Highlights

The US China trade war paused for now after the Trump administration decided to put additional tariff on hold. The joint statement after the meeting between Liu He and US officials did not explicitly specify the amount of trade surplus reduction. This may alleviate the pressure for China in the near term. Nevertheless, the statement did not mention US's exports of restricted high-tech products and China will rely mainly on imports of farm and energy products to reduce the goods trade surplus. This may be read by market observers as China's compromise to reach the agreement. It might be too early to declare the end of trade war as details will only be worked out gradually in the coming months. Watching out for negotiations about the details.

Three potential implications we should think about China's trade surplus reductions. First, should US continue to restrict exports of high-tech exports to China, the easiest way for China to reduce trade surplus with the US is to substitute the imports from other countries with imports from US, which may exacerbate trade tensions between China and other economies such as EU in future. Second, Chinese companies may move some production lines to its neighbouring emerging market to book its trade with US under other countries. As such, it may benefit the regional manufacturing hub such as Vietnam. Third, as US's largest Treasury foreign holders, what will be the impact on the US Treasury market should China's current account surplus shrank further. Noting that China recorded its first current deficit in the first quarter since China joined the WTO in 2001.

On economy, China's economy shows signs of cooling domestically though external demand remains supportive. China's investment and consumption growth slowed while production surprised the market on the upside. Domestically, infrastructure investment decelerated further to 12.4% from 13% as China continued to tighten local government funding. The recent clampdown on PPP may curb the funding for infrastructure investment. China's housing prices remained relatively stable in April. China's Ministry of Housing and Urban Rural Development reiterated that China will not relax its property tightening measures.

On currency, RMB continued to benefit from capital inflows under the capital market as a result of China's opening of its capital market. In the near term, the inflows under capital market may provide the buffer to China's shrinking current account surplus. In the near term, RMB may still depend on broad theme. China's currency regulator SAFE eased the requirement for RMB derivative transaction to support genuine currency hedging demand. China widened support to real hedging demand under the capital market. In addition, supporting documents are no longer a must before corporates entered a forward contract after the regulator reckons the difference between spot transactions and forward transactions.

In Hong Kong, all eyes were on HKD last week as USD/HKD spot rate tested 7.85 repeatedly and prompted the HKMA to buy HKD for the first time since 18 April. Given cautious carry trade, the HKMA merely bought a total of HK$13.03 billion, much less than the total of HK$51.33 billion in April. Against the backdrop of reduced aggregate balance, we expect May's month-end effect to tighten the front-end liquidity. From mid-June onwards, a raft of potential liquidity squeezing events including quart-end, Fed's possible rate hike, several large IPOs and large dividend payouts could also start to drive up short-term interbank rates. As such, we expect USD/HKD spot rate to retreat to around 7.84 and aggregate balance to decrease only moderately from the current HK$115.4 billion before stabilizing between HK$80-HK$100 billion in the next two months. In terms of longer-end HKD liquidity condition, it remains tight due to several reasons including further reduction in aggregate balance, high HKD loan-to-deposit ratio, and elevated 10-year US Treasury Bond Yield. Besides, market players have continued to prepare for the possible funding crunch on upcoming large IPOs (including Xiaomi and China Tower). Moving forward, as longer-end HKD rates might have largely priced in the liquidity squeezing factors, we expect them to rise at a much slower pace than the front-end rates. Still, given tight liquidity, banks may scramble for HKD deposits through continuous deposit rate hikes. Elsewhere, HK's residential land price refreshed its record high of HK$25.16 billion last week. Increasing residential land price as well as development and construction cost may add onto the significant imbalance between housing supply and demand in limiting the downside for the housing market.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The US China trade war paused for now after the Trump administration decided to put additional tariff on hold after the meaningful progress was made last week following China's Vice Premier Liu He's visit to Washington. ▪ The joint statement of the US and China trade consultation showed that China will significantly	▪ The joint statement did not explicitly specify the amount of trade surplus reduction. This may alleviate the pressure for China in the near term. Nevertheless, the statement did not mention US's exports of restricted high-tech products and China will rely mainly on imports of farm and energy products to reduce the goods trade surplus. This may be read by market observers as China's compromise to reach the agreement.

