Highlights:

PBoC unveiled the details about targeted reserve requirement ratio cut on 30 Sep, three days after the State Council mentioned that in its regular meeting on 27 Sep. It is the first time for PBoC to announce forward RRR cut. The targeted RRR cut will only be rolled out in 2018. In addition, by redefining inclusive finance, it will standardize the qualification criteria to make targeted RRR cut more transparent and more targeted to support China's reform agenda. Meanwhile, it will also overwrite previous targeted measures. Given majority of banks are qualified for the targeted RRR cut, this targeted RRR cut is as good as universal RRR cut, which may inject about CNY600-700 billion. However, as the new targeted RRR cut is expected to overwrite all previous targeted RRR cut, the actual net injection is likely to be smaller. As such, we think the net injection in 2018 could be around CNY300-400 billion.

The targeted RRR cut is kind of structural easing for smaller financial institutions, which previously have to reply on interbank market for funds due to their inaccessible to PBoC under current PBoC's liquidity operation framework. However, we consider this targeted RRR cut is more about reform than easing. We think this targeted RRR cut will serve as carrot for banks to increase their support to inclusive finance to support China's reform agenda.

China's official PMI unexpectedly expanded further to 52.4 in September, up from 51.7 in August. However, this is in contrast to the private Caixin PMI, which fell by 0.6 to 51 in Sep. The divergent trend between official PMI and Caixin PMI is probably the result of different sample size. As China has stepped up its tightening in environmental; protection, we think the improvement of output index may not be translated to stronger industrial production. On currency, China has used the counter cyclical factor last week to slow down the pace of RMB depreciation. The fact that RMB fixing has been set at a stronger than expected level last week showed that China is uncomfortable with current pace of depreciation. We think a two-way movement within the range of 6.40-6.70 is still preferred ahead of 19th Party Congress.

In Hong Kong, a narrowed gap between HIBOR and LIBOR on tighter liquidity has led to a slight rebound in the HKD. However, we expect the interest rate differential to widen and the HKD to drop again as liquidity condition will likely improve after the golden week holiday. However, downward risks on the HKD might have been alleviated as recent retreat in the RMB discouraged investors from buying CNH and selling HKD. Therefore, the rebound in CNH deposits may moderate in the coming months. On the other hand, approved new mortgage loans fell for the second straight month as housing price index growth softened further to 17.95% yoy in August. In addition, loans for use outside of HK expanded at a slower pace due to a less tight liquidity condition and the eased capital outflow pressure in the Mainland, as well as the curbed overseas M&A activities and land purchases by Mainland companies. Therefore, we expect total loan growth to soften slightly. In Macau, as hotels have been nearly fully booked during the golden week even with much higher room rates, gaming revenue growth may strengthen remarkably in October.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC unveiled the details about targeted reserve requirement ratio cut on 30 Sep, three days after the State Council mentioned that in its regular meeting on 27 Sep. ▪ Since 2014, PBoC has used targeted RRR cut to incentivise financial intuitions to support funding needs of small and micro companies as well as agriculture sectors. ▪ Qualification criteria for targeted RRR cut has been expanded this time to include broader definition of inclusive finance, which include the funding supports for mass innovation and entrepreneurship etc. ▪ In addition, there will be two-tier assessment for targeted RRR cut. Financial institutions, which total outstanding or flows of inclusive finance as percentage of total loan for the past one year exceeds 1.5%, will be qualified for tier one 50bps RRR cut. Should those ratios go up to 10% and	▪ Different from previous targeted RRR cut in the past few years, we see three unique features this time, which may bring PBoC's monetary policy tool to a new height to balance growth and structural reform. ▪ First, it is the first time for PBoC to announce forward RRR cut. The targeted RRR cut will only be rolled out in 2018, three months from the announcement. We see two possible rationales behind that. First, the three-month period window may give some financial institutions, which are not qualified for the targeted RRR, time to realign their lending policies with China's direction to support inclusive finance. Second, it also may give PBoC some time to withdraw previous liquidity support via open market operation and medium term lending facility to maintain its prudent monetary policy tone. ▪ Second, by redefining inclusive finance, it will standardize the qualification criteria to make targeted RRR cut more transparent and more targeted to support China's reform agenda. ▪ Third, the new targeted RRR rule will overwrite previous

