Highlights:

"Opening" is probably the key word for China last week. Both China's bond and equity markets are ready to welcome more foreign investors. China's central bank unveiled detailed guideline for northbound bond investment under China Hong Kong bond connect programme in supportive of Governor Zhou Xiaochuan's comments about opening in the recent Lujiazui Forum. Foreign investors are able to access to both primary and secondary bond market in China's interbank bond market via bond connect. The design of bond connect is clearly positive for Hong Kong as foreign investors will have to go through RMB clearing bank or participating bank in Hong Kong to access to onshore bond market. This will help boost demand for CNH and as a result reinforce Hong Kong's position as the largest offshore RMB market. In order to attract more foreign investors, a better shaped yield curve is necessary. China's MoF started its bond market making operation to improve liquidity for certain tenor to correct the recent inverted yield curve.

On equity, the MSCI announced to include China's A-share into its benchmark index effective from June 2018. The decision was formed on the back of improving accessible standard thanks to expansion of stock connect program in China as well as easing restriction about the creation of index-linked investment vehicle. The news is likely to be the catalyst for more capital inflows into China's equity market. In fact, we started to see relocation of equity flows from Hong Kong to mainland. The net northbound flows under both Shanghai Hong Kong connect and Shenzhen Hong Kong connect reached the record weekly high of CNY1.5 billion last week. Nevertheless, given the limited size, we think the performance of China's equity market will still be dominated by China's domestic investors.

Despite positive development from MSCI, the volatility returned to China's equity market following the panic sale of a few Chinese conglomerates' bonds and equities. The market sentiment remains fragile about potential political risk leading to the leadership reshuffle in 19th Party Congress.

On currency, after one month's observation, it seems that the introduction of counter cyclical factor helped slow the depreciation of RMB fixing when dollar strengthened. However, one of the unintended consequence of this counter cyclical factor is that the gap between fixing and closing widened again, which increased the basis risk for RMB again. The persistent gap may not bode well for sentiment.

In Hong Kong, the road for Hong Kong dollar to re-peg to RMB is still long after Norman Chan specified four "essential conditions" which the HKMA will take into consideration before deciding to change the currency regime to a peg with the RMB.

