Highlights

With China being forced to retaliate, the trade war has officially started on 6 July. We think a full-blown trade war is still quite unlikely at the current stage as a slow cook situation to keep things warm but avoiding the direct impact on the economy rather than direct conflict serves President Trump purpose to win mid-term election better. However, with the stake being talked up to US$550 billion, the overall sentiment is expected to remain jittery as the risk for rhetoric to become reality heightens. In the near term, market should also pay attention to Trump administration position in China's investment as the current tension is no longer restricted to trade.

As President Trump heads for Europe this week, there is hope that officials in the UK and Europe may press Trump on trade issue. BOE Governor Carney estimated at least 1% of global growth could be lost should the US impose tariff by 10% against all its trading partners. The pressure from European officials could be a temporary relief to the market.

China's commitment to further financial reform and openness has not been disrupted by the recent trade war and RMB depreciation. China increased it QDII quota for the third consecutive month in June with total QDII quota rising to US$103.3 billion. China's security regulator announced to seek public opinion on proposed measures to further open China's stock market to foreigners including those working in China or in listed Chinese companies' offshore subsidiary. Meanwhile, China's head of banking and insurance regulator Guo Shuqing said in the latest interview that China will speed up its pace of reform.

On currency, RMB's sharp depreciation paused following a number of PBoC officials' comments. We think PBoC is likely to be less interventionist this round. Looking ahead, the key word for RMB will be "cycle". As long as RMB's performance is in line with the economic cycle, there is no urgency for PBoC to intervene decisively. The best way to define cycle could be RMB index. Should RMB index fall swiftly to below 94, which could be considered as beyond the cycle, there will be higher chance for China to step up its intervention.

In Hong Kong, with the hoarded money for Xiaomi's debut returning to the market, front-end liquidity improved. As a result, one-month HIBOR came off from 2.04% on 4 July to 1.696% on 6 July. Moving ahead, we do expect HIBOR to have some room for retracement in the coming months as market players may not aggressively pre-position for the upcoming IPOs as they did in the past months amid bearish stock market sentiments. However, we do not expect HIBOR to drop significantly as several large IPOs are set to lock up substantial amount of money given the relatively large IPO size. All in all, one-month HIBOR and three-month HIBOR may find some support around 1.5% and 1.8% respectively in the near term. Meanwhile, the possibility of HKD reaching the weak-end of the peg cannot be ruled out. Still, concerns about tight liquidity may keep those who short HKD cautious. Therefore, it is unlikely for the HKMA to buy much HKD to defend the currency peg system in the coming month. Elsewhere, Hang Seng Index dropped for the fourth consecutive week and was down by more than 2% last week due to the lingering trade war concerns. Total southbound flows under the two stock connect registered net outflows of RMB 4.43 billion month-to-date. Moderate capital outflows may add downward pressure to the HKD and help to cap the downside for the HIBOR. In Macau, gaming revenue dropped 11.8% mom to MOP22.5 billion in Jun, the lowest level since September 2017. This is mainly due to the World Cup betting which would have dented Macau's gaming revenue during June and July. Besides, policy risks are looming over the gaming sector. Adding on high base effect, we expect gaming revenue growth will moderate from 19.1% in 2017 to 10%-15% in 2018.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's tariff on US$34 billion US imports automatically kicked in at 12:01pm on 6 July immediately after the USTR imposed punitive tariff on first set US$34 billion Chinese imports. China defended its position that it was forced to retaliate. ▪ President Trump said the second round of tariffs on US$16 billion Chinese imports will follow in two weeks' time. In addition, he also threatened the total amount could reach US$550 billion should China retaliate. ▪ In addition, the Trump administration also recommended rejecting China Mobile's application to offer services in the US market citing national security risk.	▪ With China being forced to retaliate, the trade war has officially started on 6 July. Since President Trump will head for Europe for his meetings this week, there is hope that there may not be follow-up development on US-China trade war given the tension may shift to US-EU relationship. This may be a relief to market. ▪ As we mentioned before, President Trump's unpredictability approach has rallied animal spirits in the US Congress and it has become new political correctness to some extent to take a hawkish position against China. As such, we think the tension is likely to be dragged longer than initial expected. ▪ Nevertheless, we think a full-blown trade war is still quite unlikely currently as a slow cook situation to keep things warm but avoiding the direct impact on the economy rather than direct conflict serves President Trump purpose to win mid-term

