Highlights

A string of economic indicators reveal that US-China trade war had limited initial impact on China's real economy. First, trade activities remained resilient in July. Exports continued to exhibit double-digit growth, mainly due to strong external demand as well as the front-loading of exports before new tariff took effect on 6 July. Imports also surged amid revival of domestic demand on the back of fiscal stimulus and accommodative monetary policy. China cut tariff on imported products effective 1 July, which also supported the imports. Second, FX reserve surprised to the upside in July. It suggests that the PBOC's direct intervention in the FX market was limited and the capital flows across the border remained largely balanced despite RMB's weakness. Third, the trade war has not yet brought much inflationary risks to China with July's CPI growth accelerating mainly due to seasonality and low base effect.

Though we should not read too much into a single month's data prints, the data do show that inflationary pressure remains moderate at the juncture and will not impede the PBOC from tweaking the policy. As such, more supportive policies and further opening up of the market would help to weather some impact of trade war on imports. However, the outlook of exports remains uncertain as China re-enters the "tic-for-tac" mode and leads to higher risk of trade war escalation. In this case, we are wary that trade surplus will shrink gradually. On a positive note, the sizeable FX reserve and the balanced capital flows may offset the possibly shrinking trade surplus and help to cement the expectations of RMB's two-way volatility in the long term.

In the short to medium term, RMB's outlook will mainly hinge on China's economic fundamentals, trade war development and easing expectations. As such, RMB may still face downward risks due to three reasons. First, it looks inevitable for economic growth to slow down in 2H18, albeit at a moderate pace amid supportive policies. Second, the risk of trade war escalation is mounting. Third, though the PBOC stresses that monetary easing will not be excessive while the major authorities continue their structural de-leveraging efforts, US-China monetary policy divergence is still set to widen. On a positive note, the strong signals from the PBOC to stabilize the FX market has made market players more cautious about shorting the RMB. As a result, though RMB followed the broad trend to decline against the USD last week, RMB rose against the currency basket with RMB index based on spot rate breaking 93. More notably, the PBOC states that they may make counter-cyclical adjustment if herd behaviour and momentum-chasing moves in the FX market intensify cyclical volatility. Therefore, we think the risk for the USDCNY to break 7 has diminished significantly.

In Hong Kong, all major banks raised the cap on HIBOR-based mortgage rates and the Prime-based mortgage rates by 10bps last week. Over the past few years, about 80% of approved new mortgage loans have been priced with reference to one-month HIBOR. However, due to HIBOR's recent uptrend, HIBOR-base mortgage rates (1M HIBOR+1.3%/1.4%) have stayed above the cap (2.15%) since this April. Besides, higher HIBOR prompted banks to scramble for HKD fixed deposits with higher rates. Due to higher funding costs, banks' net interest margin (NIM) has been compressed. Moving forward, we expect HKD to touch the weak end of the trading band soon given ample liquidity. However, without external speculative pressure, any liquidity drainage is expected to be orderly and moderate. Adding that there is no more mega IPO ahead, we expect HIBORs will not rise to June/July highs any time soon. All in all, we see higher probability of prime rate hike in December than in September. If this is the case, commercial banks may have to lift mortgage rates by another 10bps or so to ease the pressure on the NIM. On the other hand, GDP growth decelerated from 4.6% yoy in 1Q18 to 3.5% yoy in 2Q18. Despite the slowdown, GDP growth remained resilient, led by strong growth of private consumption (+6.1% yoy), government spending (+4.4% yoy), goods exports (+4.6% yoy) and services exports (+6.1% yoy). However, moving into 2H18, we expect economic growth to slow down further due to trade war concerns and global monetary tightening (see below for details). All in all, we expect GDP to expand by 3.6% yoy in 2018 if US-China trade tension does not escalate. Otherwise, the possibility of GDP showing a slower growth of 3.2% yoy in 2018 cannot be ruled out.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US said it will impose 25% duties on an additional US$16bn in Chinese imports starting 23 Aug. ▪ China's Ministry of Commerce announced a 25% tariff on $16 billion worth of U.S. goods on 23 Aug as well.	▪ This is within market expectations and therefore did not have much impact on the market sentiment or the RMB. ▪ Nevertheless, it is notable that China re-enters the "tic-for-tac" mode. Last week, China threatened to retaliate with new tariffs on another US$60 billions of US goods. ▪ The heightening risks of trade war escalation could weigh on market sentiment. Also, it signals that the downside risk for the RMB has not yet eased.
▪ Five Chinese authorities including the National Development and Reform Commission (NDRC), the	▪ This echoes the latest politburo meeting's statement that the authorities will continue effort to curb leverage. However,

