Highlights

PBoC injected higher than expected long term liquidity via 1-year MLF into the banking system last week, a sign that China tries to ease market concern about the credit risk. Although the recent MLF injection may have delayed the anticipated reserve requirement ratio cut, we think it is unlikely to replace the RRR cut as the RRR cut serves wider purposes. As such, we think China is likely to manage its liquidity via both MLF operation and RRR cut.

China's trade surplus with most countries shrank but not with the US. The widen of surplus with the US may be distorted by the recent trade tension. On trade tension, China's ZTE went back to the business with hefty prices. The largest penalty the US Commerce department has ever levied was considered by market as China's compromise to avoid the trade war. As the deadline for the USTR to unveil its list of Chinese imports to be taxed by additional tariff is approaching, the asset market is likely to trade on assumptions about China's compromise.

On regulation, China's banking regulator and central bank issued a joint statement to improve its monitoring of deposit fluctuation. The new rule will increase the deviation in deposits on the final day of the month to 4% of a bank's monthly average deposit from previously 3%. In addition, the penalty for the banks to breach the deposit fluctuation requirement will be lowered. The recent fine-tune of deposit fluctuation rules is likely to alleviate bank's pressure to compete for deposits.

On currency, China's compromise in trade tension could provide some support to RMB. However, from flow perspective, the recent spike of imports may lead to persistent dollar demand which may cap the upside of RMB. The trajectory of the pair may well depend on the meeting outcome of the ECB and FOMC.

In Hong Kong, after month-end, HIBOR refused to come off. One-month HIBOR climbed for the ninth consecutive day to 1.457% while three-month HIBOR rose to 1.96% on 8 Jun. With FOMC meeting, half-year end, dividend payment flows and mega IPOs around the corner, market players continued to position for the expectedly tighter liquidity. We expect one-month HIBOR to test 1.5% in the near term. In comparison, three-month HIBOR has remained elevated since late April and might have priced in most of the upcoming liquidity draining factors. As such, three-month HIBOR may consolidate around its current level. Therefore, in the next two months, we expect the spread between three-month and one-month HIBOR will narrow to about 30 bps from the current 51bps. Due to higher interbank rates, the battle for HKD fixed-deposits continued among the banking system. One-year HKD fixed-deposit rate is lifted to as high as 2%. The adjustment of one-year fixed-deposit rate is roughly in tandem with the movement of the 12-month HIBOR (2.4% on 8 Jun). We expect one-year HKD fixed-deposit rate to continue moving up moderately towards 2.3% given possible funding squeeze associated with half-year end and mega IPOs. A combination of higher HIBOR and HKD fixed-deposit rate means increasing funding costs for banks. However, HIBOR-based mortgage rates (one-month HIBOR plus 1.3%) remained capped by the prime cap (Prime rate minus 3.1%). This suggests that the net interest margin (NIM) on mortgage loans has continued to narrow. Therefore, in order to ease the compression in mortgage NIM, the banking system is still likely to kick off the prime rate hike cycle around mid-year.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC injected higher than expected CNY463 billion long term liquidity via 1-year medium term lending facility (MLF) to offset maturing CNY259.5 billion MLF on the same day. This resulted in net injection of CNY203.5 billion long term liquidity.	▪ The higher than expected long term liquidity injection against the backdrop of rising default risk shows central bank's intension to ease market concern about the credit risk. China's bond futures rallied and interbank liquidity eased following the announcement of MLF operation. ▪ Although the recent MLF injection may have delayed the anticipated reserve requirement ratio cut, we think it is unlikely to replace the RRR cut as the RRR cut serves wider purposes. The RRR cut will unfreeze more liquidity for those smaller banks with no direct access to central bank liquidity facility, which may in turn support the funding demand from SMEs. As such, we think China is likely to manage its liquidity via both MLF operation and RRR cut.
▪ China's ZTE reached a deal with the US Commerce Department to resume its purchases of US supplies by paying hefty penalty. ▪ ZTE will pay US$1 billion fine and additional US$400 million in suspended penalties in escrow. In	▪ The largest penalty the US Commerce department has ever levied was considered by market as China's compromise to avoid the trade war. As the deadline for the USTR to unveil its list of Chinese imports to be taxed by additional tariff is approaching, market think China may continue to compromise. The asset