above, additional tier two 100bps cut will apply.	targeted measures. For those big financial institutions, which have already benefitted from previous targeted RRR cut, may not receive additional benefit from this round of targeted RRR cut unless they increase their lending support to inclusive finance to more than 10% of their total lending to be qualified for the tier two RRR cut. ▪ **How much liquidity will this targeted RRR cut inject?** According to PBoC estimation, almost all big banks, 90% city commercial banks and 95% rural commercial banks are qualified for tier one targeted RRR cut. As such, this targeted RRR cut is as good as universal RRR cut, which may inject about CNY600-700 billion. However, as the new targeted RRR cut is expected to overwrite all previous targeted RRR cut, the actual net injection is likely to be smaller. As such, we think the net injection in 2018 could be around CNY400 billion. ▪ There are two possible implications of this targeted RRR cut. First, we think it will lead to structural easing for smaller financial institutions. As most of financial institutions are unable to get the liquidity directly from PBoC's active liquidity management. A RRR cut, however, will directly inject liquidity to those smaller intuitions. Second, we don't consider this as change of monetary policy. Instead, we think this targeted RRR cut will serve as carrot for banks to increase their support to inclusive finance to support China's reform agenda.
▪ 1-month HIBOR refreshed its highest level since February and marked 0.558% on Sep 28. The tighter liquidity was probably due to HKMA's bill sales on Sep 26, recent ZhongAn IPO, the quarter-end effect and the rising expectations on Fed's third rate hike this year. As a result, the gap between 1-month LIBOR and 1-month HIBOR narrowed from 0.8187 percentage points on Sep 15 to 0.6762 percentage points on Sep 28, the lowest level since May. A narrower yield differential supported rally in the HKD.	▪ However, rally in HIBOR may be unsustainable due to several reasons. First, the quarter-end effect and the impact of ZhongAn IPO will dissipate soon. Second, though the Fed is set to reduce its balance sheet next month, the scale of reduction at the beginning is too small to shake the global markets or lead to any spike in the HIBOR. Third, equity flows to HK have remained resilient (net flows from China to HK under two stock connects totalled over RMB13 billion in September). Therefore, the interest rate gap may widen again after China's golden week holiday and curb the rebound in HKD. ▪ Nevertheless, downward risks on the HKD might have been eased as compared to the previous months. On the one hand, market frets that the HKMA may issue more exchange fund bills to guide the local rates higher and the Fed's gradual rate hikes ahead may pose upward pressure to the HIBOR. As such, investors have become more cautious about shorting the HKD. On the other hand, retreat in the RMB might have discouraged investors from buying CNH and selling HKD. In conclusion, we expect USDHKD spot rate to show two-way volatility between 7.80-7.82.

Key Economic News

Facts	OCBC Opinions
▪ China's official PMI unexpectedly expanded further to 52.4 in September, up from 51.7 in August. However, this is in contrast to the private Caixin PMI, which fell by 0.6 to 51 in Sep.	▪ The divergent trend between official PMI and Caixin PMI is probably the result of different sample size. ▪ For breakdown, demand remains strong for official PMI. Both new order and new export order increased to 54.8 and 51.3 respectively from 53.1 and 50.4. In addition, output also improved further to 54.7 from 54.1. However, as a result of recent tightening in environmental policy, the rise of output index may not be translated to higher industrial production data.

