Highlights

China's policy makers drew the lines in the sands in both growth and RMB spaces. The latest politburo meeting confirmed that China has shifted their focus to downside growth risk. As such, the key work going forwards will be safeguarding the bottom line of no systemic risk. Therefore, we expect more marginal easings in both monetary and fiscal front. However, the reiteration of de-leverage and commitment to limit the appreciation of property prices show that China is unlikely to go back to old path of excessive easing. China's equity market continued to fall as the message from the politburo meeting is less dovish than expectation.

On currency, RMB rebounded sharply on Friday night after PBoC announced to restart punitive 20% reserve for long dollar forward position, which was previously removed in September 2017. Although we think the reserve policy is unlikely to be a game changer, the still fresh memory about intervention back in 2015-16 reminds investors that there might be more to come. As such, we think the risk to chase the USDCNY higher has heightened. With the RMB index has tested the historic low of 92 this , we think the next possible intervention is the restart of counter cyclical factors to smooth the volatility of daily RMB fixing.

China raised its total stake to US$110 billion on Friday in retaliation for total US$250 billion lists unveiled by the US side. Although China's absolute retaliation is much smaller, from percentage perspective, China's lists have covered about 80% of Chinese imports from US, much higher than about 50% ratio proposed by the US. This is a surprise in our view as it shows that China does not fear further escalation of the trade war. Nevertheless, this could be bad for market sentiment. The escalation of trade war may cap the gain of RMB. Market should continue to monitor the development of US-China trade war.

In **Hong Kong,** USDHKD spot rate moved up to as high as 7.8498 on 3 Aug while one-month HIBOR fell from 1.8988% on 25 July to 1.47% on 3 Aug. After China Tower closed its IPO order book on 31 July, the money previously hoarded for the IPO returned to the market and led to retracement in both HKD and HIBOR. In the near term, we expect HIBOR will subside further with one-month HIBOR and three-month HIBOR to fall towards 1.3% and 1.75% respectively. Meanwhile, USDHKD spot rate may test 7.85 again in the near term. If this is the case, any intervention by the HKMA could push the aggregate balance from HK$109.4 billion to below HK$100 billion in the coming months. Notably, HKD loan-to-deposit ratio rose to the highest since Nov 2011 at 85.4% in June. Commercial banks may keep HKD deposit rates high in order to scramble for deposits. Given a combination of reducing aggregate balance and high HKD deposit rates, it is possible for the commercial banks to kick off the prime rate hike cycle following the Fed's possible rate hike in September. Elsewhere, HK's total loans grew at the slowest pace since February 2017 by 10.5% yoy in June. The slowdown could be attributed to three major factors including US-China trade tensions, higher interest rates as well as the reduced funding demand of Mainland companies in the offshore market. Adding on high base effect, we expect total loans growth to decelerate in the second half of 2018 and reach around 5% by end of this year. Finally, HK's retail sales growth (+12% yoy in June) will likely moderate in 2H18 amid bearish stock market, uncertain outlook for Asia's growth, a stronger HKD and a fading low base effect.

Key Events and Market Talk

Facts	OCBC Opinions
▪ China's Commerce Ministry unveiled the second list of US$60 billion US import subject to additional tariff ranging from 5%-25% in reaction to the news that US is considering raising the tariff rate for US$200 billion Chinese imports to 25% from previous proposed 10%. ▪ The new tariff will only take effect should Trump Administration go ahead with the plan to impose further tariffs on US$200 billion Chinese goods.	▪ The news flow on trade war has been mixed in the past week after both sides signalled that they are ready to go back to negotiating table to solve the dispute. The higher tariff threat by both sides may be part of the strategy to collect the bargaining chips for the upcoming negotiation. ▪ The launch of the second batch will bring China's total stake to US$110 billion in retaliation for total US$250 billion lists unveiled by the US side. Although China's absolute retaliation is much smaller, from percentage perspective, China's lists have covered about 80% of Chinese imports from US, much higher than close to 50% ratio proposed by the US. This is a surprise in our view as it shows that China does not fear further escalation of the trade war. Nevertheless, this could be bad for market sentiment. ▪ In addition, the risk of escalation of trade war may also cap the gain of RMB following the announcement of PBoC to impose 20% reserve ratio for long dollar forward position.
▪ China's politburo fine-tuned its economic policies in its latest meeting to focus more on the downside	▪ "Stabilize" is the key word for the latest politburo meeting. The core task for the next stage is to stabilize six areas including job

