Summary

Almost all major economic indicators in July surprised the market on the downside. The disappointed data set raised the concern about China's growth quality as well as whether Chinese growth is still in the first stage of L-shaped trajectory. Although the weaker than expected growth data was partially attributable to one-off factors such as extreme weather, we think it also shows that the adjustment of over capacity is not done yet. In addition, the weak data also fuelled speculation on further monetary policy easing. Indeed, it seems to us that the weak growth data, together with easing global environment, argue for further monetary easing in China. **However, we think PBoC may find itself caught in the dilemma between stimulating growth and containing asset bubble.** Looking at the breakdown of July new Yuan loan data, more than 90% of new Yuan loan were related to housing mortgage. The divergent trend between cold economy and hot property market may limit PBoC's room to ease further. In addition, inflationary pressure is muted but not low enough to trigger further rate cut. CPI may decelerate further in the coming months but is expected to rise above 2% again in the last quarter on base effect. As such, we think China may continue to take wait-and-see approach. We expect no interest rate cut for the rest of the year despite the chance of reserve requirement ratio cut cannot be ruled out.

The weak July data drove China's bond prices higher despite unclear monetary policy outlook. China's 10-year treasury yield broke below 2.7%. The demand for longer tenor Treasury bonds, such as 50-year bond, also surged. RMB strengthened against the dollar in celebration of one-year anniversary of its fixing mechanism reform. The fixing was fairly choppy last week, but mainly the result of volatile broad dollar movement. The latest assessment from the IMF shows that RMB is in line with its fundamental. The weakness of broad dollar will give RMB more room to perform its two-way movement. Shen Zhen Hong Kong connect is likely to be back in focus after the HKEX said it has done all the preparations for the new stock connect and is waiting for approvals of Mainland authorities.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The International Bank for Reconstruction and Development, a unit of World Bank, plans to issue 2 billion SDR denominated bond in China's interbank bond market.	▪ The first batch of issuance, underwritten by ICBC, will be sold in August. ▪ Since last year, China has openly said it plans to issue SDR denominated bonds in onshore interbank bond market. The issuance will kill two birds with one stone. First, it will help promote the use of SDR to diversify from the dollar dominant world. Second, it will give onshore Chinese investors window to diversify from RMB depreciation risk as the value of SDR linked to five currencies. This may also help alleviate capital outflow risk.
▪ IMF published its annual consultation paper about China, highlighting the urgency of addressing the corporate debt problem.	▪ IMF encouraged Chinese authorities to harden budget constraints on SOEs and liquidate over-indebted firms. ▪ On currency, the fund said RMB remains broadly in line with fundamentals. ▪ On currency reform, the fund said achieving an effective float within the next couple of years, ideally by 2018, remains a key goal. We think the goal to allow RMB to float cleanly may by 2018 might be still too ambitious as China is likely to continue to keep tight control on its capital account. As mentioned by IMF, the capital account liberalization may await longer until China strengthen its financial systems, enhanced corporate sector governance and greater exchange rate flexibility.
▪ HKMA is said to check the credit risks faced by commercial banks amid property developers' offering high mortgages	▪ HKMA may investigate via special surveys on the local and foreign banks that have actively lent to property developers. The authority would also like to get the information about the outstanding loans of each property developer, the proportion of loans used to offer high loan-to-value mortgages. Market expects that the HKMA may require the banks to raise the weight of highly risky loans for property developments when calculating the RWA, in turn prompting the banks to increase the lending rates for the developers. As such, the HKMA may aim to indirectly crack down on the extremely high loan-to-