	election better. However, with the stake being talked up to US$550 billion, the overall sentiment is expected to remain jittery as the risk for rhetoric to become reality heightens. ▪ In addition to the development of trade war, market should also pay attention to Trump administration position in China's investment as the current tension is no longer restricted to trade with China Mobile is the latest victim. ▪ Should Trump administration step up their efforts to block China's investment, the risk of misfire could increase further. Overall speaking, we think market should brace for volatility as there is no easy solution given the underlying problem is about the US competitiveness as well as sitting power to defend its leadership in global order against a rising power.
▪ China increased it qualified domestic institutional investor (QDII) quota for the third consecutive month in June with total QDII quota rising to US$103.3 billion.	▪ China's commitment to further financial reform and openness has not been disrupted by the recent trade war and RMB depreciation. The further expansion of QDII quota shows that there is no imminent risk of fresh round of capital control. ▪ In addition, China's head of banking and insurance regulator Guo Shuqing said in the latest interview that China will speed up its pace of reform.
▪ China's security regulator announced to seek public opinion on proposed measures to further open China's stock market to foreigners. Two types of foreigners including foreigners working in China and foreigners working for the China listed companies' offshore subsidiary with access to stock option will be allowed to set up security account in the onshore market.	▪ The open of China's stock market to more foreigners shows China's commitment to financial reform remained intact despite looming uncertainties in the global market. This will also help attract more capital inflows.
▪ The USDHKD spot rate dropped to as low as 7.8421 early last week due to tight front-end liquidity before rallying to 7.8485.	▪ With the hoarded money for Xiaomi's debut returning to the market, front-end liquidity improved. As a result, one-month HIBOR came off from 2.04% on 4 July to 1.696% on 6 July. Moving ahead, we do expect HIBOR to have some room for retracement as market players may not aggressively pre-position for the upcoming IPOs as they did in the past months amid bearish stock market sentiments. However, we do not expect HIBOR to drop significantly as several large IPOs are set to lock up substantial amount of money given the relatively large IPO size. For example, China Tower is said to launch IPO in July and to raise as much as US$10 billion. All in all, one-month HIBOR and three-month HIBOR may find some support around 1.5% and 1.8% respectively in the near term. Meanwhile, the possibility of HKD reaching the weak-end of the peg cannot be ruled out. Still, concerns about tight liquidity may keep those who short HKD cautious. Therefore, it is unlikely for the HKMA to buy much HKD to defend the currency peg system in the coming month.

Key Economic News

Facts	**OCBC Opinions**
▪ Housing prices growth accelerated to 14.7% yoy in May after slowing down over the past two months. Approved new mortgage loans rose 2.3% yoy or 14.4% mom to HK$42.65 billion. Furthermore, June's housing transactions increased 10% yoy to the highest level since April 2017 at 6713 deals, reverting three consecutive months of year-on-year	▪ All data prints signal that the housing market frenzy remains intact due to several reasons. First, commercial banks refrained from following the Fed's step to raise prime rate in June. This cements market expectations that local borrowing costs will not surge in the near term. Second, market has built up expectations that housing market will not crash due to severe undersupply. Therefore, the acceptability of sky-high housing prices is rising.

