Highlights

China's bond market rallied last week after the PBoC did not follow the Fed to hike its money market rate for the second time this year. In its 3Q monetary policy meeting, the PBoC reiterated to keep all the asset classes stable. The PBoC aims to strike the balance among interest rate, exchange rate and balance of payment. Although China is unlikely to go back to old path of excessive easing, it seems that PBoC will go back to old path of multiple-mandates. As such, the multi-mandates may continue to confuse market players which may result in the volatility in both interest rate and currency market.

Not surprisingly, RMB weakened against both dollar and its major trading partner after the decline of onshore rates. As China is unwilling to support currency at expense of interest rate stability, China may rely more on administrative measures to keep currency stable in the near term.

On the positive note, China's opening of its financial market paid off. Net portfolio investment jumped to US$61 billion in 2Q, highest in record with portfolio inflows into equity market rose to the record high of US$21.4 billion while portfolio inflows to bond market remained strong at US$43.9 billion. Meanwhile, the latest data from IMF shows that global FX reserve in RMB surged further by 32.6% qoq to US$193.38 billion in 2Q from US$145.88 billion in 1Q. Given the global index provider FTSE Russell will include China's A-share into its benchmark from June 2019; we should expect more passive inflows into China's onshore equity market. The latest announcement from the State Council to reduce import tariff also shows that China continues to commit its reform and opening.

In **Hong Kong,** following the Fed's rate hike, all commercial banks in Hong Kong announced that they will raise prime rate for the first time in 12 years by 12.5bps or 25bps. An increase of 12.5bps is less than expected but reasonable as it could be costly for larger banks to simultaneously raise prime and savings rates by as much as 25bps given their sizeable CASA. Besides, given the still ample liquidity (aggregate balance stabilizes at HK$76.4 billion), larger banks are not under pressure to raise prime rate by as much as 25bps. Still, it is necessary to lift the prime rate amid the higher funding costs. In Aug, HKD time deposits registered double-digit growth for the third straight month by 16.7% yoy to HK$2.59 trillion. As a result, the share of HKD fixed deposits in total HKD deposits rose to 38.6%, a level last seen in Jun 2014. This suggests that on top of higher HIBOR, banks' funding costs continued to increase with the rising fixed deposit rates. Moving forward, should HIBOR tick up further and prompt banks to scramble for fixed deposits again, it is possible for banks to further raise the prime rates. We hold onto our view that prime rate will be increased by 25bps this year. Nevertheless, in the near term, with all major banks announcing prime rate hike, market players may "buy the rumor, sell the fact" and in turn help ease HKD liquidity. HKD liquidity could also improve after quarter-end and the National Daily Holiday. All in all, we expect HIBORs will retrace some of their recent gains. For example, 1M HIBOR may retreat towards 2%. With any further improvement in HKD liquidity, USD/HKD spot may rally to 7.83 or above in the coming sessions.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In its 3Q monetary policy meeting, the PBoC reiterated to keep all the asset classes stable. RMB exchange rate was mentioned twice in the statement. The PBoC aims to strike the balance among interest rate, exchange rate and balance of payment.	▪ Stability will remain the key word for the rest of the year. The PBoC echoed the tone from politburo meeting in late July that it will use its policy tools to ensure stability in job market, financial market, trade, foreign investment, investment and expectation. Meanwhile, the central bank has not forgotten about the de-leverage. However, it will control the pace of structural de-leverage. ▪ Although China is unlikely to go back to old path of excessive easing, it seems that PBoC will go back to old path of multi-mandates. The ambitious target to keep the balance between low interest rate and stable currency against the backdrop of escalation of trade war and repricing of emerging market assets is a big challenge for PBoC. ▪ As such, the multi-mandates may continue to confuse market players which may result in the volatility in both interest rate and currency market.
▪ China's State Council announced to reduce the import tariff for 1585 products effective from 1 November. The average tariff rate will be lowered to 7.5% from 9.8% in 2017.	▪ By further cutting import taxes, China is sending a message that it will keep opening up and reform no matter how the trade war goes. It's more like a commitment to both domestic and international audience. It's a good gesture though it may not be