People's Bank of China (PBOC), the Ministry of Finance (MOF) , the China Banking and Insurance Regulatory Commission (CBIRC) and the State Administration of State-owned Assets (SASAC) issued the a guideline on reducing corporate leverage in 2018. ▪ According to the guideline, a mechanism to contain corporate debt risks will be established. There will be two thresholds for SOEs. Those SOEs with leverage ratio above the two thresholds will be closely monitored and required to set goals and deadlines for leverage reduction. ▪ The authorities will jointly improve the debt-to-equity swap projects in a market-oriented and law-based manner. ▪ They will also accelerate the disposal of loss-making zombie companies' debt.	different from the previous de-leveraging campaign, the focus for this year will be structural de-leveraging which aims to curb the borrowing of SOEs. ▪ This also suggests that the monetary policy will not be too accommodative to hinder the government's structural de-leveraging efforts.
▪ According to the PBOC's 2Q18 monetary policy execution report, the central bank will strike a balance between tightening and loosening. The PBOC will not unveil ultra-easing policies but rather slightly tweak the policy according to the market conditions. Liquidity will be reasonably adequate and aggregate financing will be kept moderate. ▪ The report stresses on increasing support to the smaller companies while points out structural de-leveraging efforts will continue. ▪ While containing financial risks, the PBOC will continue to open up the financial industry.	▪ The report helps to build up expectations that monetary easing will not be excessive. As such, it is unlikely to see renewed housing market frenzy due to recent policy change. Also, the easing policy may not hinder the structural de-leveraging efforts. ▪ The focus on supporting the financing needs of the smaller companies is likely to help narrow the credit spread. ▪ However, due to the easing bias, 3M SHIBOR dipped to the lowest since Oct 2016. The policy divergence between the PBOC and the Fed may be a main source of downside risks for RMB in the short to medium term.
▪ Hong Kong: all major banks raised the cap on HIBOR-based mortgage rates and the Prime-based mortgage rates by 10bps last week. ▪ One-month HIBOR came off from 1.47% on 3 Aug to 1.33% on 10 Aug.	▪ Over the past few years, about 80% of approved new mortgage loans have been priced with reference to one-month HIBOR. ▪ However, due to HIBOR's recent uptrend, HIBOR-base mortgage rates (1M HIBOR+1.3%/1.4%) have stayed above the cap (2.15%) since this April. Besides, higher HIBOR prompted banks to scramble for HKD fixed deposits with higher rates. The share of HKD fixed-deposit in total HKD deposits rose to 37.4% in June, the highest since 2015. Due to higher funding costs, banks' net interest margin (NIM) has been compressed. ▪ Moving forward, we expect HKD to touch the weak end of the trading band soon given ample liquidity and wider US-HK yield differential. However, without external speculative pressure, any liquidity drainage is expected to be orderly and moderate. Adding that there is no more mega IPO ahead, we expect HIBORs will find some support around current levels but will not rise to June/July highs any time soon. ▪ All in all, we see higher probability of prime rate hike in December than in September. If this is the case, commercial banks may have to lift mortgage rates by another 10bps or so to ease the pressure on the NIM.

Key Economic News

Facts	OCBC Opinions
▪ China's trade growth surprised to the upside in July. Exports grew by 12.2% yoy while imports rose by	▪ The first round of the trade war (US$34 billion) appeared to have limited initial impact on China's trade activities.

