Summary

RMB's gradual depreciation trend continued last week. However, unlike early January, the current depreciation did not induce market volatility as well as heighten capital outflow risk. The latest rally in China's equity market, together with stable liquidity situation and improving FX reserve numbers, is encouraging, which may underpin PBoC's confidence in its current fixing mechanism. The latest article from CFETs also reinforced market's view that China is comfortable with a gradual depreciation trend. Given it is difficult to quantify China's bottom line over RMB policy, we reiterated our view that RMB will drift lower against both USD and basket currency till dollar retreats significantly in the global market.

China announced to implement the System of National Accounts, an international framework for compiling economic data, endorsed by the UN in 2008 (SNA2008). Under the SNA2008, the research and development spending is considered as fixed asset investment rather than intermediate input. This boosted China's nominal GDP by 1.3% and added 0.04% to GDP growth in 2015. The adoption of SNA2008 is a common practice in OECD countries, as such, there is no need for market to suspect China's intention to revise its GDP. The impact on 2Q GDP due on 15 July is unlikely to be significant in our view. One thing worth highlighting is that China's nominal GDP may be still underestimated as China has not adopted new techniques to capture intangible activities.

The latest June CPI has limited impact on market's expectation on easing policy. As the liquidity remained flush in China's onshore market even after PBoC net withdrew CNY645 billion from banking system, there is no urgency for PBoC to cut its RRR should equity market remain stable. For this week, market will look at China's June economic data as well as China's reaction to Hague court ruling on South China Sea dispute.

<table>
<tr><th colspan="2">Key Events and Market Talk</th></tr>
<tr><th>Facts</th><th>OCBC Opinions</th></tr>
<tr><td>China announced to implement the System of National Accounts, an international framework for compiling economic data, endorsed by the UN in 2008 (SNA2008). Under the SNA2008, the research and development spending is considered as fixed asset investment rather than intermediate input.</td><td>The latest revision shows that China's nominal GDP has been revised higher by 1.3% to CNY68.5 trillion from CNY67.6 trillion in 2015. However, after adjusting for inflation, the impact on the real economic growth is limited with the new method adding 0.04% to 2015 GDP growth.
As the SNA2008 has been widely by the OECD countries and the latest implementation by the US in 2013 has also led to significant upward revision of GDP, there is no need for market to suspect China's intention to revise its GDP.
The 2Q GDP, due on 15 July, will be reported using the new method. As such, it may slightly boost the GDP higher. However, we think the impact is unlikely to be significant. Therefore, we maintain our 2Q GDP forecast unchanged at 6.5%.
Last but not least, the current revision did not show the complete picture of SNA2008. In addition to inclusion of research and spending as fixed investment, the SNA2008 also adopted new techniques to capture intangible activities. The missing puzzle here is how China captures the services of owner-occupied housing in GDP component. The imputation under the current method is based on out-dated cost method rather than rent paid. As such, this may underestimate China's GDP. Should China revise that again in future, the GDP is likely to be revised up again.</td></tr>
<tr><td>China expanded 20% reserve ratio for long foreign currency forward position to certain CNH forwards.</td><td>Offshore financial institutions, participating in the onshore interbank FX market, are required to pay 20% reserve ratio should they square their customer's offshore long dollar forward position with onshore interbank market.
Given more offshore commercial banks are allowed to participate in China's onshore interbank FX market as part of opening, the expansion of 20% reserve ratio is nothing but filling the gap.</td></tr>
</table>