<table>
<tr><th colspan="2">Key Events and Market Talk</th></tr>
<tr><th>Facts</th><th>OCBC Opinions</th></tr>
<tr><td>▪ PBoC unveiled detailed guideline for northbound bond investment under China Hong Kong bond connect programme.
▪ The guideline on southbound investment is still not clear yet.</td><td>▪ Foreign investors are allowed to invest in all the bonds in China's interbank bond market. In addition to the secondary market, investors are also able to access to primary issuance in China's interbank bond market.
▪ Foreign investors are allowed to use both RMB and foreign currency for northbound investment. However, all foreign exchange transaction will be settled in Hong Kong with either RMB clearing bank or participation bank. In addition, foreign investors are also able to access to offshore derivative market to hedge their currency risk. Previously, offshore investors have been allowed to tap the onshore derivative market for currency hedging. The availability of hedging tools may give investors more confidence in participating in China's bond market.
▪ This will boost demand for CNH, which will help deepen the offshore currency market.
▪ The bond connect is clearly positive for Hong Kong, which will reinforce Hong Kong's position as the largest offshore RMB market. Meanwhile, it also gives both PBoC and HKMA opportunity to work more closely to enhance the cross border regulatory collaboration.</td></tr>
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▪ The MSCI announced to include China's A-share into its benchmark index effective from June 2018. The decision was formed on the back of improving accessible standard thanks to expansion of stock connect program in China as well as easing restriction about the creation of index-linked investment vehicle.	▪ The trading suspension activity and restriction on hedging tools are key hurdles for China's A-share to attract more foreign investors. As mentioned by China's security regulator CSRC deputy chief Fang Xinhai, the inclusion may help discourage Chinese companies from trading suspension to suit themselves. ▪ We think the near term impact is limited
▪ The net northbound flows from Hong Kong to mainland under both Shanghai Hong Kong connect and Shenzhen Hong Kong connect reached the record weekly high of CNY1.5 billion last week.	▪ The recent relocation from Hong Kong back to mainland may be due to expectation on MSCI inclusion as well as improving currency outlook. We expect northbound to record the first positive inflow in June since China launched both stock connect programs. ▪ However, from Hong Kong's perspective, the low weight of China A-shares in the MSCI emerging markets index means that the impact on HK's stock market is limited in the short term. Besides, Hang Seng China AH premium index remains relatively high at 124, which means that H-shares could still be attractive.
▪ The volatility returned to China's equity market despite positive news from inclusion of A-share into MSCI benchmark index after Chinese conglomerate Wanda and Fosun's equities and bonds were sold off last week.	▪ The recent saga started from the sudden drop of bond prices of Wanda commercial property, which were listed in China's exchange on rumors that some big Chinese banks staretd to dump the bond for no obvious reasons. It was later spread to Wanda related equity as well as other names such as Fosun as news reported that China's banking regulator have ordered big banks to check their risk exposure to five big conglomerates which are actively involved in overseas acquisition. ▪ Market sentiment later stabilized and both affected bonds and equities recovered partially. Nevertheless, the recent saga served as another stress test showing that market sentiment remains fragile about potential political risk leading to the leadership reshuffle in 19th Party Congress.
▪ China's Ministry of Finance launched its first market making operation on 20 June. The MoF purchased CNY1.2 billion at the auctioned yield of 3.49% for 1-year government bond, lower than the prevailing yield in the secondary market. As a result, bond rallied in the secondary market.	▪ The purpose of market making operation by MoF is to improve liquidity for certain tenor, which help make yield curve more reflective of underlying fundamentals. The official launch of market making operation will help correct the recent inverted yield curve, although the size is unlikely to influence the market.
▪ China's Ministry of Finance issued RMB 2 billion five-year bond in HK. The bond yield is 4.1%, the highest level since 2009 when MOF started to issue Dim Sum Bond. Meanwhile, the MOF issued RMB 5 billion three-year bond in HK, which offers a record-high yield of 3.99%.	▪ The increase in bond yield offered in the primary market is mainly due to low liquidity and limited supply. Looking forward, funding needs associated with the One Belt One Road initiative is expected to increase while demand for the CNH may also grow following the launch of the bond connect. As a result, the development of HK's offshore yuan market is likely to deepen while the liquidity of Dim Sum Bond market may improve.
▪ China's insurance regulator has blocked 35 websites and social media accounts that have been selling Hong Kong insurance products to Mainland investors. Mainland institutions have been increasingly violating the laws by directly selling or acting as proxy for sales of Hong Kong insurance products to mainland investors.	▪ As the outlook of RMB has been improving, the major factor driving Mainlanders to invest in foreign assets is their increasing needs of assets diversification. However, these needs may not be easily met as Chinese authorities appear to have remained cautious about outflows under capital account. Adding on China's deleveraging campaign, we believe that capital flows from Mainland China to HK will decelerate and lend less support to the HKD.
▪ With USDHKD breaching 7.8, it reignited market concerns about the de-peg risks of the HKD against the greenback. However, the Chief Executive of the	▪ More notably, Norman Chan specified four "essential conditions" which the HKMA will take into consideration before deciding to change the currency regime to a peg with

HKMA, Norman Chan, reiterated that they will remain the linked exchange rate system unchanged.	the RMB. Firstly, the RMB should be fully convertible. Secondly, capital account should be totally opened up. Thirdly, there should be a financial market with sufficient depth and width that enables the Exchange Fund to hold assets to support HK's monetary base. Fourthly, the economic cycle of Mainland China and Hong Kong should be synchronized. Clearly, nearly all the four conditions are not met at this juncture. Therefore, HKD's pegging with RMB is unlikely in the medium term. On the other hand, as RMB is more stable than it was in 2016, the spill-over effect of concerns about RMB risks on the HKD has abated. Furthermore, short-end HIBOR is gradually catching up with the USD LIBOR. Therefore, we believe that the USDHKD will be able to find its resistance in the range of 7.8-7.83. Limited downward pressure on the HKD also means that the depeg-risk is unlikely to heighten in near term.