27.3% yoy. As a result of the robust import growth, trade surplus narrowed to US$28.05 billion from US$41.47 billion.	▪ The imports of hard commodities rebounded on strong local demand buoyed by a raft of supportive polices. Also, the reduction of tariff on some imports effective 1 July might have helped to bolster import growth. As China is set to further open up the market and unveil more supportive policies, the revival of domestic demand may help to weather the impact of US-China trade war on China's imports. ▪ On the other hand, exports growth remained resilient given buoyant external demand and the front-loading of exports before new tariff took effect on 6 July. ▪ However, the outlook for exports remains uncertain. China's trade surplus with the US hovered around historical high of US$28.09 billion. This suggests that the US may not easily compromise in the trade war. ▪ Lately, China re-enters the tic-for-tat mode. Worse still, new export orders, the sub-index of manufacturing PMI, stayed below 50 for the second consecutive months in July. We expect exports growth to slow down and in turn further narrow the trade surplus.
▪ China's CPI growth accelerated further to 2.1% yoy in July from 1.9% yoy in June. ▪ PPI growth decelerated from 4.7% yoy in June (the highest in 2018) to 4.6% yoy in July, better than expected.	▪ The faster growth of CPI was mainly attributable to seasonality and the strong growth of oil prices on low base effect. Also, it is notable that pork prices continued to rebound on a monthly basis. Despite that, inflationary pressure remains moderate at this juncture and may not impede the PBOC from implementing accommodative monetary policy. Still, we will closely monitor whether the escalation of trade war and a weak RMB would translate into imported inflation. ▪ On the other hand, the growth of PPI appeared to have peaked in June. As the boost to PPI growth from supply side reform subsided, PPI growth may have more room for retracement. However, the slowdown in PPI growth is rather moderate. As such, China's industrial profits and fiscal revenue are likely to hold up well in the near term. This will help to ease the concerns over corporate debt burdens and allow more room for further fiscal stimulus.
▪ China's FX reserve rose slightly to US$3.118 trillion in July from US$3.112 trillion in June.	▪ Despite a weaker RMB and volatile asset prices, the data print surprised to the upside. This suggests that the PBOC's direct intervention in the FX market was limited over the past months. Also, the resilient data print indicates that China's capital flows remained largely balanced in spite of RMB's weakness. This may help to reinforce market expectations of RMB's two-way volatility.
▪ In 2Q18, current account balance was running a surplus of US$5.8 billion as goods trade surplus increased to US$104.2 billion while services trade deficit stabilized at US$73.7 billion. On the other hand, capital account balance continued to register a surplus of US$18.2 billion as net capital inflows remained strong. Given the curb on irrational overseas investment, outbound direct investment (US$28.7 billion) continued to be outweighed by foreign direct investment (US$58.6 billion).	▪ Moving ahead, we will closely monitor the risk of a narrowing goods trade surplus amid US-China trade tensions. Travel services trade deficit may also remain wide in the long term given the expanding base of middle-class households. ▪ On the other hand, despite RMB's weakness, capital outflow risks appeared to have been well contained. In the longer term, the open up of China's market may help to keep the cross-border capital flows largely balanced and therefore bode well for RMB's two-way volatility.
▪ HK's GDP growth decelerated from the downwardly adjusted 4.6% yoy in 1Q18 to 3.5% yoy in 2Q18, slightly worse than our expectation of 3.7% yoy.	▪ Despite the slowdown, GDP growth remained resilient, led by strong growth of private consumption (+6.1% yoy), government spending (+4.4% yoy), goods exports (+4.6% yoy) and services exports (+6.1% yoy).

