Highlights:

What is the most efficient way for China to lower its growth deliberately? Guess what, it is probably the environmental policy. Well, this is just one of the jokes circulating in China now. Nevertheless, the latest round of tougher environmental inspection from 7 August has been one of the important triggers for speculators to drive the commodity prices higher further in China. It seems market tends to believe that environmental protection-led supply side reform will continue to reduce commodity outputs even though the demand outlook remains murky. For bond traders, they have to look at what is happening in the commodity space now as the bond bull has been locked by commodity bull.

Other than commodity story, I am particular interested in the development of mixed ownership reform by the telecom giant China Unicom. China Unicom took down the announcement of selling stocks to private investors last week without explanation one day after they announced the plan, which raised concerns about China's SOE reform. Although the SOE reform has been identified as one of the most important structural reforms to unlock China's growth potential by the current Xi administration, little progress has been made since Sep 2015 after China unveiled detailed document to deepen SOE reform. Consolidating SOEs has been long- preferred methods of reform as it will avoid sensitive political questions of selling state assets. But it did not solve the problem such as efficiency and weak oversight etc. On the positive note, CSRC gave the green light this morning and this marked an important milestone for China to kick off its mixed ownership reform.

In Hong Kong, the economic calendar was light for the past week while the market kept an eye on the volatile move of the HKD, which wiped out most of its gains fueled by the HKMA's bill sale plan. As long as the Fed refrains from a third rate hike this year, capital outflow risk is unlikely to escalate in HK. Adding on a still ample interbank liquidity, interest rate differential between the HKD and the USD is likely to remain wide and continue to fuel carry trade and suppress the HKD. On the other hand, improved RMB outlook and the relatively high yield of RMB-asset might have encouraged investors to short HKD and buy CNH. Furthermore, bond connect has boosted RMB demand in HK market while the two stock connects brought less capital to HK stock market in August. Therefore, we expect the HKD's weakness to persist, which may in turn prompt the HKMA to announce more bill sale plans. This will allow USD/HKD spot rate to find strong resistance at 7.83.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The recent commodity bull market in China was initially driven by expectation on China's supply side reform and was subsequently fuelled by a wield reason the campaign of Make China Greener led by Ministry of Environmental Protection, which led to speculation about the decline of commodity outputs, such as steel, aluminium and certain chemical products etc.	▪ With the appointment of new Minister for Environmental protection in May this year, the joke in the market is that the Ministry of Environmental Protection is probably the second most important division other than the Central Commission for Discipline Inspection in 2017. Indeed, thousands of people has been held responsible for negligence while hundreds have been arrested according to the local media after tougher inspection imposed by the Ministry. ▪ The latest round of inspection from 7 August has been one of the important triggers for speculators to drive the commodity prices higher further although outlook for demand factor remain unclear. ▪ It addition, market also believes that China is not particular worried about the negative impact of tighter environmental inspection on the growth as the strong growth in the first half has created significant room for China to cut the pollutant capacity without missing the growth target. ▪ For bond traders, they also started to feel the heat from the strong commodity market as it has created the pressure for bond yields to go higher even after China softened its tone on monetary policy and financial de-leverage. For commodity traders, they will have to focus back on demand story as the environment led supply cut may not be sustainable, while for bond traders, they may take cue from the commodity market.
▪ China's push towards SOE's mixed ownership reform last week raised uncertainty after the state owned telecom giant China Unicom took down the	▪ Although the SOE reform has been identified as one of the most important structural reforms to unlock China's growth potential by the current Xi administration, little progress has

announcement of selling stocks to private investors without explanation one day after they announced the plan. ▪ Initially, China Unicom plans to raise almost US$12 billion from private investors including three of China's biggest technology players BAT as well as its employees under China's mixed ownership reform. ▪ However, in early this morning, China's security regulator gave the green light and said in the statement that China Unicom's mixed ownership reform is important and the regulator will apply old rules rather than the latest amended one to the deal.	been made due to the concerns about economic and political stability even after China has officially unveiled the guideline for deepening the reform of State-Owned-Enterprises by the State Council 《关于深化国有企业改革的指导意见》 back in September 2015. ▪ China announced to merger The China High-Tech Group with The China National Machinery Industry Corp (Sinomach) in June 2017 as part of SOE reform. Consolidating SOEs has been long- preferred methods of reform as it will avoid sensitive political questions of selling state assets. Meanwhile, it is also in line with China's strategy to create global competitive conglomerate to support China's Belt and Road Initiative. However, the creation of mega SOEs via mergers did not solve the problem such as efficiency and weak oversight etc. ▪ As such, market has paid more attention to privatisation and marketisation of SOEs, in China's context mixed ownership reform. Therefore, China Unicom's attempts for mixed ownership reform marks an important step for China to deepen its SOE reform, in particular after China Central Economic Work Conference considered the mixed ownership reform as the breakthrough to China's SOE reform in December 2016. ▪ The back and foth of the deal shows that there might be communication gap among different regulators, which shows the hurdle is high for SOE reform. Nevertheless, we think China will eventually carry on with its mixed ownership reform as this is one of the important ways for SOEs to lower their corporate leverage.
▪ The HKD wiped out most of its gains fueled by the HKMA's bill sale plan announced on August 9. We will closely monitor the impact of the Exchange Fund Bill (EFB) expansion starting from this Tuesday.	▪ As long as the Fed refrains from a third rate hike this year and takes a cautious step to unwind its balance sheet, capital outflow risk is unlikely to escalate in HK. Adding on a still ample interbank liquidity, HIBOR may not climb rapidly. Therefore, interest rate differential between the HKD and the USD is likely to remain wide and continue to fuel carry trade and suppress the HKD. ▪ On the other hand, improved RMB outlook and the high yield of RMB-asset might have encouraged investors to short HKD and buy CNH. Furthermore, bond connect has boosted RMB demand in HK market while the two stock connects brought less capital to HK stock market in August. ▪ Therefore, we expect the weakness in the HKD to persist, which may in turn prompt the HKMA to announce more bill sale plans. In fact, the HKMA announced four EFBs sale plans per year over the past two years while issued a total of HK$75 billion and HK$132 billion of additional EFBs in 2015 and 2016 respectively. Based on this, we believe that the HKMA still has rooms to sell EFBs after the issuance of HK$40 billion of additional EFBs. This will allow USD/HKD spot rate to find strong resistance at 7.83.