Key Economic News

Facts	OCBC Opinions
▪ China's housing price stabilized in May. 6 out of 15 major tier-2 cities and tier-1 cities reported the month-on-month decline of new residential prices while new residential price in another 3 cities remained unchanged.	▪ The softer price trend shows that recent property tightening measures started to take effect. In addition, property investment and sales growth also moderated in May. We think the support from property market to growth will be limited. As such, we expect growth to gradually slow down in the coming quarters.
▪ Over the first four months, total housing completions increased by 139% yoy to 5576 units, reaching a 13-year high. This also means that the government's target of increasing 17,100 units of new home supply will likely be achieved. During the first four months, total housing starts continued to grow by 8.9% yoy to 9814 units, its highest level since 2001. This indicates that housing supply is set to increase substantially in a longer term.	▪ With increasing new home supply, we believe that the housing frenzy is likely to cool down from 2H onwards. However, 72% of the new home supply over the next 4 years consists of small to medium size houses while the demand for smaller housing units is expected to remain resilient. Firstly, due to the low supply of public housing, lower income households may be propelled to rent or purchase small-size flats in the private housing market. Secondly, based on the strong demand for smaller flats in the leasing market, the wealthier residents will also continue to invest in small-size flats for rental income. Thirdly, with housing prices index continuing to refresh its record highs, larger flats become less affordable. This results in higher owner-occupier demand from middle income households for smaller flats. Taken together, we believe that the increasing supply and increasing borrowing costs will calm the housing frenzy but will not lead to any collapse in the housing market.
▪ HK's seasonally adjusted jobless rate was unchanged at 3.2% during the three months through May. This cements our view that the labour market remains tight and would likely support private consumption.	▪ Specifically, unemployment rate in the construction sector rose to its highest level since May 2016, printing 4.8%. The rate is expected to decrease as housing starts have been increasing while government has planned to increase spending on infrastructure projects. As for the trade and wholesales sector, the unemployment rate which stood at its highest level since July 2013 at 3.2% is expected to reduce as a better outlook of trade sector on global recovery could improve the sector's hiring sentiments. On the other hand, jobless rate in the retail, accommodation and food services sector increased slightly from 4.7% to 4.8%. As the recovery of the retail sector has been rather moderate, we expect this sector's jobless rate to oscillate around its current level. Finally, the financial sector's jobless rate (2.3%) is also likely to

	remain stable around its multi-year low as the launch of new home projects will boost labour demand in the real estate sector while the launch of bond connect may encourage financial companies to increase headcounts. All in all, we expect labour market to remain solid and lend some support to the housing market and the economic growth.
▪ Macau's visitor arrivals increased for the third consecutive month by 3.8% yoy in May, due to the effect of the Labor Day Holiday and Dragon Boat Festival.	▪ Though the number of visitors from Mainland China grew at a slower pace by 4.4% yoy and that from Hong Kong dropped by 1.3% yoy, the number of visitors from Taiwan, Japan and South Korea grew rapidly by 9.5% yoy, 20.2% yoy and 50.1% yoy respectively. Due to a slew of new hotel projects opened during the past two years, Macau appears to have successfully diversified its source of tourists from Hong Kong and Mainland China to other Asian countries. This is supportive to the mass-market segment of the gaming centres. However, there are barely any public holidays during June to September. Therefore, we would closely monitor whether the growth of tourists from countries other than Mainland China could sustain and help to reinforce the recovery of tourism activities.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened against the dollar last week. However, RMB remained relatively stable against its currency basket ending the week at 93.22. However,	▪ As we have mentioned previously, the introduction of counter cyclical factor helped slow the depreciation of RMB fixing when dollar strengthened based on our recent observation. However, one of the unintended consequence of this counter cyclical factor is that the gap between fixing and closing widened again, which increased the basis risk for RMB again. The persistent gap may not bode well for sentiment. ▪ Clearly, counter cycical factor is not a panacea to remove RMB depreciation pressure when dollar strengthens although it may partially alleviate some pressure.

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