Highlights

China is showing off its policy tool box on various fronts including monetary policy, fiscal policy and currency policy. On monetary front, China's rates fell again after China continued to offer longer term liquidity generously. However, the easing monetary policy drove the USDCNY higher gradually last week. This triggered the announcement of resumption of counter cyclical factor in the RMB fixing on Friday night. Since early August, China has rolled over most policies tools developed over time in 2015-2017 within one-month; this is a very strong signal in our view.

It seems China is trying to achieve an ambitious balance to keep liquidity flushed while maintaining currency stability. We doubt this will be a sustainable balance in the medium term. To some extent, China may have to give up one parameter. Given China has drawn the line in the sands clearly, the outlook of RMB may depend on China's economic fundamentals other than the dollar trajectory. Should China's economy decelerate more than expected, the pressure on RMB weakness may come back again. Otherwise, we expect the USDCNY to stay below 7 comfortably.

Other than monetary policy, fiscal policy was back to the centre stage as China plans to accelerate its funding support to local government debt issuance via both supply side and demand side measures. China is expected to increasingly rely on fiscal policy to support growth given the room for further monetary policy easing is limited.

In **Hong Kong,** the HKMA bought another HKD1.766 billion to defend the currency peg system and reduced the aggregate balance to HKD91bn. In the absence of mega IPOs, ample front-end liquidity is expected to sustain and continually push USDHKD to 7.85 in the coming month. As Fed is poised to raise rate in Sep, increasing speculation on a wider US-HK yield differential could further boost carry trade activities and prompt more liquidity withdrawal. On a positive note, HK's strong fundamentals would help to ease capital outflow pressure. Further decline in aggregate balance combined with quarter-end effect may also make short HKD traders cautious. We expect HIBOR to edge up only moderately with 1M HIBOR to touch 1.8% while aggregate balance may hold above HK$50 billion by end of Sep. Unless external uncertainties including trade war escalation and emerging market rout spur capital flight from HK, we see lower probability of prime rate hike in Sep than in Dec. Elsewhere, last week, the Centa-City Leading Index dropped to one-month low. We expect housing market to soften with several reasons. First, banks have lifted mortgage rates and are likely to raise prime rate. Second, trade war and China's slowdown have clouded HK's economic outlook, which may in turn hurt salary prospect. Fourth, bearish stock market has reduced wealth effect. Finally, new housing measures might have shifted some housing demand to public market. All in all, we expect housing prices will drop by 5% in 2H18 and fall by another 5%-8% in 2019. In **Macau,** GDP expanded for the eighth consecutive quarter, but at the slowest pace since 3Q16 by 6% yoy in 2Q18. Growth may decelerate further given the downside risks from trade war, a stronger MOP, Asia's muted economic outlook, higher interest rates and bearish stock market. We expect GDP will grow by 5%-7% this year.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The second round of tariff on US$16 billion goods kicked off on 23 August from both sides as expected. Meanwhile, the trade negotiation led by China's Vice Commerce Ministry in Washington also ended with no major breakthrough.	▪ With tariff on US$50 billion goods in place from both sides, the focus will shift to whether US side will go ahead with additional tariff on US$200 billion Chinese goods, which is currently under hearing. Should the stake are raised to US$250 billion, the impact on the real economy is likely to be more visible.
▪ Although China reiterated to maintain its prudent monetary policy intact in two separate occasions last week including the State Council meeting and article from the newly elected PBoC deputy governor, PBoC stepped up its liquidity injection last week via MLF and reverse repo operation.	▪ China continued to offer longer term liquidity into the interbank market via 1-year MLF. The unexpected injection of CNY149 billion liquidity last Friday shows that PBoC is caring about the market and alleviate the pressure ahead of the month-end. As a result of central bank's liquidity operation, China's money market rates fall again with overnight and 7-day repo rate fell by 21bps and 13bps respectively. The easing money market rates also lent the support to bond market with bond yields fell across the credit curve.
▪ China's State Council reiterated its commitment to solve the funding difficulties for SMEs although it said prudent monetary policy tone has not changed. The State Council will development the high yield bond market for SMEs. Meanwhile, it will also the financial institutions to issue asset backed securities to support SMEs financing.	▪ The increasing focus on SME funding shows that China's commitment to lower the barrier for monetary policy transmission mechanism.

