Summary

Chinese market was relatively quiet ahead of golden week holiday. In addition, the upcoming inclusion of RMB into SDR basket also kept RMB volatility at bay. The actual impact on capital flow is likely to be limited as SDR is only potential claim with no immediate need for portfolio rebalancing for global central banks. The common question is whether PBoC will ease its tight control on both CNY and CNH after the SDR inclusion. We think the chance is low for the next few weeks as the sudden spike of RMB volatility after inclusion will dampen RMB's image. In addition, China may also keep its currency relatively stable ahead of semi-annual US Treasury economic and currency report in mid-October.

1 Oct is not only the big day for SDR inclusion; it also marks the day for China to ease its rules for foreign investment. Effective from 1 Oct, China will expand its negative list approach for foreign investment from free trade zone to nationwide. The latest Chinese data remains solid with official PMI stands firm at 50.4 in September. This reinforced market expectation that Chinese economy may have found the near-term bottom. More Chinese cities announced property tightening measures. The massive announcement of property tightening measures in the past two weeks shows that China's top level may have reached consensus that the concerns about overheating in property market may have overshadowed the concerns about the economic slowdown. The shift of policy tone also shows that China is unlikely to stimulate the economy further aggressively. This may not bode well for market sentiment in the longer run.

Last but not least, the latest comprehensive report from China's currency regulator SAFE gave us a bird view on China's balance of payment position. We identified three big trends which may continue to press China's balance of payment including overseas travel, overseas direct investment (ODI) and rising demand for offshore financial assets. We will elaborate in more details in a separate report on China's big trend. So far, the balance of payment remained largely balanced in the first half thanks to sizable goods trade surplus. This should continue to stabilize RMB exchange rate. This week is China's golden week holiday so we expect limited headline news from China.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China continued to ease rules for foreign investment. ▪ Effective from 1 Oct, China will expand its negative list approach for foreign investment from free trade zone to nationwide.	▪ Foreign investment enterprises (FIEs) will only follow a record filing process when investing in industries and sectors not in negative list. This will shorten timeframe for foreign investment. A prior approval is still needed for investment in industries and sectors in the negative list.
▪ China's security regulator officially announced to remove asset allocation restrictions on QFII and RQFII investment.	▪ Both QFII and RQFII investors are allowed to invest in certain China's equity and bond markets. However, investors are required to allocate no less than 50% to equity market while cash ratio are not allowed to exceed 20%. ▪ The removal of asset allocation restriction will grant more flexibility to offshore investors who invest in China's capital market via QFII and RQFII scheme.
▪ Since last week, more Chinese cities including Nanjing, Suzhou, Tianjin, Beijing, Zhenzhou, Chengdu and Hefei have announced property tightening measures. ▪ The new measures ranged from higher down payment ratio and home purchase restrictions.	▪ The massive announcement of property tightening measures in the past two weeks shows that China's top level may have reached consensus that the concerns about overheating in property market may have overshadowed the concerns about the economic slowdown. The shift of policy tone also shows that China is unlikely to stimulate the economy further aggressively. This may not bode well for market sentiment in the longer run.
▪ Moody's stated that if Hong Kong does not diversify its economy away from reliance on Mainland China, it will downgrade the city's sovereign rating.	▪ In fact, the close connection with Mainland China brings huge opportunities to Hong Kong's crucial financial sector via further liberalization of capital account (such as stock links). However, the city does continue to feel the pain of China's slowdown and anti-corruption campaign. The city's effort to diversify its economy via re-industrialization does not show any positive results at this juncture. According to the latest Global Competitiveness Report by World Economic Forum, Hong Kong only ranked the 27th in terms of innovation and technology (the city ranked ninth as a whole). Moreover,

	Moody's concerns that filibuster may intensify after anti-establishment camp won more seats than previously in the new Legislative Council (LegCo). It is possible that the rating agency gives higher weight to the political stability and efficiency of the LegCo. Nevertheless, a downgrade of one-notch on HK's sovereign rating may not translate into significant increase in the borrowing costs to the city's government and the local cyclical industries due to still sound fundamentals.
▪ The HKMA pointed out that banks should be alert to the risks of increasing household debt burden.	▪ According to the Half-Yearly Monetary & Financial Stability Report, the delinquency ratio of the credit card and mortgage loans stayed low at 0.27% and 0.04% respectively in 1H 2016. The debt-service index of new mortgages also improved from 49 in 4Q 2015 to 44 in 2Q this year. However, the index could increase significantly to 60.6 in a four-quarter period of US rates are raised by 300 bps. Though it is more likely that the US rate hikes will be slow and gradual, recent housing frenzy fueled by low borrowing costs and pent-up demand may still risk the asset quality of banks' mortgage portfolios. The reason behind the concern is the stretched housing affordability. Specifically, the housing price-to-income ratio remained high at 14.0 in 2Q, close to the peak of 14.6 in 1997. Also, the income-gearing ratio was 62.9% in 2Q, higher than the long-term average of around 50%, according to the HKMA. Looking ahead, we share the view of the HKMA that increasing new home supply and uncertain global financial environment will cloud the prospect of the housing market. Therefore, whether the HKMA will set a lower bound to curb the battle of mortgage rate cuts among banks remains to be closely watched.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's currency regulator SAFE published the detailed report on the China's Balance of Payment for first half of 2016.	▪ Capital outflow improved in the second half with FDI and portfolio inflows recovered. Foreign investors net purchased US$4.6 billion China's financial assets in the second quarter after RMB stabilize. ▪ However, we identified three big trends which may continue to press China's balance of payment including overseas travel, overseas direct investment (ODI) and rising demand for offshore financial assets. ▪ China's current account surplus remained sizable in the first half at US$103.5 billion, accounting for 2% of GDP due to strong surplus in goods trade. However, service trade deficit widened significantly in the first half due to strong pickup of overseas travel. Total service trade deficit was at US$105.5 billion, accounting for 93% of total service trade deficit. ▪ The direct investment turned deficit in the first half due to spike of ODI. ODI increased by US$121.4 billion up by 71% yoy while FDI increased by US$74.8 billion, down by 43% yoy. As such, the deficit in direct investment widened to US$44.6 billion. ▪ Despite portfolio inflows from offshore investors turned positive, portfolio outflows remained sizable. Chinese investors net purchased US$19.2 billion foreign equities and US$18.5 billion foreign bonds in the first half, resulting in

