Highlights

China announced a package of measures to support market sentiment including higher than expected longer term liquidity injection via MLFs and fresh rounds of targeted reserve requirement ratio cut against the backdrop of rising default risk, slowing economic growth and looming US-China trade war. With the stake for trade war increasing to US$200 billion, there is no way for China to match. But at least, it has signaled clearly that China will not give up its bottom line to support its own high-tech industries.

Instead of becoming trapped in this tit-for-tat vicious cycle, we expect China to expedite its plan to boost its domestic demand via proactive fiscal policies to cut tax and increase expense. China's Ministry of Finance proposed to cut income tax for individual. The minimum threshold for personal income tax will be raised to CNY5000 per month from currently CNY3500 per month pending on People's Congress approval. The proactive fiscal policy is expected to provide buffer to counter the negative impact of trade tension.

The latest targeted RRR cut is the follow-up to State Council's call to support debt for equity swap and alleviate funding stress for SMEs. The targeted RRR cut with the feature of promoting debt-for-equity swap is well designed to kill two birds with one stone. On one hand, it will inject about CNY700 billion liquidity to the system to support market sentiment. On the other hand, it also gives Chinese banks window to lower its non-performing loan ratio via debt for equity swap to free up more credit quota, which is also in line with China's strategy to lower the overall leverage ratio.

On currency, RMB returned to self-engineered depreciation mode for the first time this year as a result of looming US-China trade war. The rapid move last week was mainly driven by corporate flows. Although PBoC stepped in to slow down the pace of depreciation via fixing and 4:30pm closing prices, there is no urgency for PBoC to intervene to stop the depreciation for two reasons. First, RMB still outperformed most of its Asian peers year to date. Second, RMB index remained strong and RMB still appreciated against its major trading partners by more than 2% year to date. As such, we think PBoC is still comfortable with mild depreciation though it will closely monitor the pace of movement.

In Hong Kong, USD/HKD spot rate moved to as high as 7.8499 last week due to carry trade. The increased concerns about US-HK trade tension led to sell-off of HK stocks which also added downward pressure onto the HKD. Nevertheless, half-year end and Xiaomi's mega IPO resulted in an extremely tight liquidity condition. As such, carry trade was sidelined and the HKD rallied. We expect USD/HKD spot rate to remain below 7.85 in the near term and retreat to about 7.84 by end of this month. On the HKD rates front, tighter liquidity is set to push up HIBOR further in the coming week. Still, we believe that the room for three-month HIBOR to go up is limited. Three-month HIBOR may stabilize around 2.1% while one-month HIBOR is expected to test 2.05% or even surpass three-month HIBOR should Xiaomi's IPO register huge oversubscription this week. Moving into the third quarter, Meituan, Haidilao, China Tower and Midea will also launch IPOs successively with a relatively large IPO size. Therefore, even in the aftermath of half-year end and Xiaomi's IPO, the room for HIBOR to subside in the coming month should be small in our opinion. For example, one-month HIBOR may not fall below 1.5%. Elsewhere, Hong Kong government is set to announce the details of tax on vacant property within this month. However, the total vacancy rate reached decades-low at 3.7% in 2017. We believe that unless the structural imbalance between supply and demand is eased (the actual supply of public housing units for 2017/18 was more than 15% lower than previously estimated while the average waiting time for general applicants reached record high), the vacant property tax will do little to help calm the overheated housing market.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ PBoC announced the fresh round of targeted reserve requirement ratio cut on 24 June effective from 5 July. The reserve requirement ratio for big five banks and 12 joint stock banks will be cut by 50bps to support debt for equity swap. Meanwhile, the reserve requirement ratio for smaller banks such as city commercial bank, rural bank and foreign banks will also be cut by 50bps to support lending to small business. ▪ Total net CNY700 billion will be injected into the system. ▪ PBoC will keep track of the use of liquidity from RRR cut via MPA assessment.	▪ The latest targeted RRR cut is the follow-up to State Council's call to support debt for equity swap and alleviate funding stress for SMEs. ▪ Different from previous targeted RRR cut, which the central bank usually decided which groups of banks will be qualified; this round's targeted RRR cut mainly targeted the use of funds. This shows China's commitment to de-leverage via debt for equity swap. ▪ The impact of this round's targeted RRR cut, which will inject about CNY700 billion liquidity, is as good as a universal RRR cut. The RRR cut together with CNY663 billion injection of MLF shows that PBoC has shifted to a more accommodative stance against the backdrop of rising default risk and slowing economy. This