▪ Other than monetary policy, fiscal policy was back to the centre stage as China plans to accelerate its funding support to local government debt issuance via both supply side and demand side measures.	▪ On supply side, China's Ministry of Finance instructs local government to accelerate the issuance of special bond to complete at least 80% of this year's CNY1.35 trillion quota by end of September. The resumption of local government special bond may help fixed asset investment find bottom, which provide the floor to Chinese growth. ▪ On demand side, the onshore newspaper also reported quoting source that China may lower the risk weights for banks holding of local government debt to zero from currently 20% to create the demand for local government bond ahead of massive issuance of local government special bond in the next two months. China has increasingly relied on fiscal policy to support growth given the room for further monetary policy easing is limited.
▪ China announced on Friday night to resume counter cyclical factor in RMB daily fixing.	▪ Interesting to note, the statement said RMB fixing submitters have started to use counter cyclical factor since August. This explains the discrepancy between actual fixing and forecasted fixing in the past two weeks. ▪ Since early August, China has showed off its tool box and "dumped" most policies tools developed over the time in 2015-2017 within one-month; this is a very strong signal in our view. Given China has clearly drawn the line in the sands, we are increasingly more comfortable to expect the USDCNY to stay below 7 this year.
▪ USDHKD frequently touched 7.85 last Thursday and prompted the HKMA to buy another HKD1.766 billion to defend the currency peg system. As a result, aggregate balance reduces from HKD92.6bn to HKD91bn on 27 Aug 2018.	▪ Compared to the liquidity withdrawal (HK$16.79 billion) during mid-Aug, last week's drainage was rather moderate. As such, front-end liquidity remained flushed and kept USDHKD well elevated near 7.85. 1M HIBOR rose only slightly from 1.43% on 17 Aug to 1.45% on 24 Aug. ▪ Moving forward, in the absence of mega IPOs, ample front-end liquidity is expected to sustain. Therefore, we expect USDHKD to continually touch 7.85 in the coming month. As Fed is poised to raise rate in Sep, increasing speculation on a wider US-HK yield differential could further boost carry trade activities. As such, we expect to see more liquidity withdrawal ahead. On a positive note, HK's strong fundamentals would help to ease capital outflow pressure. Further decline in aggregate balance combined with quarter-end effect may also make short HKD traders cautious. All in all, we expect HIBOR to edge up only moderately with 1M HIBOR to touch 1.8% by end of Sep. Aggregate balance may hold above HK$50 billion by end of Sep. Unless external uncertainties including trade war escalation and emerging market rout spur capital flight from HK, we see lower probability of prime rate hike in Sep than in Dec.
▪ The development of the Greater Bay Area will focus on five major areas. ▪ HK government announces that Hong Kong Express Rail Link will start operation from 23 September.	▪ First, the government will unveil negative list for foreign investment as well as investment from HK, Macau and Taiwan. The time needed to set up a company in the bay area will be shortened to five days. Second, the bay area will build a "Guangzhou-Shenzhen-Hong Kong-Macau" corridor for technology innovation. There has been 151 subsidized innovative projects jointly launched by HK company and Guangdong company. Third, the government will lower the threshold for HK companies to expand their businesses in the bay area. Data shows that HK and Macau companies located in the three free trade zones including Guangzhou Nansha, Shenzhen Qianhai and Zhuhai Hengqin totaled 1700, 8000 and 2800 respectively. Fourth, residence permit will be granted to

	the residents from HK and Macau who will then enjoy the convenience regarding ticket purchase, hotel check-in and financial services. Residents from HK and Macau can be exempted from employment permit if they work in Nansha, Qianhai or Hengqin. Finally, the government will develop collaboration platforms in the bay area, including Guangzhou Nansha Information Technology Park, PKU-HKUST ShenZhen-HongKong Institution, Guangzhou HKUST Fok Ying Tung Research Institute, Shenzhen Virtual University Park, as well as the Traditional Chinese Medicine Science and Technology Industrial Park of Co-operation between Guangdong and Macau. ▪ The proposed development plan implies that China will use the Greater Bay Area as a test field for further collaboration between HK, Macau and Mainland China. With infrastructure improvement and the removal of the obstacles to cross-border employment, we expect collaboration across the bay area to be smoother. The development of the bay area will also pave way for further opening up of China.