	value mortgages offered by the developers. Still, it is difficult to monitor the developers' allocation of their borrowed funds. Also, the strong financial status of developers is able to allow them to offer high mortgages without bank loans. More notably, the percentage of homebuyers enjoying such sweetener offered by developers is low, indicating that the resulting credit risks are still controllable.
▪ The HKEX released its 2016 interim report, which mentioned the completion of the development and testing of the required system for Shenzhen-Hong Kong Stock connect.	▪ The HKEX has done all the preparations for the new stock connect and is waiting for approvals of Mainland authorities. Data show that the SH-HK Connect Southbound and Northbound average daily trading value both dropped by 40% yoy in 1H respectively to HKD3 billion and CNY2.6 billion despite the notable net southbound inflows seen since late April. As such, we expect that the new scheme is unlikely to bring any extra benefits to the stock market across the border. On one hand, offshore investors have shown little interest in the onshore stock market as the northbound aggregate quota balance has remained high at CNY152.375 billion, more than half the total quota of CNY300 billion. On the other hand, concerns about depreciation in the Yuan and the limited investment channels in the onshore market propelled onshore investors to tap the Hong Kong stock market in 2Q and drove southbound aggregate quota balance down to HKD48.3 billion, or 19.32% of total quota. However, the market expectation of the Yuan has been stabilized while the gap between AH share has been shrinking gradually. Moreover, onshore investors searching for dividend-paying stocks of Mainland companies listed in Hong Kong might find the stocks less attractive post-dividend payment.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's export rose by 2.9% yoy in RMB term but fell by 4.4% in dollar term. Import fell by more than expected 12.5% yoy in dollar term. As a result, China's trade surplus widened to US$52.3 billion in July.	▪ The divergence between RMB denominated and dollar denominated export data was mainly the result of RMB's depreciation against the dollar in the first half of July. ▪ The decline of export in dollar term is also in line with the fall of new export orders from official PMI. The outlook of external demand remains murky following the unexpected Brexit event although global equity market rallied in July on easing expectation. We expect export to remain weak in the coming months. ▪ The sharp decline of import is mainly the result of falling prices in our view. Although iron ore prices outperformed in July, oil prices fell significantly in July. The imports of crude oil fell by 23.7% yoy in value but rose slightly by 1.2% in volume term. ▪ The impact of still weak trade data on RMB is mixed. The decline of export growth may continue create depreciation pressure for RMB, however, that might be mitigated by still sizable trade surplus.
▪ China's CPI growth moderated to 1.8% yoy in July, down from 1.9% in June. On sequential basis, CPI rose by 0.2%. ▪ PPI fell by 1.7% yoy in July, contracting for 53rd consecutive months. However, the contraction has been narrowing recently.	▪ The moderation is mainly due to easing food prices, which fell by 0.2% mom. Vegetable prices rose by 3.8% mom due to extreme weather, but mitigated by falling pork prices. Non-food prices rose by 0.3% mom, stronger than expected. This could be partially attributable to rising housing rental prices. ▪ Looking forward, CPI is likely to fall further before rebounding

	to 2% in the fourth quarter due to base effect. Food prices will remain the key swing factors for our CPI forecast. The impact of flood in China may start to impact pork and vegetable prices in the coming months. As such, we need to closely monitor the development of food prices. ▪ PPI rebounded by 0.2% mom after falling by 0.2% mom in June, in line with the recovery of input price component of PMI, driven by the rally of metal prices in July. Finally, we see the hope for China's PPI growth to return to positive territory after contracting for more than 50 months.
▪ All three key growth indicators in July surprised the market on the downside. ▪ Fixed asset investment growth decelerated further to 8.1% yoy in the first seven months from 8.9% in the first half. ▪ Industrial production grew by 6% yoy in July, down from 6.2% yoy in June. ▪ Retail sales grew by 10.2%, below market expectation of 10.5%.	▪ Although the weaker than expected growth indicators in July were partially attributable to one-off factor such as flooding, the data generally were disappointment to us. ▪ Private investment continued to decelerate to 2.1% yoy in the first seven months from 2.8% yoy in the first half despite Chinese government has vowed to support private sectors. This shows that the adjustment of over capacity is not done yet despite improvement of PPI deflation.
▪ China's broad money supply M2 growth collapsed to 10.2% yoy in July from 11.8% yoy in June. ▪ New Yuan loan increased by CNY463.6 billion in July, below market expectation of 800 billion. ▪ Aggregate social financing increased by CNY487.9 billion, missing market expectation of CNY1 trillion.	▪ The collapse of M2 growth in July was partially due to base effect as the M2 in July 2015 was distorted by China's state rescue of equity market amid turmoil. Meanwhile, the weaker than expected loan growth also weighed down on M2 growth. As a result of distorted base effect last summer, the M2 growth is expected to remain weak in the coming months, which is falling short of 13% target. ▪ The new Yuan loan was a disappointment to market. Looking at the breakdown, loan to enterprise unexpected fell by CNY2.6 billion in July. This was mainly the result of CNY201 billion decline of short term loan, which may be driven by weaker private investment as well as debt swap for lower interest rate. The only bright spot is medium to long term loan to household, which grew by CNY477.3 billion driven by housing loan. This also raised concerns about the asset bubble. ▪ Aggregate social financing also surprised the market on the downside due to shrinking off balance sheet lending. Undiscounted bankers' acceptance fell by CNY512.2billion in July, responsible for the sharp decline of aggregate social financing. ▪ Clearly, weaker than expected financial data, together with economic indicators, fuelled expectation on further monetary easing. However, PBoC may find itself stuck in the dilemma that further monetary easing may fuel already-hot asset bubble in property market. As such, we think China may continue to take wait-and-see approach. We expect no interest rate cut for the rest of the year despite the chance of reserve requirement ratio cut cannot be ruled out.
▪ Hong Kong economy regained some traction in 2Q 2016, up significantly from the 0.8% yoy to 1.7% yoy.	▪ Pick-up in exports of goods mainly led the improvement. Outlook of HK's economy was still subpar amid weak tourism sector and global headwinds. Investment remained in negative territory while domestic consumption was still weak. ▪ Analyzed by major GDP component, private consumption expenditure increased at a slower pace of 0.6% yoy, compared with the 1.2% yoy growth in 1Q 2016. The growth is expected to remain sluggish this year given mired consumer sentiment on job insecurity in the retail and tourism sectors as well as