	should be supportive of market sentiment in our view. ▪ The latest targeted RRR cut is positive for banks in our view as it gives Chinese banks window to lower its non-performing ratio via debt for equity swap to free up more credit quota. Meanwhile, it is also in line with China's strategy to de-leverage as debt for equity swap will help lower the overall leverage ratio. As such, the latest targeted RRR cut is well designed to kill two birds with one stone.
▪ On trade tension, President Trump threatens to ask the US Trade Representative to identify US$200 billion imports from China subject to additional tariffs of 10% should China retaliate. ▪ Meanwhile, the US Senate passed a US$716 billion defence bill, which may put ZTE back to coma again.	▪ The uncertainty about the fate of ZTE may be prolonged for another month as the House and Senate will work together to reconcile their defence spending bill. Should the US Senate convince the House to add ZTE clause to the spending bill, ZTE may not be able to survive. ▪ With the stake for trade war to increase to US$200 billion, there is no way for China to match. But at least, it has signaled clearly that China will not give up its bottom line to support its own high-tech industries. Instead of becoming trapped in this tit-for-tat vicious cycle, we expect China to expedite its plan to boost its domestic demand via proactive fiscal policies to cut tax and increase expense.
▪ PBoC conducted CNY200 billion MLFs last week despite there were no MLFs maturing. This brought total long term liquidity injection to CNY663 billion in June.	▪ Against the backdrop of rising default risks, slowing growth and looming trade war, it is getting easier for PBoC to turn more flexible to safeguard the bottom line of no financial risk. As such, we expect China will continue to inject liquidity via MLFs and RRR cut if necessary.
▪ China's Ministry of Finance proposed to cut income tax for individual. The minimum threshold for personal income tax will be raised to CNY5000 per month from currently CNY3500 per month pending on People's Congress approval.	▪ The income tax cut is part of China's plan to boost its domestic demand amid heightening trade tension. The recent faster fiscal revenue growth is expected to provide room for China to run its proactive fiscal policies. The proposed income tax is estimated to be equivalent to about CNY250-300 billion fiscal stimulus.
▪ USD/HKD spot rate moved to as high as 7.8499 last week due to carry trade. The increased concerns about US-HK trade tension led to sell-off of HK stocks which also added downward pressure onto the HKD.	▪ Nevertheless, as the possibility of US and China making a deal has yet to be ruled out, HK stock market wiped out some loss. In addition, half-year end and Xiaomi's mega IPO resulted in an extremely tight liquidity condition. As such, carry trade was sidelined and the HKD rallied. We expect USD/HKD spot rate to remain below 7.85 in the near term and retreat to about 7.84 by end of this month. On the HKD rates front, tighter liquidity is set to push up HIBOR further in the coming week. Still, we believe that the room for three-month HIBOR to go up is limited. Three-month HIBOR may stabilize around 2.1% while one-month HIBOR is expected to test 2.05% or even surpass three-month HIBOR should Xiaomi's IPO register huge oversubscription this week. Moving into the third quarter, Meituan, Haidilao, China Tower and Midea will also launch IPOs successively with a relatively large IPO size. Therefore, even in the aftermath of half-year end and Xiaomi's IPO, the room for HIBOR to subside in the coming month should be small in our opinion. For example, one-month HIBOR may not fall below 1.5%. Should the banking system continue to refrain from hiking the prime rate, small to medium banks may face more pressure as higher HKD fixed-deposit rates and rising HIBOR have been suppressing the net interest margin on mortgage loans.
▪ Hong Kong government is set to announce the details of tax on vacant property within this month.	▪ As a large number of the vacant flats have been hoarded by developers, the government may aim to prompt developers to sell the empty new flats as soon as possible. Before the details of the vacant property tax is announced, developers scrambled to sell the newly built flats they have been hoarding. Still, we

	believe that the vacant property tax is unlikely to have much impact on the property market as developers could simply sell all the empty flats and then slow down the pace of construction of new property projects. On the other hand, should the tax be imposed on all vacant property, it is also unlikely to notably increase the supply in the secondary housing market as total vacancy rate was the lowest since 1990 at 3.7% in 2017. All in all, we believe that unless the structural imbalance between supply and demand is eased, the property control measures will do little to help calm the overheated housing market.

Key Economic News	
Facts	**OCBC Opinions**
▪ It is reported that the actual supply of public housing units for 2017/18 was 21.4 thousand, more than 15% lower than the 25.4 thousand units estimated previously.	▪ The average waiting time for general applicants has increased from 4.7 years to a record 5.1 years. The persistent undersupply of public housing units has forced some lower-income households to rent a private flat. As the control measure on low value residential property is relatively loose, some lower-income households have also been encouraged to purchase low value property. Therefore, the property developers increasingly built nano flats with acceptable total price but unreasonably high price per square foot. On a positive note, for the fiscal year of 2018/19, Hong Kong Housing Department estimates that the public housing construction program will increase the supply of public rental housing and subsidized sale flats by 20.5 thousand and 6.6 thousand respectively. The private housing supply is also set to increase gradually in the coming years. Adding on prospects for higher interest rates, we expect housing market growth to slow down slightly in the second half of this year. However, any slowdown in housing market may be cushioned by slow increase in local rates, strong pent-up demand and a very tight labor market.
▪ HK's jobless rate stayed unchanged at 2.8%, an over twenty-year low, during the three months through May. The employment across tourism- and trade-related sectors showed improvement.	▪ Specifically, the unemployment rate of tourism-related sector reduced further to 4.0%, the lowest since the early 2014, mainly supported by the revival of inbound tourism activities. Besides, the jobless rate of trade sector dropped from 2.6% to 2.3% as US-China trade conflicts have not yet materialized and global demand remained sanguine. Moving forward, we do expect to see further improvement in tourism sector and its employment. However, the outlook of trade sector as well as its employment looks bleak given the escalating US-China trade tension. Elsewhere, financial sector's hiring sentiments may also take a hit as the prospects of local interest rate hikes and trade war may weigh down financial activities. All in all, even though the still positive economic outlook could help to sustain a tight labor market, we expect the jobless rate to increase slightly in 2H18.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY and USDCNH jumped from 6.40 to 6.50 within one week. ▪ As a result of sharp depreciation, RMB also weakened against its basket currency with the RMB index fell to 97 this morning.	▪ RMB returned to self-engineered depreciation mode as a result of looming US-China trade war. The rapid move last week was mainly driven by corporate flows. Although PBoC stepped in to slow down the pace of depreciation last week via fixing and 4:30pm closing prices, there is no urgency for PBoC to intervene

	to stop the depreciation for two reasons. First, RMB still outperformed most of its Asian peers year to date. Second, RMB index remained strong and RMB still appreciated against its major trading partners by more than 2% year to date. As such, we think PBoC is still comfortable with mild depreciation though it will closely monitor the pace of movement.

OCBC Greater China research

Tommy Xie Xied@ocbc.com

Carie Li Carierli@ocbcwh.com

Co.Reg.no.:193200032W