	▪ Specifically, broad-based recovery across Asia have supported HK's inbound tourism as well as the trade activities. Fiscal stimulus bolstered government expenditure. Besides, tight labor market and positive salary prospect buoyed local consumption. ▪ However, moving into 2H18, we expect economic growth to slow down further due to trade war concerns and global monetary tightening. ▪ Specifically, any escalation of US-China trade war would directly affect HK's trade activities as HK serves as the major re-export port connecting China and the US. ▪ Besides, trade war could have many indirect impacts. First, it may cloud Asia's economic outlook and hit Asian currencies. As such, HK's tourism activities may lose some growth momentum. ▪ Second, trade war fears may weigh down local consumer sentiment with a bearish stock market and the possibly weakening hiring sentiments. ▪ Elsewhere, given the Fed's gradual rate hikes and other major central banks' plan to tighten the policy, we see heightening risks of capital outflows from emerging markets including HK. This may weigh down HK stock market and push up HKD rates. As such, business and local consumer sentiments are likely to weaken. ▪ All in all, we expect GDP to expand by 3.6% yoy in 2018 if US-China trade tension does not escalate. Otherwise, the possibility of the GDP marking a slower growth of 3.2% yoy in 2018 cannot be ruled out.
▪ Hong Kong's housing prices growth accelerated from 14.8% yoy in May to 15.9% yoy in June. Housing transaction volume rose for the second consecutive month by 73% yoy to 6091 deals in July. On a monthly basis, the transaction volume dropped 9.3% in July.	▪ In the rest of 2018, we expect transaction volume will drop to around 5500 deals due to several reasons. First, the government announced a slew of housing measures in late June which might have shifted some demand from the private housing market to the public one. Second, stock market has turned bearish on trade war fears. This may dent investor sentiment. Third, HIBOR is set to edge higher given possible capital flight from HK amid a wide US-HK yield differential and trade war concerns. As such, commercial banks have lifted mortgage rates and may raise prime rate for the first time since 2006. ▪ All in all, we expect housing price growth to moderate in the coming months. However, any slowdown in housing price growth may be capped by several favourable factors. ▪ First, a tight labour market and positive salary prospect would continue to encourage some prospective buyers to enter the market. Second, the weakening outlook of the RMB would propel Mainland investors to hold more foreign assets to hedge against RMB's depreciation risks. Third, the severe undersupply is unlikely to be improved any time soon. Housing completion and housing start dropped by 21.4% yoy and 29.1% yoy respectively during the first five months of 2018. Worse still, the new housing measures will reduce potential private housing supply by about 10000 units. ▪ We expect the housing price growth will only moderate to 5%-10% yoy by end-2018.
▪ Macau housing transaction volume rose 14.1% yoy to 1044 deals in June. Month-on-month growth decelerated from 6.8% in May to 0.5% in June. ▪ New approved mortgage loans for residents dropped 2.4% mom or 0.8% yoy to MOP4.7 billion. ▪ Average housing price rose 24.3% yoy to MOP117,160/square meter.	▪ Housing market remained resilient on the back of sanguine economic outlook and tight labour market. As such, non-first-home buyers increased with their share in total buyers rebounding to 14.8%. This indicates that the impact of the housing control measures ebbed gradually.

	▪ On the other hand, recent housing measures continued to support first-home local buyers, representing 81.4% of total buyers. ▪ Given strong demand, combined with higher selling price of new projects amid high costs, average housing price rose to the highest since January. ▪ Lately, HIBOR came off amid flushed liquidity. This may give some room for banks to hold off on prime rate hike in September. If this is the case, low borrowing costs together with slow growth of housing supply (housing completions and housing starts dropped by 63% yoy and 69% yoy in 1H18) may allow housing prices to remain elevated at current levels. ▪ Nonetheless, we expect stock market correction and higher interest rates will slow down housing market growth in the medium term.

RMB	
Facts	**OCBC Opinions**
▪ RMB followed the broad trend and ended last week slightly lower against the USD. ▪ Despite that, RMB rose against the currency basket with RMB index based on spot rate breaking 93, the first time since late July.	▪ After lifting the reserve ratio, the central bank is reported to guide the banks to prevent any "herd behaviour" in chasing the USD-CNY higher. According to 2Q18 monetary policy execution report, the PBOC reiterates that they will not use RMB as a retaliation tool in the US-China trade war. ▪ The strong signals from the PBOC to stabilize the FX market has made market players more cautious about shorting the RMB. ▪ Moving forward, RMB will still be market-driven, as stated by the PBOC in 2Q18 monetary policy execution report. In other words, RMB's outlook will mainly hinge on China's economic fundamentals, trade war development and easing expectations. As such, RMB is still facing downward risks in the near term. ▪ On a positive note, the PBOC states that they may make counter-cyclical adjustment if herd behaviour and momentum-chasing moves in the FX market intensify cyclical volatility. We think the risk for the USDCNY to break 7 has diminished significantly. ▪ In the long term, the sizeable FX reserve and the balanced capital flows may help to cement the expectations of RMB's two-way volatility.

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