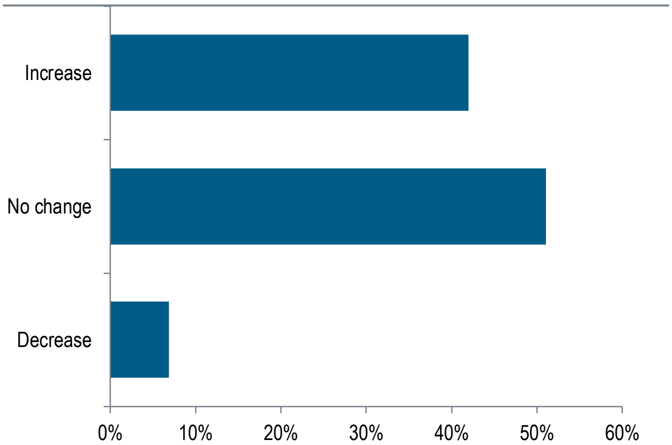
Source: HKTDC, Standard Chartered Research

Figure 5: Would your business benefit more from Renminbi internationalisation by operating in the GBA vs other mainland cities/regions? *(% of respondents)*



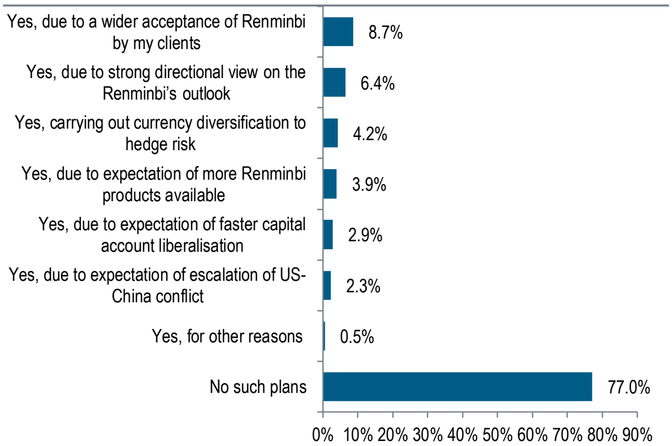
Source: HKTDC, Standard Chartered Research

Figure 6: How do you expect the overall pace of Renminbi internationalisation to change in the coming year?
% of responses



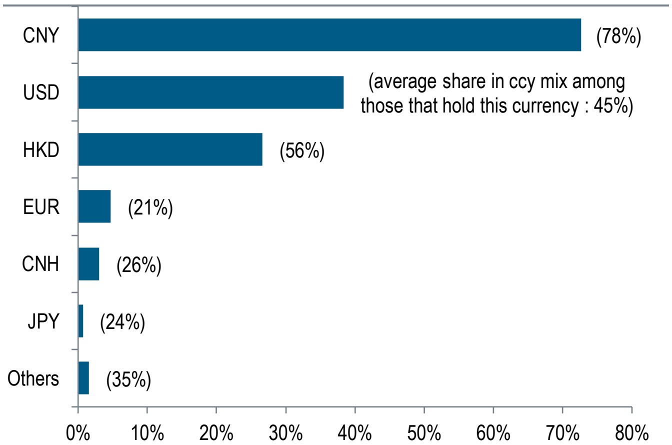
Source: HKTDC, Standard Chartered Research

Figure 7: Do you plan to use more Renminbi for your cross-border and/or offshore activity in the coming year?
% of respondents



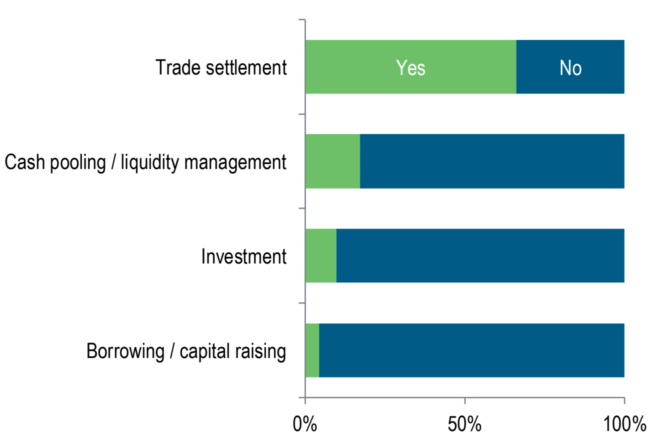
of Source: HKTDC, Standard Chartered Research