increase purchases of US goods and services to support growth and employment in the US.	▪ We think it might be too early to declare the end of trade war as details will only be worked out gradually in the coming months. The Trump administration is likely to continue to use tariff to press China in future negotiations. ▪ In addition, the US's reluctance to export those high-tech products China wanted suggested the potential substituting effect which China may have to swap some imports of products from other countries to US. This may potentially exacerbate trade tensions between China and other economies such as EU in future.
▪ China's currency regulator SAFE eased the requirement for RMB derivative transaction to support genuine currency hedging demand.	▪ Two notable changes from the revised rulings. First, China widened support to real hedging demand under the capital market. Corporates are able to enter RMB forward contract to hedge their foreign currency liability while offshore financial institutions are able to hedge their currency risk arising from onshore bond investment via forward contracts. Nevertheless, real demand principle still applies. ▪ Second, supporting documents are no longer a must before corporates entered a forward contract after the regulator reckon the difference between spot transactions and forward transactions. Even without the document to support hedging need, corporates or banks are still allowed to enter the long dollar forward contract to meet their hedging demand. ▪ Overall, the ease is likely to boost RMB forward market.
▪ China's NDRC issued the new guidance to tighten its supervision on offshore bond issuance by Chinese companies as part of efforts to manage the potential risk arising from external debt.	▪ The new supervision measures ban corporate issuers to use local government as guarantor. Meanwhile, offshore issuers are also not allowed to leverage on local government credit.
▪ China's Ministry of Housing and Urban Rural Development reiterated that China will not relax its property tightening measures.	▪ In its latest circular, the department asks each city to compile its housing development plan to increase effective land supply. Meanwhile, the department also called for enhancing the management of mortgage. Local government will continue to bear the responsibility to stabilize the housing prices and cap the rentals.
▪ On 14 May, the MSCI unveiled the final list of the 234 A-shares, which will be added to the MSCI emerging market index from June 1. The MSCI estimated US$17 billion inflows to China from passive funds.	▪ As active funds have pre-positioned for the inclusion of A-shares to MSCI emerging market index (month-to-date northbound net inflows under the two stock connects reached RMB34.08 billion after printing a record RMB40.5 billion in April), we do not expect passive funds' investment to significantly increase capital inflows to China's A-shares market from June 1. Instead, the inflows are more likely to increase progressively as the weighting of A-shares will gradually be lifted from 2.5% in June to 5% in September. Still, continuous capital inflows could translate into supports to the RMB.
▪ USD/HKD spot rate tested 7.85 repeatedly last week. This prompted the HKMA to buy HKD to defend the currency peg, the first time since 18 April.	▪ Given cautious carry trade, the size of short HKD positions has been rather small. Therefore, the HKMA merely bought a total of HK$13.03 billion, much less than the total of HK$51.33 billion in April. Against the backdrop of reduced aggregate balance, we expect May's month-end effect to tighten the front-end liquidity. Besides, a raft of potential liquidity squeezing events including quart-end, Fed's possible rate hike, several large IPOs and large dividend payouts could also start to drive up short-term (no longer than 1-month) interbank rates from mid-June. As such, we expect USD/HKD spot rate to retreat to around 7.84 and aggregate balance to decrease only moderately from the current HK$115.4 billion before stabilizing between HK$80-HK$100 billion in the next two months.

▪ Following Xiaomi's step, China Tower filed for HK IPO to probably raise US$10 billion in 3Q18. Besides, Canaan Creative, a Chinese maker of bitcoin mining equipment, is also said to raise about US$1 billion via HK IPO in 3Q18.	▪ With a new wave of large IPOs to come in 3Q18, market players have continued to prepare for the possible funding crunch in the coming months. This added to the following factors in elevating longer-end HKD interest rates. First, the HKMA's FX intervention has drained liquidity from the banking system. Second, high HKD loan-to-deposit ratio has prompted banks to scramble for longer-term HKD funding to meet the strong loan demand. Third, 10-year US Treasury Bond Yield broke the strong resistance of 3.05%, which exerted spill-over effect on long-end HKD rates. In comparison, front-end liquidity remains flushed with 1-month HIBOR falling below 1% once again. ▪ Moving forward, as longer-end HKD rates might have largely priced in the liquidity squeezing factors, we expect them to rise at a much slower pace than the front-end rates. In other words, the gap between 3-month and 1-month HIBORs is believed to narrow gradually to around 30bps from the current 75bps. Given tight liquidity, banks may scramble for HKD deposits through continuous deposit rate hikes.