	able to change the course of US-China trade war.
▪ China published its white paper on US-China trade war.	▪ In its white paper, China vowed to continue to push its reform as the gesture to react to trade war. Meanwhile, China also reiterated that it will protect foreign business interests in China regardless of the development of trade war. This also alleviates the concern that China may retaliate via hurting the US business interest in China.
▪ The global index provider FTSE Russell announced that it will include China's A-shares into its global benchmark indices effective from Jun 2019.	▪ A-share is expected to comprise of 5.5% of the FTSE Emerging index upon completion of initial phase of inclusion next June. As such, we should expect more passive inflows into China's onshore equity market.
▪ China's bond market outperformed after the PBoC did not follow the Fed to hike its money market rate for the second time this year.	▪ It seems that China wants to achieve the best of two worlds to keep rates low while maintaining currency stable though it is an unsustainable balance in the medium term. In the near term, China may rely more on administrative measures to keep currency stable.
▪ Following the Fed's rate hike, the HKMA raised base rates by 25bps to 2.5% on 27th Sept. After that, all commercial banks in Hong Kong announced that they will raise prime rate for the first time in 12 years by 12.5bps or 25bps.	▪ An increase of 12.5bps is less than expected but reasonable as it could be costly for larger banks to simultaneously raise prime and savings rates by as much as 25bps given their sizeable CASA. Besides, given the still ample liquidity (aggregate balance remains unchanged since late Aug at HK$76.4 billion), larger banks are not so imminent to raise prime rate by as much as 25bps. Still, it is necessary to lift the prime rate amid the higher funding costs. Due to fierce competition, banks' funding pressure increased with higher fixed deposit rates. On top of that, smaller banks which mainly rely on interbank financing even suffered from higher HIBOR. 1M HIBOR and 3M HIBOR rose by 108.3bps and 96.7bps YTD to 2.274% and 2.273% respectively on 27th Sep. As such, it is also reasonable for some smaller banks to lift prime rate by a larger magnitude of 25bps. ▪ Moving forward, should HIBOR tick up further and prompt banks to scramble for fixed deposits again, it is possible for banks to further raise the prime rates. We hold onto our view that prime rate will be increased by 25bps this year. ▪ Nevertheless, in the near term, with all major banks announcing prime rate hike, market players may "buy the rumor, sell the fact" and in turn help ease HKD liquidity. HKD liquidity could also improve after quarter-end and the National Daily Holiday. All in all, we expect HIBORs will retrace some of their recent gains. For example, 1M HIBOR which fell 4bps to 2.23% on 28th Sep may retreat towards 2%. With any further improvement in HKD liquidity, USD/HKD spot may rally to 7.83 or above in the coming sessions.

Key Economic News

Facts	**OCBC Opinions**
▪ China's official manufacturing PMI fell by 0.5 to 50.8 in September, lowest since March.	▪ On demand, new order decelerated further to 52 from 52.2 in August while new export order fell further to 48.5, below threshold line for the third consecutive month as a result looming uncertainty due to trade war. ▪ Raw material input prices however rebounded to 59.8 from 58.7. This may slow down the deceleration of China's PPI. ▪ The deceleration of PMI in September shows that the impact of US-China trade war on manufacturing sector has taken effect.
▪ China's current account returned to a small surplus	▪ Net portfolio investment jumped to US$61 billion in 2Q, highest

<table>
<tr><td>of US$5.3 billion in 2Q after recording the first current account deficit of US$34.1 billion in 1Q.
▪ However, capital account surplus shrank to US$30 billion in 2Q from US$98.9 billion in 1Q.</td><td>in record with portfolio inflows into equity market rose to the record high of US$21.4 billion while portfolio inflows to bond market remained strong at US$43.9 billion. This shows the strong interest from foreign investors in China's onshore assets amid China's opening of domestic financial market.
▪ Foreign direct investment remained steady at US$52.7 billion while China's overseas direct investment increased to US$27.9 billion from US$17.9 billion but still way below the peak as a result of tightening supervision on capital outflows.
▪ On current account, China's service trade deficit rose further to a record high of US$73.7 billion from US$73.6 billion. The trend of widening service trade deficit is unlikely to be reversed, which will continue to cap China's current account surplus.</td></tr>
<tr><td>▪ The latest data from IMF shows that global FX reserve in RMB surged further by 32.6% qoq to US$193.38 billion in 2Q from US$145.88 billion in 1Q.</td><td>▪ Despite the stall in RMB internationalization, the demand for RMB assets as FX reserve continued to grow globally. The relative high yield and need for diversification may continue to bolster the demand for RMB assets amid China's opening of its domestic financial market to ease access for foreign investors.</td></tr>
<tr><td>▪ HK's total loans and advances grew at the slowest pace since Dec 2016 by 8.4% yoy to HK$9.7 trillion in Aug 2018.</td><td>▪ Zooming in, the growth of loans for use in Hong Kong (excluding trade finance), which takes up 65% of total loans and advances, also decelerated from 9.2% yoy in Jul to 8.6% yoy in Aug. This is mainly attributed to sluggish business sentiment amid trade war concerns, China's economic slowdown and prospects of higher borrowing costs. Besides, demand for mortgage loans may also soften as housing transactions and prices retreated and all major banks kick-started a new cycle of prime rate hike.
▪ On the other hand, loans for use outside of HK increased by 8.8% yoy, the weakest pace since Jan 2017. Given the PBOC's easing bias and the Fed's gradual rate hikes, offshore financing may become less attractive to Mainland companies. All in all, we expect the growth of total loans and advances will slow down to 3%-5% yoy by end of this year.</td></tr>
<tr><td>▪ HK's total HKD deposits dropped by 0.1% mom in Aug to HK$6.7 trillion.
▪ HKD loan-to-deposit ratio remained unchanged at 85.1%, slightly below the more than six-year high of 85.4% seen in Jun.</td><td>▪ More specifically, HKD savings deposits decreased for the second consecutive month by 2.8% yoy to HK$2.97 trillion. In contrast, HKD time deposits registered double-digit growth for the third straight month by 16.7% yoy to HK$2.59 trillion. As a result, the share of HKD CASA in total HKD deposits lowered further to 61.4% while that of HKD fixed deposits rose to 38.6%, both reaching the level last seen in Jun 2014. This suggests that banks' funding costs continued to increase due to higher HIBOR and rising fixed deposit rates. It also justifies banks' move to lift prime rate despite ample liquidity. Moving forward, we expect ample liquidity to bring the HIBOR lower. If this is the case, adding on the increased prime rate, the pressure on banks' net interest margin may be eased. The uptrend of fixed deposit rates may pause at this juncture.</td></tr>
<tr><td>▪ HK's RMB deposits saw double-digit growth for the fifth consecutive month and was up by 16% yoy to RMB618 billion, the highest since Nov 2016.</td><td>▪ The growth remains robust despite RMB's depreciation against the HKD. In fact, overseas investors also continued to increase the holding of onshore bonds. Taken all together, it indicates that investors have been more confident in RMB assets compared to few years ago as the PBOC well managed RMB expectations. Besides, the yield of RMB assets remains appealing at this juncture. Despite the PBOC's easing bias, the central bank may try to manage offshore liquidity and in turn help stabilize the RMB if necessary. Therefore, offshore RMB rates may hold up well amid strong expectations for tight offshore RMB liquidity. In a nutshell, we expect RMB deposits growth to</td></tr>
</table>