Figure 8: What currencies are you currently holding, and what is the mix?
% of responses, with average holding % in brackets



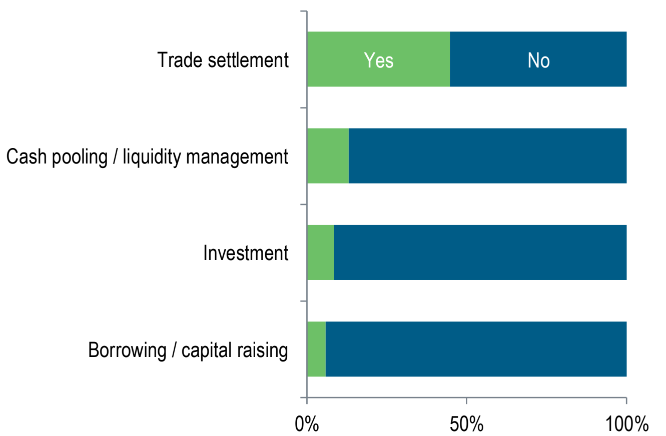
Source: HKTDC, Standard Chartered Research

Figure 9: Do you currently use the following Renminbi cross-border products and services?
% of respondents



Source: HKTDC, Standard Chartered Research

Figure 10: Do you plan to start using/increase usage of the following cross-border Renminbi products/services in the coming year? *(% of respondents)*



Source: HKTDC, Standard Chartered Research

Appendix: How the GBAI works

The GBAI is a diffusion index based on responses from no less than 1,000 enterprises across 11 GBA cities and key industry sectors

The GBAI is compiled based on a quarterly survey conducted by the HKTDC in collaboration with Standard Chartered. Every quarter, no less than 1,000 enterprises in key business sectors across the GBA provide valuable feedback on a range of subjects, including their current business situation and credit conditions, and their outlooks on these subjects for the coming quarter. The GBAI also asks respondents thematic questions that help us understand what drives their business decisions and plans, and how this might shape the GBA's future.

Index calculation: The GBAI comprises two main business indices, one gauging 'current performance' (in this case Q3), and the other looking at 'expectations' (Q4). Each index is calculated as an average of eight sub-indices that reflect different aspects of business activity, as outlined in Figure 1. Respondents indicate the corresponding changes, actual or expected, in three ways: up, same or down; a diffusion index is then calculated using the following formula:

$$\text{Up\%} \times 100 + \text{Same\%} \times 50 + \text{Down\%} \times 0$$

An index reading above 50.0 means that respondents are generally optimistic about the business environment in the coming quarter, while a reading below 50.0 indicates predominantly pessimistic sentiment. A reading of 50 is neutral.

The two credit indices are calculated in the same way, but with five of their own sub-components that focus on measuring the costs and ease of obtaining credit, and respondents' willingness and/or eagerness to do so (Figure 2).

Sample distribution: The sub-indices above are weighted according to the sample sizes and GDP of these industries in the respective cities. Figure 11 shows the distribution of survey responses, which are based on the cities' industrial sectors and number of enterprises. The five designated industrial sectors are (1) manufacturing and trading, (2) retail and wholesale, (3) financial services, (4) professional services, and (5) innovation and technology. By GBA city, Hong Kong, Guangzhou and Shenzhen have the largest samples, of 200 each.

Figure 11: GBAI

Number of respondents

By city		By industry	
	Targeted respondents		Targeted respondents
Hong Kong	200	Manufacturing and trading	500
Guangzhou	200		
Shenzhen	200	Retail and wholesale	200
Foshan	100		
Dongguan	100	Financial services	125
Huizhou			
Zhongshan		Professional services	125
Jiangmen	200		
Zhuhai		Innovation and technology	50
Zhaoqing			
Macau			
Total	**1,000**	**Total**	**1,000**

Source: HKTDC, Standard Chartered Research

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Document approved by
Shuang Ding
Chief Economist, Greater China and North Asia

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