addition, ZTE's board and senior management team will be replaced and US Commerce department will install its own compliance persons to monitor the company for a period of 10 years.	market is likely to trade on assumptions about China's compromise. A compromising China may support risk sentiment in the global market. However, domestically the impact could be mixed.
▪ China's banking regulator and central bank issued a joint statement to improve its monitoring of deposit fluctuation.	▪ The new rule will increase the deviation in deposits on the final day of the month to 4% of a bank's monthly average deposit from previously 3%. In addition, the penalty for the banks to breach the deposit fluctuation requirement will be lowered. ▪ The phrase "attract deposit with higher yield" was deleted in line with China's direction for interest rate liberalization. ▪ As a result of the competition from alternative deposit channels such as internet financing, bank's deposit growth has slowed down significantly, leading to higher funding costs. The recent fine-tune of deposit fluctuation rules is likely to alleviate bank's pressure to compete for deposits.
▪ After month-end, HIBOR refused to come off as more and more companies filed for or planned to launch mega IPO in Hong Kong. One-month HIBOR has climbed for nine consecutive days to 1.457% on 8 June from 0.981% on 28 May. Also, three-month HIBOR rose to 1.96% on 8 June from 1.77% as of the end of May.	▪ With FOMC meeting, half-year end, dividend payment flows and mega IPOs around the corner, market players continued to position for the expectedly tighter liquidity. We expect one-month HIBOR to test 1.5% in the near term. In comparison, three-month HIBOR, which has stayed elevated since late April, may consolidate around its current level. Therefore, in the next two months, we expect the spread between three-month and one-month HIBOR will narrow further to about 30 bps after coming down from over 70bps to the current 51bps. On the currency front, slightly wider US-HK yield spread could be expected following the FOMC. However, the return of any carry trade is unlikely to bring HKD down to the weak end amid concerns about half-year end funding squeeze. All in all, we expect USD/HKD spot rate to hover between 7.845-7.85 before retracing to around 7.84 by end of this month.
▪ HK: The battle for HKD fixed-deposits continued among the banking system. One-year HKD fixed-deposit rate is lifted to as high as 2%.	▪ The adjustment of one-year fixed-deposit rate is roughly in tandem with the movement of the 12-month HIBOR. 12-month HIBOR reached 2.4% on 8 Jun. In fact, longer-end liquidity has been tightening since late April and might have priced in most of the upcoming liquidity draining factors. Despite that, we expect one-year HKD fixed-deposit rate to continue moving up moderately towards 2.3% given possible funding squeeze associated with half-year end and mega IPOs. A combination of higher HIBOR and HKD fixed-deposit rate means increasing funding costs for banks. However, HIBOR-based mortgage rates (one-month HIBOR plus 1.3%) remained capped by the prime cap (Prime rate minus 3.1%). This suggests that the net interest margin (NIM) on mortgage loans has continued to narrow. Therefore, in order to ease the compression in mortgage NIM, the banking system is still likely to kick off the prime rate hike cycle around mid-year.
▪ It is reported that due to external uncertainties, the release of development plan of the Greater Bay Area is on hold.	▪ Despite that, the ongoing construction of infrastructure projects across Hong Kong, Guangdong and Macau is set to pave way for increasing collaboration between three areas. For example, Hong Kong-Zhuhai-Macau Bridge will commence operation this year. This will highly likely boost the tourism and trade activities across the bay area. In terms of the trade sector, the nine cities in Guangdong covered by the Greater Bay Area took up 74.4% of Guangdong's cargo throughput and 93.4% of Guangdong's container throughput in 2017. The export dependency of Shenzhen (74%), Zhuhai (73%), Dongguan (93%) and Hong Kong (152%) has been high. Besides, Guangdong's exports and