Key Economic News	
Facts	**OCBC Opinions**
▪ Last week, the Centa-City Leading Index dropped to one-month low. Lately, some buyers in primary and secondary housing market gave up deposits to pull out of deals. Meanwhile, some sellers reduced the offering price by as much as 10%. Besides, some property developer sold the second batch of its new project at a price 10% lower than the price of the first batch. This even has spill-over effect on the secondary public housing market.	▪ Over the past few years, HK's housing frenzy was mainly attributed to four factors including low borrowing costs, positive economic outlook, tight labor market and wealth effect from bullish stock market. However, these factors start to abate. First, banks have lifted mortgage rates by 10bps to 20bps. Global monetary tightening and trade concerns could continue to prompt capital outflows from HK and in turn drive up HKD rates. Second, US-China trade war as well as China's economic slowdown have clouded HK's economic outlook, which could in turn hurt salary prospect. Third, stock market has turned bearish and reduced wealth effect. Finally, government's housing measures announced lately might have shifted some housing demand to public market. All in all, we expect housing transaction volume to reduce and housing price growth to slow down gradually in the coming months. However, any correction in the housing market may be capped by the persistent undersupply. Housing completion and housing start dropped by 30.2% yoy and 37.9% yoy respectively during 1H2018. We expect housing prices will drop by 5% in 2H18 and fall by another 5%-8% in 2019.
▪ Macau's economy expanded for the eighth consecutive quarter by 6% yoy in 2Q18, mainly supported by strong household spending and external demand.	▪ Buoyed by tight labor market and benign salary growth, private consumption grew at the strongest pace since 3Q 2014 by 5.3% yoy. Besides, exports of goods increased by 29.9% yoy on robust external demand. More notably, exports of gaming services and other tourism services rose by 13.7% yoy and 13.0% yoy respectively. This was in line with the rosy performance of the gaming and tourism sector. Despite that, the economic growth for 2Q18 was the slowest since 3Q16 due to sharp decline in private investment (-18.9% yoy) following the gradual completion of mega entertainment projects and housing projects. Moving into 2H18, we expect to see slower economic growth given three major downward risks. First, due to high base effect and the lack of much uncompleted mega projects, private investment may remain subdued. Second, a stronger MOP combined with Asia's muted economic outlook on trade

	war concerns will likely decelerate the growth of Macau's exports of goods and services. Third, higher interest rates and bearish stock market could dent business and consumer sentiments. On a positive note, strong infrastructure investment (government investment in fixed assets +28.9% yoy in 2Q18) may help to offset some downward risks to economic growth. Besides, the upcoming completion of HK-Zhuhai-Macau Bridge may lend some support to the tourism and gaming sectors. All in all, we expect GDP will grow by 5%-7% this year.
▪ Macau's visitor arrivals increased for the sixth consecutive month and were up 4% yoy in July 2018.	▪ Notably, the number of overnight visitors has seen positive year-on-year growth consecutively for three years. Besides, overnight visitors accounted for an average of 52.8% of total visitors during Jun 2016 to Jul 2018, higher than the average of 47.2% during Jan 2008 to May 2016. Furthermore, the average length of stay of visitors remained unchanged at a record high of 1.3 days. Taken all together, it indicates that a raft of new hotel openings and Asia's broad-based recovery has boosted tourism and hotel sectors over the past few years. However, visitors from Hong Kong, Taiwan, South Korea and Japan decreased by 2.5% yoy, 1% yoy, 19.8% yoy and 4.2% yoy in July. A strong MOP as well as Asia's subdued economic outlook on trade war fears may shrug off some growth momentum of the tourism activities. On a positive note, the upcoming infrastructure improvement (including the completion of HK-Zhuhai-Macau Bridge) and more new hotel openings may help to cap the slowdown in the tourism sector. All in all, we expect visitor arrivals will continue to increase but at a slow pace in the coming months. The same may be true to mass-market gaming revenue.

RMB	
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▪ The USDCNH tried to test 6.90 before collapsing to 6.80 after the official announcement of the resumption of counter cyclical factors. ▪ RMB index rebounded sharply to around 93.3 before dipping to 92.40 range.	▪ The renewed RMB depreciation in the second half of last week was mainly the result of China's easing monetary policy. The USDCNH was sent to 6.90 again on Friday following the unexpected conduction of MLF. ▪ It seems China is trying to achieve an ambitious balance to keep liquidity flushed while maintaining currency stability. We doubt this will be a sustainable balance in the medium term. To some extent, China may have to give up one parameter. ▪ Given China has drawn the line in the sands clearly, the outlook of RMB may depend on China's economic fundamentals other than the dollar trajectory. Should China's economy decelerate more than expected, the pressure on RMB weakness may come back again. Otherwise, we expect the USDCNY to stay below 7 comfortably.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com