economic risk.	market, financial market, international trade, foreign investment, infrastructure investment and market expectation. Against the backdrop of US-China trade war and rising default risk, China has focused more on the downside risk. ▪ In order to safeguard the bottom line of no systemic risk, China's top policy makers have turned more flexible on monetary and regulatory policy. China fine-tuned its monetary policy tone to prudent monetary policy from previously prudent and neutral monetary policy. The removal of the word "neutral" shows that there is room for marginal easing. ▪ Nevertheless, the reiteration of de-leverage and commitment to limit the appreciation of property prices show that China is unlikely to go back to old path of excessive easing. ▪ In addition, as infrastructure investment only ranked number 5 out of six areas China plans to stabilize, it shows that infrastructure investment is unlikely to be significant and current support is mainly help complete the existing infrastructure projects.
▪ PBoC announced on Friday night that it will restart the 20% reserve requirement for long dollar forward position in the onshore market effective from 6 August.	▪ To recap, the 20% reserve was first introduced in September 2015 to slow down the disorderly RMB depreciation and was subsequently removed in September 2017 after two-way movements of RMB was successfully restored. As this 20% reserve will be frozen for one year in a no interest bearing account regardless of the tenor the forward contract, this will effectively raise the cost for speculators and cross border arbitrage flows. ▪ The reserve is not a game changer back in 2015 as it failed to stop RMB from weakening further. But it is a strong signal. China will not hesitate to intervene the market should the currency depreciation risk the financial stability. ▪ The still fresh memory about intervention back in 2015-16 reminds investors that there might be more to come with counter cyclical factor could be the next. ▪ The intervention may change the demand supply matrix in the near term. The medium term RMB outlook will still depend on economic fundamentals, development US-China trade war and easing expectation on China's monetary policy.
▪ USDHKD spot rate moved up from 7.8449 on 26 July to as high as 7.8498 on 3 Aug. One-month HIBOR fell from 1.8988% on 25 July to 1.47% on 3 Aug.	▪ Though China Tower IPO is set to be the world's largest listing in four years, investor sentiments for the IPO turned out to be sluggish amid US-China trade war concerns. As such, the money previously hoarded for the IPO was released to the market and led to retracement in both HKD and HIBOR. Though Mainland Companies will pay a large amount of dividends in August, the impact on the USDHKD spot rate and the HKD liquidity seems to be limited. ▪ In the near term, we expect HIBOR will subside further with one-month HIBOR and three-month HIBOR to fall towards 1.3% and 1.75% respectively. Meanwhile, USDHKD spot rate may test 7.85 again in the near term. If this is the case, any intervention by the HKMA could push the aggregate balance from HK$109.4 billion to below HK$100 billion in the coming months. Notably, HKD loan-to-deposit ratio rose to the highest since Nov 2011 at 85.4% in June. Commercial banks may keep HKD deposit rates high in order to scramble for deposits. Given a combination of reducing aggregate balance and high HKD deposit rates, it is possible for the commercial banks to kick off the prime rate hike cycle following the Fed's possible rate hike in September.

▪ HK's exchange funds registered a loss of HK$7.7 billion in 2Q 2018, the first time since 4Q 2016. This is mainly attributed to the foreign exchange losses of HK$21.3 billion amid broad dollar strength.	▪ Local stock investments marked a loss of HK$5.1 billion due to two major reasons. First, concerns about heightening US-China trade tensions and higher USD rates have resulted in capital flows out of emerging markets including Hong Kong. Second, investors have increasingly tapped onshore stock market in anticipation of the inclusion of A-shares into MSCI emerging market index. As a result, total southbound net inflows under the two stock connects decreased from a total of RMB153.1 billion in 1Q 2018 to a total of RMB16.4 billion in 2Q 2018. On a positive note, overseas stock investments and bond investments gained HK$4.7 billion and HK$14 billion respectively in 2Q18. The cautiousness of major central banks towards tightening has translated into some support to the stock market and the bond market in the second quarter of 2018. ▪ Moving ahead, the broad dollar strength may remain intact in 3Q18 and continue to result in foreign exchange losses. Bond investments are likely to see some losses due to a hawkish Fed and the other central banks' plan to tighten the monetary policy. All in all, we expect the exchange fund's investments to perform worse in 2018 than last year. Still, the sizeable exchange fund (currently HK$4.15 trillion as compared to HK$0.91 trillion as of end-1998) could allow the HKMA to well maintain the linked exchange rate system.
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Key Economic News	
Facts	**OCBC Opinions**
▪ China's manufacturing PMI fell by more than expected to 51.2 in July.	▪ Both demand and production data softened further in July partially due to trade war. New export orders stay below 50 for the second consecutive months while new orders also slipped to 52.3 from 53.2. ▪ In addition, the purchasing price also eased to 54.3 from 57.7 in June, implying that PPI may have peaked in June. We expect PPI growth to decelerate to around 4.3% in July. Inflation is unlikely to be the constraints for easing monetary policy. ▪ Given China has fine-tuned its monetary and fiscal policies. The more supportive policy tone may support domestic demand, which in turn provide the floor to China's PMI data.
▪ Foreign ownership of Chinese bonds increased further despite RMB's sharp deprecation.	▪ The sharp depreciation of RMB in June did not stop foreign investors from increasing their exposure to Chinese onshore RMB assets. Bonds held by foreign investors increased to CNY1.6 trillion from CNY1.49 trillion in May though foreign ownership of equity fell to CNY1.275 trillion from CNY1.323 trillion. In addition, foreign ownership of NCD also rose further to CNY203 billion from CNY181.6 billion in May.
▪ Hong Kong's total loans and advances grew at the slowest pace since February 2017 by 10.5% yoy to HK$9.8 trillion in June 2018. The slowdown could be attributed to three major factors including US-China trade tensions, higher interest rates as well as the reduced funding demand of Mainland companies in the offshore market.	▪ Loans for use in HK (excluding trade finance), which account for 64.4% of total loans and advances, increased by 11.2% yoy. The growth is the softest since January 2017 as higher interest rates and trade war concerns might have hit corporate sentiments. ▪ On the other hand, the growth of loans for use outside of HK, which represent 30% of total loans and advances, moderated to the weakest since January 2017 at 10% yoy. Lately, China shifted the focus from deleveraging to containing downward growth risks and unveiled a raft of stimulus measures. As a result, the flushed liquidity and the narrowed credit spread encouraged