	▪ On price, input price index expanded further to 68.4 from 65.3. This implied that September PPI is likely to remain elevated at around 6%.
▪ Hong Kong's total loans and advances continued to show substantial growth (+15.7% yoy) in August amid low funding costs and improved business sentiment on global recovery. Trade finance grew by 4.7% yoy, underpinned by resilient trade activities. Other loans for use in HK increased by 16.2% yoy. However, any correction in the overheated asset market may tame the loan demand for financial concerns, given global uncertainties, geopolitical tensions and Fed's monetary policy normalization. Besides, approved new mortgage loans dropped for the second straight month by 10.7% mom amid moderation in housing market growth (housing price index growth softened to 17.95% yoy in August).	▪ On the other hand, we note that growth in loans for use outside of HK (+17.1% yoy) decelerated with a lower onshore average government bond yield. A less tight liquidity condition in the Mainland may reduce some funding needs of Chinese companies in the offshore market. Also, given the eased capital outflow pressure, Chinese authorities that struggled to increase capital inflows by encouraging Mainland companies to shift their financing demand overseas may become less likely to do so. Furthermore, overseas M&A activities and land purchases by Mainland companies have been curbed lately, which in turn shrank the corresponding loan demand in offshore market. All in all, we expect total loan growth to soften slightly in the coming months.
▪ Decline in CNH deposits (RMB 532.75 billion) moderated further to 18.4% yoy to in August in Hong Kong thanks to the improved RMB outlook.	▪ However, with the USD rebounding on a broad basis lately and the PBOC signaling its low tolerance of RMB's rapid appreciation, recent retreat in the RMB may slow down the rebound in CNH deposits. Still, we believe that RMB is likely to exhibit two-way volatility rather than one-way slide in the near term. Therefore, we see little risks of offshore yuan liquidity pool tumbling to the level seen early this year.
▪ Hong Kong's trade activities remained resilient in August. Specifically, exports grew by 7.4% yoy after rising 7.3% yoy in the previous month. Exports to the mainland jumped by 10.8% yoy while those to other Asian countries including Japan (+11.4% yoy), India (+5.1% yoy), Taiwan (+23.6% yoy) and Vietnam (+5.7% yoy) all increased notably.	▪ The rosy data points out that the strong demand from Asian countries (especially for electrical machinery, apparatus and appliances, and electrical parts +11% yoy) has contributed to HK exports' robust performance. In contrast, overseas shipments to the US fell for the second consecutive month by 5.5% yoy. This reinforces our concern about the sustainability of US' economic growth and the trade friction between China and the US as both factors could hit HK's exports. On the other hand, imports growth accelerated to 7.7% yoy amid higher commodity prices and a weaker HKD. Therefore, trade deficit widened to HK$35.5 billion. Moving forward, various negative factors may still pose downward pressure to HK's trade activities in the longer term but could be offset by the supporting factors including vigorous external demand associated with Christmas Holiday in the near term.
▪ Macau's jobless rate was unchanged at 2% during the three months through August. A combination of tight labour supply and strong labour demand from the services industry has helped to sustain the resilience in the jobs market.	▪ Still, all the major sectors continued to show volatility in their employment. On the one hand, employment in the construction sector (-3.1% mom) is expected to remain subdued amid the successive completion of mega entertainment projects. On the other hand, the opening of new project in the coming months may prompt the gaming sector (+1.2% mom), retail sector (-3.2% mom) and hotel & restaurants sector (-1.2% mom) to increase headcount. Moving forward, as there will be a new wave of mage entertainment projects scheduled to open in the coming years, we expect the labour market to remain tight and the unemployment rate to oscillate around 2%. A stable labour market and the sustained economic advancement may encourage employers to raise wages and in turn buoy private consumption.
▪ Macau's hotel guests increased merely by 1.1% yoy	▪ As it takes time for the hotels to recover two typhoons, we do

while the hotel occupancy rated also dropped by 4.6 percentage points on a yearly basis to 86.4% in August.	not expect a significant rebound in hotel sector until October which starts with Chinese Golden Week Holiday. As media reported that hotels have been nearly fully booked during the golden week even with much higher room rates, we expect gaming revenue growth to strengthen in October.

RMB	
Facts	**OCBC Opinions**
▪ RMB extended its weakness against the dollar due to recovery of broad dollar in the global market. However, RMB index stabilized last week after China set RMB fixing stronger than expected for five consecutive days.	▪ China has used the counter cyclical factor last week to slow down the pace of RMB depreciation. The fact that RMB fixing has been set at a stronger than expected level last week showed that China is uncomfortable with current pace of depreciation just as it was uncomfortable with pace of appreciation in mid-Sep. We think a two-way movement within the range of 6.40-6.70 is still preferred ahead of 19th Party Congress.

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