Summary

The focus shifted back to China's monetary policy stance last week in a event light week. The research article published by research department of China's economic planning agency NDRC fuelled easing expectation after the paper said China will find appropriate time to lower interest rate and reserve requirement ratio. However, the revision of the article to drop the call for more monetary policy easing a few hours later shows still prudent monetary policy. This was later confirmed by PBoC second quarter monetary policy report, which said that high frequency of reserve requirement ratio cut may reinforce easing expectation, which in turn may create depreciation pressure on currency. We think China is still comfortable with current unconventional measures and the chance of near term RRR cut is likely to remain low, in particular after the FX reserve has stabilized recently (US$3.2 trillion as of July).

On data front, the surprising sharp rebound of Caixin PMI despite the further decline of official one created optimism that new economy may perform well, shadowing the slowdown in the heavy industries. Nevertheless, we think it is still too early to call for the bottom for Chinese economy. This week's July data may provide more colours on economic situation. On currency, we are approaching one year anniversary of 811 currency reform. RMB sentiment has improved since the second half of July after PBoC showed the near term line of defence at 6.70. Meanwhile, emerging Asia and China also benefited from the return of capital inflows driven by hunting for yields theme. We expect more portfolio inflows to China's interbank bond market, which may provide some supports to RMB. CNH swap was in focus last week with the 12m USDCNH swap points dropped from 1300 to around 1100, lowest since August 2014. We think this might be due to expectation on forward book rollover. The USDCNY fixing is expected to open higher above 6.6600 as a result of dollar rebound last Friday following the stronger than expected US non-farm payroll data.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The language tweak about monetary policy easing in the article published by research department of NDRC within one day sparked the discussion about the policy outlook.	▪ The research department of China's economic planning agency NDRC said China will find appropriate time to lower interest rate and reserve requirement ratio in its latest article published in the NDRC website. ▪ However, the agency revised the article and dropped the call for more monetary policy easing a few hours later after the article fuelled speculation that China may ease further. ▪ The drama shows the divergent view about China's monetary policy across different government bodies. We still hold the view that PBoC may rely more on unconventional measures such as the combination of SLF, MLF and PSL to maintain liquidity stable rather than interest rate cut risking fuelling bubbles in property market.
▪ China's central bank wrote in its second quarter monetary policy report that the high frequency of reserve requirement ratio cut may reinforce easing expectation, which in turn may create depreciation pressure on currency.	▪ The PBoC monetary policy report reiterated the prudent monetary policy, shadowing the easing expectation amid global easing. This, together with the NDRC research paper saga earlier last week, shows that China is still comfortable with current unconventional monetary policy tools. The near term RRR cut is likely to remain low, in particular after the FX reserve has stabilized recently.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's official PMI dipped by 0.1 to 49.9 in July, below the threshold line while the Caixin PMI surged by 2 points to 50.6 in July from 48.6, above 50 for the first time since Feb 15.	▪ Although it is not the first time to see the divergence between official and Caixin PMI, it is unusual for market to see the sharp rebound of Caixin PMI while official PMI slipped to below 50. The divergence may be attributable to difference in weightage. According to Caixin, its PMI may have higher weights on eastern part of China as well as the new economy while official PMI may have higher weights on heavy industries. This suggests that new economy may recover while heavy industries still suffer from excessive capacity problems.

	▪ Nevertheless, we think it is still too early to call form bottom for Chinese economy. And we may need to wait for more data points.
▪ China's foreign exchange reserve fell by US$4.1 billion in July to US$3.2 trillion after rising by US$13.4 billion in June.	▪ The marginal decline in July is partially due to valuation effect as a result of dollar appreciation in July following the unexpected Brexit event. We think the flow has been more balanced due to still tight control on outflows as well as return of inflows to China's bond market. We expect China to continue its current tight control on outflows for the rest of year. As such, the FX reserve is expected to remain largely stable.
▪ The preliminary data from the SAFE shows that China's capital and financial account deficit hit a new high in 2Q.	▪ The deficit in financial and capital account widened to a record high of US$59.4 billion in 2Q. There is no detailed breakdown of BoP data under the preliminary data. ▪ Current account surplus improved to US$59.4 billion in 2Q from US$39.3 billion in 1Q.
▪ HK retail sales fell for the 16th straight month by 8.9% yoy in June.	▪ Total retail sales fell for the 16th straight month by 8.9% yoy in June. Retail sales fell by 10.5% yoy in 1H16. The decline in the luxury segment continued to pose a severe drag on HK retail sales. Value of sales in jewelry and watches contracted for the 21st straight month by 20.4% yoy in June, which was also the 10th consecutive double-digit contraction. Meanwhile, sales of consumer durable goods dipped notably by 26.2% yoy. In the near term, HK retail sector is likely to be constrained by weak inbound tourism activities amid Chinese economic downturn and external uncertainties, in turn possibly denting consumer sentiment and weighing down employment in this sector. Gloomy prospect for Hong Kong's retail sector will as a result translate into downward pressure on HK retail shop property market. More rental concession by the landlord and higher vacancy rate in core business district could also be expected.
▪ HK's residential property transaction volume registered 4,232 units in July, the lowest in recent four months.	▪ On a yearly basis, the decline of residential property transactions moderated significantly from 45% in March to 22% in July. Though Hong Kong's dimmer economic outlook clouded the property market and dent investor's sentiment, the delayed rate hike may provide buffer to slow down the pace of correction. Looking ahead, tightened housing purchase rules announced early 2015 would continue to deter end-user demand mainly for smaller ticket flats. In the longer term, HK government is striving to increase housing supply, which will also depress the housing price.
▪ Though the gross gaming revenue (GGR) in Macau dropped for the 26th straight month to MOP17.77 billion, it fell at a much slower pace by 4.5% yoy, reinforcing the sector's stabilization.	▪ The continuous growth in overnight visitors might have lent momentum to the expanding mass-market segment. Looking ahead, given the effect of summer holiday, two new projects to be completed in 2H are expected to bring more leisure gamblers to the city and further underpin a recovery in the gaming sector. However, due to the government's restriction on the growth of gambling tables, one of the two new projects may have only 100 gambling tables approved, much fewer than expected. If this is the case, the expansion pace of the mass-market segment may be constrained, especially given the relatively low minimum bet amount of each table. To make things worse, VIP segment which still accounted for 51.5% of total GGR in 2Q is likely to continue its downward trend amid tighter rules and China's anti-corruption campaign.

	All in all, we expect that the GGR to drop by around 5% yoy over 2016 as a whole.

RMB	
Facts	**OCBC Opinions**
▪ Despite the choppy USDCNY fixing, the USDCNY was traded in a narrow range between 6.6250-6.6500 last week. ▪ RMB index fell below 95 last week.	▪ The choppy USDCNY fixing is mainly the result of volatile dollar and JPY movement in the global market. Fixing continued to be driven by market last week. ▪ RMB sentiment has improved since the second half of July after PBoC showed the near term line of defence at 6.70. Meanwhile, emerging Asia and China also benefited from the return of capital inflows driven by hunting for yields theme. We expect more portfolio inflows to China's interbank bond market, which may provide some supports to RMB. ▪ CNH swap was in focus last week with the 12m USDCNH swap points dropped from 1300 to around 1100, lowest since August 2014. We think this might be due to expectation on forward book rollover as we are approaching anniversary of 811 currency reform.

OCBC Greater China research

Tommy Xie Xied@ocbc.com

Carie Li Carierli@ocbcwh.com

Kam Liu Kamyyliu@ocbcwh.com