	deficit of US$33.1 billion portfolio flows. ▪ We will elaborate in more details in a separate report on China's big trend. So far, the balance of payment remained largely balanced in the first half thanks to sizable goods trade surplus. This should continue to stabilize RMB exchange rate. However, looking ahead, we think the pressure for RMB to weaken eventually will gradually build up as surplus from goods trade is likely to be shadowed by rising deficit in service trade, direct investment and portfolio outflows.
▪ China's official PMI remained unchanged at 50.4 in September, in line with market expectation. This reinforced market expectation that Chinese economy may have found the near-term bottom.	▪ New export order unexpectedly rebounded to 50.1 from 49.7, back to expansion for the first time in five months despite new order fell by 50.9 from 51.3. The improvement of external demand may be due to recent weakness of RMB against its currency basket given global economic recovery remained uncertain. ▪ Input prices rose to 57.5 probably due to rebound of certain commodity prices such as coal prices. This signals that China's PPI may end its 54 month's contraction. We expect PPI to remain unchanged yoy in September and returned to positive growth in October.
▪ RMB deposits shrank further by 33.3% yoy for the 12th straight month to 3.5-year low of RMB 653 billion in August as CNH depreciated 0.9% during last month.	▪ Looking ahead, RMB could remain dampened given China's economic slowdown, sustained capital outflow amid increasing M&A activities of enterprises as well as diversified portfolios of residents, and the strong greenback amid the expected rate hike of the Fed. As a result, the ongoing angst of RMB depreciation could result in persistent contraction in offshore RMB deposit. In addition, USD deposits skyrocketed 22.4% yoy to HKD 4,058 billion. ▪ Total loan and advances increased by 1.8% yoy to HK$ 7,734 billion. Loans for use outside HK grew 1% mom (-1.3% yoy), indicating that demand for Mainland related loan remained soft amid cheaper borrowing cost in Mainland and the still high credit risk of Mainland enterprises. Moreover, loans for use in HK rose by 3.2% yoy while loan to finance HK's visible trade slumped by 4.4% yoy. Sagging trade activity amid weak external demand could continue to depress growth in loan to finance HK's visible trade.
▪ HK's Export growth in value terms increased for the first time in the past 16 months by 0.8% yoy in August.	▪ Region-wise, exports to Asia as a whole grew by 3.8% yoy, led by exports to India, Taiwan and China, which increased 27.4% yoy, 20.8% yoy and 4.3% yoy respectively. On the flipside, China reported its import growth from Hong Kong to have decelerated notably to 14.3% yoy in August (vs +122.7% in July). However, this looked more likely to be seasonal factor rather than the ease of capital outflow from Mainland given the still high volatility and depreciation pressure of RMB in recent months. Elsewhere, exports to other main trading partners showed some weaknesses, in particular exports to UK (-8.3%), Germany (-8.5%) and the US (-8.7%). This may reflect a looming negative effect following Brexit. In the coming months, we expect trade growth to remain soft given sluggish external demand amid the uncertainty in the aftermath of Brexit, monetary policy divergence among major central banks as well as heightened geopolitical tensions in certain regions.
▪ The number of hotel guests in Macau continues to rise in tandem with the growth of overnight visitors, up by 7.7% yoy in August to the highest since record.	▪ The persistent room rate cuts, new hotel openings and seasonality together have helped to lure more hotel guests. On a more positive note, despite increased hotel room supply, hotel occupancy rate rose to the highest since November 2014

	at 90.3%. It is said the hotel rooms have been nearly fully booked for the Golden Week in October despite upward adjustments in room rates. On this, we believe that another new hotel opening in September as well as the effect of Mid-Autumn Festival and Golden Week will help sustain the growth in hotel guests and occupancy rate into next months. However, after the short-term boosts diminish, whether occupancy rate will retreat amid hotel room glut remain to be watched. Still, more hotel guests and longer average length of stay will lend some momentum to the gaming sector, which has shifted the focus onto the mass market segment.

RMB	
Facts	**OCBC Opinions**
▪ RMB volatility has been well capped ahead of Yuan's inclusion to SDR on 1 Oct. ▪ RMB index also remained stable last week as broad dollar was traded in a tight range globally.	▪ RMB officially joined the global reserve currency. However the actual impact on capital flow is likely to be limited as SDR is only potential claim with no immediate need for portfolio rebalancing for global central banks. ▪ The common question is whether PBoC will ease its tight control on both CNY and CNH after the SDR inclusion. We think the chance is low for the next few weeks as the sudden spike of RMB volatility after inclusion will dampen RMB's image. In addition, China may also keep its currency relatively stable ahead of semi-annual US Treasury economic and currency report in mid-October.

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