	concern about domestic economic outlook. Expenditure on machinery, equipment and intellectual property products dropped significantly by 11.3% yoy, signaling business environment deteriorated amid the bleak global economic outlook and enterprises became more cautious. But the good news was that expenditure on building and construction in the private sector ticked up further by 7.4% given accelerating pace of construction activities in private property market. In addition, growth in exports of goods reverted to 2% after remaining negative for four consecutive quarters. Exports to the EU rebounded, partly offsetting the continued declines in exports to the US and Japan. But as the data didn't count in the effect following Brexit, we believe the trade figure still needed to be closely watched. Among exports of services, decline in export of travel services narrowed amid a milder drop. But performance of tourism sector in 1H was still disappointing as compared to last year given a 7.4% yoy drop in visitor arrivals. Looking ahead, we expect weak tourism activities and depressed local sentiment continue to hit the economy. 2016 GDP growth is expected be around 1.1% yoy.
▪ Macau: Housing transaction volume rose for the fourth straight month in June by 44.8% yoy to 869 units, mainly driven by higher demand for small- to medium-size units.	▪ New residential mortgage loans (RML) approved grew for the second straight month in June by 19.7% yoy to MOP4.71 billion. This points to easing expectations on higher lending rates and upbeat sentiment due to signs of recovery in both tourism and gaming sectors. Looking ahead, two new hotel openings in 2H will be a boost to the labor market. Moreover, the borrowing costs are likely to remain low for longer than initially expected amid Fed's slower rate hike pace, thereby continuing to bolster housing demand. As average housing price was down by 40.4% in June from the peak of April 2014, potential homebuyers who believe that the housing price has bottomed out are expected to enter the market in the coming months. Therefore, average housing price may stabilize throughout 2H. However, given the prospects of slower wage growth, higher lending rates and increasing supply, we expect that the housing market to be just seeing a transitory pickup rather than a sustainable rebound in the near term.

RMB	
Facts	**OCBC Opinions**
▪ RMB strengthened against the dollar in celebration of one-year anniversary of its fixing mechanism reform. ▪ However, RMB weakened against its currency basket with RMB index fell to 94.49 last Friday from 94.72 one week ago.	▪ RMB fixing was fairly choppy last week. Fixing fell to 6.6255 on Thursday from Wednesday's 6.6530, but rebounded to 6.6543 on Friday. The choppy movement of index fully reflected the volatile broad dollar movement. The weakness of broad dollar will give RMB more room to perform its two-way movement.

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