▪ Seven out of eight land auctions in Nanjing, capital city of Jiangsu Province, were aborted last Friday. ▪ The failure of land auctions in Nanjing is not because of weak demand but strong demand.	▪ Land prices and property prices have been soaring recently. As such, Nanjing government announced to tighten its property market in May via introducing price cap for land auction. ▪ The land auction is likely to be aborted if developers' bidding offers are too high. ▪ Clearly the property fever in the wake of easing monetary policies and RMB's gradual depreciation has been spread to lower tier cities from tier-1 cities. Given there is limited investment channels in China, money may continue to flood into property market in the near term.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve unexpectedly increased by US$13.4 billion in June to US$3.21 trillion, biggest monthly increase in 14 months, despite weaker RMB.	▪ The unexpected increase was mainly attributable to three reasons in our view. First, it may be the result of less intervention in the FX market. PBoC has granted market a bigger role in deciding RMB value since this year. Second, it may also be the result of Yen appreciation. Yen has strengthened significantly in June. As such, the currency gain in Yen denominated assets may partially offset the currency loss in GBP denominated assets. Third, the recent capital account liberalization aiming to attract capital inflows may have taken effect. In particular, we expect positive inflows from offshore bond investors investing in China's onshore interbank bond market after China specified details for interbank bond market investment.
▪ China's CPI grew by 1.9% yoy in June, slightly higher than market expectation while PPI fell by 2.6% yoy.	▪ CPI contracted by 0.1% month-on-month mainly due to falling food prices. The rise of pork prices moderated to 1.1% mom, overshadowed by 12.5% mom decline of vegetable prices. However, non-food prices expanded by 0.2% mom partially due to higher fuel prices as a result of higher oil prices. Given the pork price is likely to peak, the inflationary pressure in the coming months is expected to stay muted. The recent flood in central and south China may have impact on food prices, but it is unlikely to be significant based on historical experience. ▪ PPI fell by 0.2% mom after expanding for three consecutive months.
▪ HK residential property transaction volume continued to rebound in June	▪ Residential property transaction volume improved for the third consecutive month to 4,620 units in June after property prices fell by 10% from the peak in September 2015. On a yearly basis, the decline of residential property transactions moderated significantly from 45% in March to 20% in June, mainly driven by the rebound of demand for housing units priced between HKD 3 million and HKD 5 million, which up by 13% mom from 1,694 units to 1,909 units. The delayed Fed rate hike expectation is likely to offset the weaker economic outlook, which may provide some buffer to slow down the pace of correction.
▪ Gaming revenue (MOP15.88 billion) fell for the 25th straight month to the lowest since September 2010.	▪ The persistent fall of total gaming revenue was due to government's tightening rules on junkets, scrutiny of anti-money laundering and restriction on gaming table growth. The diminishing benefit of last year's hotel and casino openings also translates into the city's decreasing attractiveness to casual gamblers. Still, it's a positive note that the decline of gaming revenue narrowed further to 8.5%, which may not deepen again despite tighter government scrutiny.

	▪ Looking ahead, should the new projects show further delays, the recovery of the gaming sector is likely to be more gradual than expected. Otherwise, upon completions, new hotels, casinos and theme park in coming 1-2 years are expected to lure more overnight visitors who will then try their luck in the mass market gambling tables. All in all, we believe that gaming revenue will drop by around 5% over 2016 and the gaming sector's recovery pace of next year depends on the opening schedules of new projects.

RMB

Facts	OCBC Opinions
▪ The gradual depreciation trend continued last week with the USDCNY tested 6.7 while the RMB index weakened to 94.2. ▪ Clearly, RMB has been mainly driven by market supply and demand for the past few weeks. ▪ Market has kind of reached consensus that PBoC is comfortable with the current gradual depreciation trend.	▪ RMB was still trapped in the current gradual depreciation trap as we pointed out last week under the current fixing mechanism. However, unlike early January, the current depreciation did not induce market volatility and heighten capital outflow risk. The outperforming equity market, stable money market as well as stable FX reserve underpinned the current currency policy. As such, we see few incentives for PBoC to tweak its current FX policy. ▪ The latest article from CFETs also reinforced market's view that China is comfortable with a gradual depreciation trend. In the article, CFETs said the depreciation of RMB nominal effective exchange rate was mainly due to two reasons including the high base and domestic price level. The base period for RMB index is at a high level and therefore it requires adjustments. In addition, China's inflation is on a level generally higher than the US. As such, there is need for nominal effective exchange rate to weaken in order to stabilize the real effective exchange rate. ▪ Given it is difficult to quantify China's bottom line over RMB policy, we reiterated our view that RMB will drift lower against both USD and basket currency till dollar retreats significantly in the global market.

Liquidity

Facts	OCBC Opinions
▪ PBoC net withdrew CNY645 billion from system via reverse repo due to flush liquidity. ▪ PBoC said central bank's queries on banks' demand for MLF is not equivalent to monetary policy signal.	▪ Despite recent RMB depreciation, liquidity in money market remained flush. As such, there is no urgency for China to cut RRR to counter capital outflows. ▪ Meanwhile, China has been increasingly relied on non-traditional monetary policy tools such as MLF and PSL to manage its liquidity. We think this trend is likely to continue.

OCBC Greater China research

Tommy Xie Xied@ocbc.com

Carie Li Carierli@ocbcwh.com

Kam Liu Kamyyliu@ocbcwh.com

Co.Reg.no.:193200032W