Key Economic News	
Facts	**OCBC Opinions**

▪ Both foreign exchange purchase data by PBoC and foreign exchange settlement and sale by banks on behalf of clients by SAFE in July showed the declining capital outflows.	▪ The deficit of foreign exchange settlement and sale by banks on behalf of clients narrowed to US$6.3 billion in July, lowest since August 2016. This is in line with the recent picture of improving currency outlook. In the forward market, the demand for long dollar forward position also fell slightly. Given RMB started to outperform in August with some corporates unwound their previous long dollar position, the chance for foreign exchange settlement and sales to return to positive cannot be ruled out in August.
▪ HK's housing completions dropped for the second consecutive month by 11.4% yoy to 2,341 units in June and grew at a slower pace by 20.4% yoy to 8,929 units over the first half of this year. Meanwhile, housing starts rebounded by 106% yoy to 2,105 units in June and increased by 15.8% yoy to 12,581 units in 1H.	▪ Property developers have slowed down their constructions of new residential property projects as housing market showed signs of corrections amid cooling measures. However, as housing completions were robust in the first half of this year, new home supply may reach around 18,000 units in 2017. On the other hand, based on the data print of housing starts, we believe that yearly new home supply will increase to over 20,000 units in the coming years. Therefore, we expect the prospect for increasing supply is likely to hit housing demand. Adding on new cooling measures and fear of higher rates, corrections in the housing market is likely to continue throughout the second half of this year. Retreat in Centaline's secondary home prices and decline in the number of residential property transaction deals which involved Double Stamp Duty (-31.7% mom) and Buyer Stamp Duty (-17.7% mom) also reinforces our view. Nevertheless, as most of the new home supply consists of small to medium-size units which are highly demanded, we expect the increasing supply is unlikely to dampen the housing market in the longer term.
▪ HK's seasonally adjusted jobless rate (3.1%) was unchanged over the three months through July at its lowest level in more than three years. A tight labor market may continue to bode well for private consumption and medium-term housing demand.	▪ Specifically, the trade sector's unemployment rate decreased to 2.9%, its lowest level since January 2017, and may decrease further in coming months given resilient trade activities on global recovery. In addition, the jobless rate of the consumption- and tourism-related sector reduced to a two-year low at 4.6% and may edge down further due to strong domestic demand and the revival of tourism activities. Furthermore, financial sector's unemployment rate decreased to 2.2%, a low level last seen in February 2017. Given a bullish stock market and increasing job opportunities associated with cross-border connect schemes between the mainland and Hong Kong, we expect the sector's hiring sentiment to remain upbeat. In contrast, slowdown in the constructions of new home projects may result in lower labor demand in the construction sector and hold its jobless rate around its current level (4.9%, the highest since May 2016) in coming months.
▪ Macau: Total spending and per-capita spending of inbound visitors increased at a faster pace by 17.5% yoy and 11.7% yoy respectively in 2Q 2017. This is mainly led by a 22.1% yoy growth in total spending of Mainland visitors which accounts for 78.9% of total visitor spending.	▪ Against the backdrop of resilient economic growth in China, Mainland visitors showed increased willingness to spend overseas. This signals that retail sales might have exhibited buoyant growth in 2Q 2017. However, an expected slowdown in China's growth in the second half of this year may undermine the spending of Mainland visitors. Furthermore, per-capita spending of visitors from Taiwan, Japan and Hong Kong fell by 6.9% yoy, 10.9% yoy and 8.3% yoy respectively. The spending of tourist from these three main sources may remain muted as they could be reluctant to spend amid high costs of accommodation and transportation. Therefore, retail sector is likely to lose momentum in 2H 2017.

RMB	
Facts	**OCBC Opinions**
▪ RMB failed to extend its gain against both dollar and currency basket after setting the RMB fixing weaker amid rebound of dollar.	▪ Our concern about RMB's overshoot risk did not materialize last week. Nevertheless, we still think this is the risk we cannot rule out given amount of dollar has been hoarded by corporate and individual in the onshore market.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W