	Mainland companies to raise funds in the onshore market. Higher borrowing costs following the Fed's gradual rate hikes also deterred Mainland companies from financing overseas. ▪ Adding on high base effect, we expect total loans growth to decelerate in the second half of 2018 and reach around 5% by end of this year.
▪ Hong Kong's RMB deposits dropped by 2.7% mom to RMB584.5 billion in June 2018. The year-on-year growth weakened from 14.5% in May to 11.1% in June.	▪ This could be attributed to the weaker outlook of the RMB. Moving ahead, we expect RMB deposits to retreat slightly in the coming months due to two reasons. First, any escalation of US-China trade tensions will weigh down RMB prospect and reduce the demand for RMB. Second, flushed RMB liquidity in the onshore and offshore markets has prompted HK commercial banks to cut RMB deposit rates.
▪ Hong Kong's retail sales remained resilient and increased by 12% yoy to HK$37.8 billion in June 2018.	▪ Sales of food, alcoholic drinks and tobacco rose at the fastest pace since February 2018 by 8.9% yoy. Also, sales of other consumer goods registered double-digit growth for the eighth consecutive month and increased by 15% yoy. This is mainly attributed to the upbeat local consumer sentiments which has been underpinned by the more than twenty-year low of unemployment rate as well as the positive salary prospects. On the other hand, sales of goods in department stores and those of luxurious goods advanced by 15% yoy and 27.8% yoy. This indicates robust tourism activities. Total visitor arrivals grew for the fifth consecutive month by 12.8% yoy to 4.74 million in June. ▪ However, we expect retail sales growth to slow down in the second half of this year. Firstly, fret about US-China trade war and expectations of gradual US rate hikes have weighed down the stock market. This could dent consumer sentiments. Secondly, China's growth has been slowing down while Asia's growth has been succumbed to downward risks from US-China trade war. Thirdly, a stronger HKD against major currencies may reduce visitors' purchasing power. low base effect will fade gradually in the coming months. All in all, we hold onto our view that total retail sales would expand by 5%-8% yoy in 2018.
▪ Macau's gross gaming revenue grew at the slowest pace since February 2018 by 10.3% yoy to MOP25.3 billion in July 2018. The slowdown was mainly due to high base effect and World Cup betting.	▪ Though World Cup betting has come to an end, we still expect gaming revenue growth to continue decelerating in the coming months due to high base effect. Besides, should the government tighten the screws on money laundering, VIP segment will face some downside risks. Higher interest rates could also deter junket operators from extending cheap credits to high-rollers. ▪ On a positive note, strong revival of the tourism sector has provided impetus for the mass-market segment of the gaming sector. Infrastructure improvement and new hotel openings will lend more support to the tourism sector and bring more recreational gamblers to the gaming centers. However, the relatively low betting amount of the casual gamblers may constrain the growth of mass market gaming revenue. Furthermore, we are wary that global uncertainties related to trade tensions would dampen the growth prospect and the outbound tourism of Asian countries. Therefore, we hold onto our view that gross gaming revenue will expand by 10%-15% yoy in 2018, slower than 19.1% yoy in 2017.

RMB	
Facts	**OCBC Opinions**

▪ Finally, PBoC drew the line in the sands after the RMB index tested the low of 92 again on Friday. RMB rebounded sharply with the USDCNH retraced to below 6.85 after PBoC announced the reserve for long dollar forward position.	▪ Although we think the reserve policy is unlikely to be a game changer, the still fresh memory about intervention back in 2015-16 reminds investors that there might be more to come. As such, we think the risk to chase the USDCNY higher has heightened. With the RMB index has tested the historic low of 92 this week, we think the next possible intervention is the restart of counter cyclical factors to smooth the volatility of daily RMB fixing. ▪ Nevertheless, the escalation of trade war after China raised the stake to US$110 billion may cap the gain of RMB. Market should continue to monitor the development of US-China trade war.

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