Key Economic News

Facts	OCBC Opinions
▪ China's investment and consumption growth slowed while production surprised the market on the upside. ▪ Fixed asset investment decelerated to 7% in the first four months, lowest in record. ▪ Retail sales growth slipped to 9.4% down from 10.1% in March. ▪ Industrial production, however, accelerated to 7% in April from 6% in March.	▪ Manufacturing activities remained robust unaffected by US-China trade tension. Manufacturing production accelerated to 7.4% from 6.6% while manufacturing investment also reaccelerated to 4.8% from 3.8%. This suggests that the external demand remains one of the important key drivers to growth now. ▪ Domestically, infrastructure investment decelerated further to 12.4% from 13% as China continued to tighten local government funding. The recent clampdown on PPP may curb the funding for infrastructure investment.
▪ China's housing prices remained relatively stable in April. Housing prices for new home in tier one cities remained unchanged while housing prices for new home in tier two and tier three cities rose slightly by 0.1% and 0.2% mom respectively.	▪ China's housing prices have been recently distorted by government's window guidance to cap the unit prices sold by developers. Judging by the queue outside the showflat, it seems that China has not found a good solution to cool the housing fever. We expect the housing prices to remain stable in the coming months with government's window guidance in place.
▪ According to the Lands Department, HK's residential land price refreshed its record high of HK$25.16 billion last week. The land price per square foot also reaches a high level of HK$17,776.	▪ This indicates the property developer's optimism about long-term property market outlook. We expect downside for the housing market to be limited despite possible local rate hikes or the government's efforts of easing housing shortage. This is due to three main reasons. First, the residential land price and the development and construction cost are increasing. Second, property developers can flexibly adjust their pace of new project launches, in order to ensure the selling prices are not too low to erode their profits. Third, there is significant structural imbalance between supply and demand in the housing market.
▪ Macau will soon announce details about new gambling licenses as the current ones will expire between 2020 to 2022, according to the Director of Gaming Inspection and Co-ordination Bureau (DICJ).	▪ We expect all the existing gambling licenses to be renewed, in order to ensure the continuous operation of all existing casinos. During the first four months of 2018, gaming revenue grew 22.2% yoy. A new wave of mega project openings, combined with improved infrastructure and a weaker MOP will help to sustain the growth momentum of the gaming sector. This also signals positive outlook of the gambling hub's economy. Nevertheless, we do not expect the DICJ will issue additional gambling licenses, since the government has been shifting the

	focus on gaming to non-gaming elements.
▪ In 1Q18, Hong Kong's Exchange Fund marked the worst investment return since 4Q16. The total investment return plunged 60% yoy to HK$26.1 billion.	▪ The gain of local stock investments fell by 88.1% yoy to HK$1.7 billion while overseas stock investments lost HK$7.4 billion in 1Q18. This is mainly due to a tumble in global stock markets in 1Q18 driven by concerns about Fed's faster rate hike pace and US-China trade frictions. In terms of bond investments, the return dropped 14.1% yoy to HK$5.5 billion as reflation trade tamed US bond market. On a positive note, foreign exchange gains increased 121% yoy to HK$26.3 billion due to the broad weakness of USD in 1Q18. ▪ Moving ahead, even though the HKMA has reduced the duration of bond investments, the reflation story could still weigh down the bond investments return in the rest of this year. Also, the USD's rally during 2Q18 may result in foreign exchange losses. However, we believe that recent broad dollar strength is unsustainable. This means that overall foreign exchange gains for this year could remain benign. Finally, for stock investments, signs of resilient global growth indicate that stock markets will remain range-bound rather than see a crash. Therefore, stock investments are unlikely to report loss for a prolonged period. All in all, we expect the exchange fund' investments to realize a moderate return rather than a loss this year. As such, a still sizeable exchange fund (currently HK$4.15 trillion as compared to HK$0.91 trillion as of end-1998) could help the HKMA well maintain the linked exchange rate system.
▪ HK's unemployment rate decreased further to a more than twenty-year low at 2.8% during the three months through April.	▪ Despite that, the employment of different industries has been mixed. On the positive note, the jobless rate of tourism-related industries improved further to 4.1%, a level unseen since Dec14 amid the continued recovery of tourism. On the negative note, trade sector's jobless rate increased from 2.4% to 2.6% due to the lingering uncertainty over US-China trade conflict. Besides, the increased volatility of global stock and bond markets in 1Q 2018 might have crippled the hiring sentiment of financial sector, driving up its unemployment rate from 2.1% to 2.3%. Moving forward, the labor market is expected to remain tight given the sanguine economic outlook. This will allow local consumer sentiment and housing demand are expected to hold up well. However, as the concerns about US-China trade frictions has not been eased, it may exert further negative impacts on trade sector and its employment. The prospects for higher interest rate and the potential correction in financial markets may also hit the financial sector's employment. Therefore, we do not expect such a low jobless rate to sustain in 2H18.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY drifted higher tracking the dollar index. However, RMB index rose further to 97.88 as RMB outperformed other currencies.	▪ RMB continued to benefit from capital inflows under the capital market as a result of China's opening of its capital market. In the near term, the inflows under capital market may provide the buffer to China's shrinking current account surplus. In the near term, RMB may still depend on broad theme.

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