Summary

China is lucky. The unwind of long dollar position on Friday night after the disappointed US May non-farm data saved RMB from recording the fifth week decline against the dollar. As we have been arguing for the past few weeks that China has been following the new fixing mechanism closely recently. The reform does not only require commitment but sometimes luck as well. The retreat of dollar just before the USDCNY tested the important psychological level of 6.6 in both onshore and offshore markets is exactly the luck China needs. The dramatic move will alleviate concerns that RMB may head for one-way depreciation. The two-way movement will help contain RMB's volatility in the coming weeks. China's equity market ended strongly last week on the back of speculation that China's A-share may be included into MSCI this year, unaffected by the weaker Yuan for most of the week. Meanwhile, China's bond market was also under pressure due to reduced easing expectation with 10-year government bond yield broke above 3%.

The announcement from PBoC to amend its calculation to assess the reserve requirement ratio last Friday is unlikely to impact onshore liquidity significantly. We think the new rule has more impact on offshore RMB liquidity rather than onshore RMB liquidity, which is likely to help smooth offshore RMB liquidity and prevent from the repeat of similar distortion as we saw on 31 March when CNH interbank deposit rate collapsed to negative. For this week, market will pay attention to China's May economic data including today's FX reserve data, trade data on Wednesday and inflation data on Thursday.

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PBoC announced on 3 June to amend its calculation to assess the reserve requirement ratio for the second time since September 2015.
With effective from 15 July, the reserve requirement ratio will be calculated based on the average total deposit level during the assessment period rather than that at the end of period.

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We think the new rule has more impact on offshore RMB liquidity rather than onshore RMB liquidity. The impact on onshore liquidity is likely to be insignificant though the net effect may be towards tighter liquidity.
To start, China's mandatory reserve requirement ratio is calculated based on the ratio of banks' deposit reserves with central bank (numerator) to total deposits (denominator).
In the past, the RRR has been assessed by the end of period data. This tended to lead to higher fluctuation of liquidity approaching end of assessment period to meet regulatory requirement.
In September 2015, PBoC announced to change the assessment of numerator of RRR to daily average rather than end of period. This gives banks more flexibility to manage the liquidity. However, the assessment of denominator remained unchanged.
The change of assessment of denominator to daily average from end of period is unlikely to have significant impact on onshore liquidity. However, it may help smooth quarter end liquidity in the offshore RMB market.
To recall, the offshore CNH interbank deposit rate and implied yield from swap fell to negative on 31 March, which is distorted by banks' behaviour to lower their quarter end deposit base to minimize their obligation for RRR following the announcement of impose of RRR on offshore RMB deposit in January this year.
However, this distortion is unlikely to happen again at quarter-end as banks have less incentive to reduce quarter-end deposit base after the change of assessment to daily average. As such, we expect a more stable offshore RMB liquidity.

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▪ PBoC Shanghai branch announced to roll out macro prudential assessment framework to Shanghai property market to promote the long term sustainable development.	▪ The new system consists of four parts including "basic database", "monitoring system", "evaluation system" and "policy toolbox". The new system will take both population and macro and economic factors such as GDP, financing, interest rate, currency, equity market and cross border capital flows into account. ▪ The policy toolbox will include down-payment ratio, mortgage rate, debt servicing capability and differentiated policies. ▪ The Shanghai government will publish the MPA report in a timely manner to guide market expectation on property market. ▪ We think the MPA is similar to what Singapore and Hong Kong have been doing to contain volatility in the housing market.
▪ RMB deposits in Hong Kong shrank for the 8th straight month to the lowest (RMB 723 billion) since August 2013 in April.	▪ The decline of RMB deposits in Hong Kong deepened to 24.3% yoy (-4.8% mom) in April as increasing expectations over Fed's summer rate hike pushed USDCNH up by 0.4% during the same month. Adding that RMB certificate of deposits dropped by 16.8% mom to RMB 107.4 billion, total RMB liquidity pool in Hong Kong further shrank by 6.5% mom to RMB 830.4 billion. ▪ Elsewhere, loans for use outside HK dropped by 0.5% mom, indicating that demand for Mainland related loans remained soft and will continue to shrink given lower borrowing cost in China and banks' increasing cautiousness of Chinese names after a series of credit events. Moreover, loans to finance HK's visible trade slumped significantly by 13.5% yoy amid sluggish trading activities in HK, which may be able to regain traction should demand of EU and some Asian countries continue to pick up.