	remain relatively strong in the coming months. However, in the longer term, we are wary that the policy divergence between the PBOC and the Fed would gradually reduce the attractiveness of RMB assets.
▪ HK's growth of exports and imports accelerated from 10% yoy and 14% yoy in Jul to 13.1% yoy and 16.4% yoy in Aug respectively.	▪ Overseas shipments to the Mainland China, the US and India surged by 13.6% yoy, 17.9% yoy and 18.2% yoy respectively. Meanwhile, the imports from ten major trading partners all registered year-on year growth with those from the Mainland China rising 16% yoy. The buoyant trading activities could be attributed to China's front-loading of exports before new tariff took effect on another batch of goods traded between China and US from 23 Aug. With regard to the exports, the strong growth might be due to resilient external demand, the revival of China's domestic demand on supportive policies and China's reduction of some imports tax. The data prints suggest that the initial impact of trade war on HK's trade sector is limited. Moving forward, export growth may slow down should US-China trade war escalate and dent external demand. On a positive note, as China's major re-export port, HK may see its trade sector benefiting from China's supportive measures and the country's move to cut tariffs beginning 1st Nov.
▪ Macau's total visitor arrival increased for the seventh consecutive month by 18.7% yoy in Aug. The number of overnight visitors surged at the strongest pace since April 2017 by 16.3% yoy.	▪ The rosy performance was driven by the low base effect as Typhoon Hato smashed Macau in Aug 2017 with its tourism activities taking a hard hit. Therefore, the robust growth may not sustain into coming months. Notably, the average length of stay of visitors reduced to 1.2 days in August while the share of overnight visitors in total visitors dropped from 53.9% in Jul to 52.9% in Aug. By major tourist sources, the visitors from China and Hong Kong grew by 25.3% yoy and 5% yoy respectively whereas those from Japan and South Korea decreased by 2% yoy and 12.6% yoy respectively. Moving forward, a stronger MOP, China's economic slowdown and the prolonged trade war may dent Macau's tourism activities. On a positive note, the Mid-Autumn Festival, National Daily Holiday, as well as the completion of HK-Zhuhai-Macau Bridge may weather some downside risks on the tourism sector. All in all, we expect tourism activities will continue to expand albeit at a moderate pace in the coming months.
▪ Macau's unemployment rate stabilized at the lowest level since 2015 of 1.8% unchanged over the three months through August.	▪ Though overall jobless rate remained low, it may be due to fewer people looking for jobs in the past three months. Specifically, the labor force reduced from 392600 to 392100 while labor force participation rate sliding to 71%. Also, the employment situation was mixed across different sectors. As the World Cup ended in July, the return of gamblers helped to revive the hiring sentiment of gaming industry where employment grew by 1.2% mom. Nevertheless, as a strong MOP and trade war concerns clouded the outlook of the tourism-related sectors, the employment of hotels, restaurants and similar activities dropped by 1.6% mom. Meanwhile, the employment of retail sector retreated by 0.7% mom. Moving forward, China's economic slowdown, stronger MOP and trade war fears may continue to weigh down Macau's economic outlook and the major sectors' employment. Therefore, though the upcoming completion of the HK-Zhuhai-Macau Bridge may help to weather some downside risks for both tourism and gaming sectors' employment, we expect the unemployment rate to rise slightly towards 1.9% in the coming months.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened last week against both dollar and its major trading partners. RMB index slipped to 92.35 last Friday.	▪ The mild depreciation of RMB last week was mainly attributable to easing monetary stance after China did not follow the Fed to hike its money market rate. In the near term, China is likely to rely more on administrative measures to contain the depreciation pressure given RMB index approaching 92 again. Watching out for whether China will keep offshore interest rate higher to keep CNH in check after China comes back from the golden week next week.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W