decline.	Third, labor market remains tight with the jobless rate reaching an over two-decade low. This adds to sanguine economic outlook in bolstering wage growth. Fourth, housing supply has been increasing at a moderate pace. Housing completions and housing starts dropped by 55.8% yoy and 49% yoy during the first four months of this year. Limited supply of public housing also pushes up the average waiting time of general applicants from 4.7 years to 5.1 years. Therefore, pent-up demand has been accumulating. ▪ Several housing measures announced lately may help to increase the availability and the affordability of public housing. This may in turn reduce some demand in the private residential rental market and the demand for small flats. Also, vacancy tax may help to increase private housing supply. However, property developers could slow down the construction pace of new projects in the future or pass through the tax to prospective buyers. Besides, with public housing to be built on nine prime sites originally reserved for private property projects, medium-term supply of private housing will reduce as a result. Therefore, the new measures may barely help to calm the housing frenzy in the near term. Instead, given global monetary tightening and global uncertainties, any resultant stock market correction as well as local rate hikes would help to slow down the housing market growth.
▪ Hong Kong's retail sales registered double-digit growth for the fourth consecutive month and were up 12.9% yoy to HK$40.5 billion in May.	▪ On the one hand, sales of clothing, footwear and allied products for the ninth straight month by 7.4% yoy while those of jewellery, watches and clocks also advanced for the 11th consecutive month by 23.8% yoy. This indicates that tourist spending has been supported by Asia's resilient growth as well as a relatively weak HKD. Total visitor arrivals have increased for four months in a row and were up 8% yoy in May. The number of tourists from Mainland China, which accounts for 77% of total inbound tourists, jumped 10.6% yoy. We expect improvement in the tourism sector will sustain into the second half of this year and continue to support the retail sector. ▪ On the other hand, sales of food, alcoholic drinks and tobacco climbed 5.9% yoy while those of consumer durable goods grew 8.8% yoy. This reveals that local consumer sentiment remained upbeat due to tight labor market. Also, wealth effect from the booming housing market has boosted private consumption. Moving forward, tight labor market combined with positive salary prospects are likely to buoy local consumption. However, we are wary that recent stock market correction could weigh on local consumer sentiment. Besides, any local rate hikes in 2H18 may help to calm the red-hot housing market. Adding on high base effect, retail sales growth is expected to slow down in 2H18 despite strong tourism spending. We hold onto our view that retail sales would increase 5%-8% in 2018. As such, we expect the growth of retail shops rents and prices to remain supported in the near term.
▪ Macau's gaming revenue dropped 11.8% mom to MOP22.5 billion in Jun, the lowest level since September 2017.	▪ This is mainly due to the World Cup betting which would have dented Macau's gaming revenue during June and July. Besides, policy risks are looming over the gaming sector as two commercial banks are reported to have removed the UnionPay machines from either pawnshops or jewellery shops around the casinos. Adding on high base effect, we expect gaming revenue growth will moderate from 19.1% in 2017 to 10%-15% in 2018 as

	the support from recreational gamblers may not be able to offset the possible slowdown in VIP revenue.

RMB	
Facts	**OCBC Opinions**
▪ RMB's sharp depreciation paused following a number of PBoC officials' comments same day after the USDCNY touched 6.72 briefly in the onshore market last Tuesday. Governor Yi Gang said the central bank is observing the recent move though he mentioned the recent weakness was mainly attributable to strong dollar and was the result of pro cyclical behaviour.	▪ As we argued last week that we are unlikely to see the repeat of capital flight similar to that in 2015 for two reasons including economic fundamental and policies. The recent swift retreat of USDCNY by 1000bps from 6.72 to 6.62 justified our argument as RMB short sellers are sensitive to potential policy intervention. This is different from that in 2015 when PBoC officials' verbal intervention failed to calm down the market. ▪ Nevertheless, one of the key lessons learned from the 2015 experience is that excessive intervention is not necessary and sometimes could be dangerous with the sharp decline of FX reserve. As such, we think PBoC is likely to be less interventionist this round. ▪ That does not mean China will be hands off. One of the key takeaways from Governor Yi's interview is the word "pro cyclical". We think as long as RMB's performance is in line with the economic cycle, there is no urgency for PBoC to intervene decisively. In fact, despite the recent sharp depreciation against the dollar, RMB's performance against its major trading partners remain steady and gained slightly year to date. This suggests the current RMB movement is still within PBoC's comfort zone. Nevertheless, should RMB move beyond the cycle, we might see more intervention from the PBoC. How shall we define the "cycle"? We think the best indicator is RMB index. Should RMB index fall swiftly to below 94, there will be higher chance for China to step up its intervention. We think market should look closely at the movement of RMB index in the near term.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com