Key Economic News	
Facts	**OCBC Opinions**
▪ China official PMI remained unchanged at 50.1 in May.	▪ For breakdown, both new orders and new export orders fell slightly to 50.7 and 50 respectively in May from 51 and 50.1 in April, signalling slightly weaker demand. However, given both numbers are still above 50, the overall demand is still supportive. ▪ The input prices fell to 55.3 from 57.6, but it is unlikely to change the trend of improving producer prices index. We expect the contraction of PPI to narrow to about 3.1% in May.
▪ **Hong Kong:** Total value of retail sales in Hong Kong fell for the 14th straight month, down by 7.5% yoy to HK$ 37 billion.	▪ Visitor arrivals in Hong Kong in the first four months decreased by 8.8% on yearly basis while Mainland visitors further fell by 12.6% yoy. Due to weak inbound tourism and subdued tourists spending, the retail sector remains in doldrums. Jobless rates are climbing up, especially in the retail sector (5.3% in April), which have also dented domestic consumer sentiment. A stronger HKD, China's ongoing anti-corruption campaign and the decreasing appeal of Hong Kong to Mainland visitors all signal that growth in Hong Kong's tourism sector is unlikely to pick up pace any time soon. ▪ Looking forward, a combination of fewer tourists, tepid tourist spending as well as cautious local consumer sentiment will further add downward pressure onto the retail sector. The sector's employment will also continue to take a hit. As a result, HK retail shop property market may tumble further

	after the retail shop rentals and prices falling by 1.3% yoy and 7.8% yoy respectively in March.
▪ **Macau's** growth contracted at a slower pace, sliding 13.3% yoy in 1Q.	▪ New hotel and casino openings since last May have brought more overnight visitors to Macau, who then tried their luck on gambling tables and helped gaming revenue in 1Q register its smallest decline since 3Q 2014. Gaming revenue's decline stabilized at 9.6% in May, confirming that the gaming sector has bottomed out. As a result, the city's growth contracted at a slower pace. ▪ The contraction of Macau's GDP in 1Q was mainly attributed to muted visitor spending (-13.6% yoy), weak private consumption (-2.3% yoy), slowdown in private investment (-33.0% yoy) and the prolonged fall of gaming revenue. Government expenditure (+1.5% yoy) turned out to be the major support to growth. Looking forward, fixed investment is expected to regain momentum as casino operators are planning to complete their new projects during 2H 2016 to 2017. Elsewhere, strong fiscal reserve will allow Macau's government to continue to increase expenditure. More importantly, the gaming and tourism sectors are experiencing a gradual recovery. This will add to resilient government expenditure and an expected pick-up in private investment to offset the impact of slackening domestic demand and subdued visitor expenditure. Therefore, we expect Macau's GDP to stabilize with modest growth in the long term after contracting by around 3% - 5% yoy in 2016.

RMB	
Facts	**OCBC Opinions**
▪ RMB ended its fifth straight weekly decline against the dollar thanks to the unwind of global long dollar position following the disappointed US non-farm payroll data. Both USDCNY and USDCNH ended down below 6.55.	▪ China is lucky. The unwind of long dollar position came at the right time just before the USDCNY tested the important psychological level of 6.6 in both onshore and offshore markets. ▪ As we have been arguing for the past few weeks, the main reason that the latest RMB depreciation against dollar has not induced fresh round of volatility is because of improving fixing mechanism. The dramatic move last Friday again confirmed our view, alleviating concerns that RMB may head for one-way depreciation. The two-way movement will help contain RMB's volatility.

Liquidity	
Facts	**OCBC Opinions**
▪ On 31st May, overnight CNH HIBOR tumbled to two-month low of 0.823%. ▪ PBoC net injected CNY20 billion last week via reverse repo, third net straight week net liquidity injection.	▪ The recent move in offshore CNH rate and HKD swap points have been distorted by the increasing demand from Chinese banks due to tight onshore dollar liquidity. The HKD swap points continued to move to the left last week as HKD remained the popular alternative sources for Chinese banks to get the dollar liquidity.

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