	imports of goods with Hong Kong accounted for 34.4% of its total exports and imports in 2017. With regard to the tourism sector, tourists from Guangdong and Hong Kong took up 28% and 19% respectively of Macau's total visitor arrivals in 2017. During the same year, Macau and Mainland visitors represented 2% and 76% respectively of HK's total inbound tourists. In conclusion, improvement in trade and tourism activities on the back of improved infrastructure will likely bode well for the bay area's growth. However, a smoother cooperation across the bay area in high-tech sector may still require more policy supports, such as tax benefits. Investment flows across the area could also increase should the new development plan comprises of new supportive measures.
▪ Macau: Two commercial banks are reported to remove the UnionPay machines from either pawnshops or jewellery shops around casinos.	▪ This reinforces our view that policy risks related to anti-money laundering are looming over the gaming sector. The upcoming World Cup would also distract some gambling interests away from Macao casinos. Therefore, it is possible for gaming revenue growth to slow down in the coming months. Nevertheless, we are still optimistic about the gaming sector, especially the mass market segment, given the upcoming completion of Hong Kong-Zhuhai-Macau bridge and new mega entertainment projects.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve fell slightly to US$3.11 trillion in May from US$3.124 trillion in April.	▪ The decline was lower than expected despite negative valuation effect as a result of strong dollar and volatile asset prices in May. This suggests that China's capital flow remains relatively balanced.
▪ China's trade data beat market expectation in May. Exports in dollar term rose by 12.6% while imports in dollar term surged by 26%. ▪ As a result of stronger imports, trade surplus shrank to US$24.9 billion.	▪ China's export to US remained strong, up by 11.6% despite renewed concerns about the trade tension. This was probably due to some frontloading activities in anticipation of worsening trade relationships. As a result of stronger exports to the US, China's trade surplus with the US widened further US$24.58 billion. ▪ China's import of crude oil by value surged by 41.25% despite import by volume only increased by 4.97%. This is mainly due to rising oil prices. Imports of electronic integrated circuit by value hit the second record high of US$26.86 billion in May, up by 35.98%. The strong imports of EIC may be distorted by recent sanction on ZTE. Nevertheless, it also shows China continue to benefit from the resilient global manufacturing cycle. ▪ Given China is likely to compromise to import more US goods from the second half, China's trade surplus is likely to narrow further. This may not bode well to support China's current account surplus, which China recorded its first current account deficit in the first quarter of 2018 since 2001.
▪ China's CPI rose by 1.8% in May, in line with market expectation. However, PPI beat market expectation and accelerated to 4.1% yoy in May.	▪ On sequential basis, China's CPI fell by 0.2% mom, in line with seasonal pattern. Food prices fell by 1.3% mom while core CPI rose slightly by 0.1% mom. The CPI is expected to return to about 2% in the coming months. However, for the whole year, China's CPI is unlikely to be high. ▪ The rebound of PPI to 4.1% from 3.4% is more than market expectation. This is probably the result of stabilization of manufacturing activities. This high PPI is expected to signal that economic recovery momentum remains.

▪ Hong Kong's housing price index refreshed its record high for the 18th consecutive month in April.	▪ With housing prices soaring, the availability of low value properties has been decreasing. Besides, recent new home launches mainly comprised of small to medium flats. As a result, transaction volume of homes priced between HK$3-5 million has tumbled for three consecutive months to 1243 deals while that of homes priced between HK$5-10 million rose 24% yoy to 2767 deals in May. Upbeat housing market sentiment was mainly supported by attractive mortgage plans offered by property developers. Also, tight labor market as well as resilient domestic economy have encouraged prospective homebuyers to enter the market. ▪ Despite that, housing market is showing signs of slowdown. May's housing transaction volume dropped for the third straight month by 4% yoy (-16.9% mom) to 5522 units. The annual growth of home price index decelerated for two months in a row from February's 16.2% to 13.9% in April. Approved mortgage loans fell 5.6% mom in April. Factors including high base effect, higher borrowing costs, volatile stock market and expected increase in new home supply may continue to slow down the housing market growth.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY returned to below 6.40 as dollar strength paused following the rebound of Euro after Italian political turmoil eased.	▪ China's compromise in trade tension could provide some support to RMB. However, from flow perspective, the recent spike of imports may lead to persistent dollar demand which may cap the upside of RMB. The trajectory of the pair may well depend on the meeting outcome of the ECB and FOMC.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com