Summary

China's bond investors remained jittery in the past week after PBoC shows less interest in further easing. The extension of MLF tenor to 6-momth and 1-year, together with the inquiry of 28-day reverse repo, signals PBoC's intention to curb leverage in the bond market via raising funding costs through longer-tenor liquidity offering. The August CPI, though surprised on the downside, is unlikely to support bond bull in our view. Given the CPI is projected to return to 2% in 4Q, the weaker than expected Aug CPI did not warrant additional imminent easing.

The latest FX reserve data signals the renewed pressure for capital outflow. We expect China's FX reserve continue to drift lower but at a manageable pace. The decline of FX reserve did not deter China's decision to gradually re-open its capital account. China's insurance regulator allowed insurers to invest in Hong Kong equity market under Shanghai Hong Kong connect. This is one of the few new channels for capital outflows allowed since China has tightened cross border flows to fight against RMB volatility in 2015. This shows increasing confidence of Chinese regulators on managing capital flows. In addition, China continued to attract capital inflows via easing RQFII rules to shorten approval procedure.

RMB continued to demonstrate its two-way movement to the market taking advantage of volatile dollar movement; we feel that risk remains towards the downside with investors are more sensitive to negative news than positive news. For now, PBoC continued to show interest in capping the USDCNY below 6.70. Market also viewed the tightening CNH liquidity in the offshore market as the signal to show China's willingness to keep USDCNH below 6.70. For this week, investors will watch out for August economic data due today to gauge the pace of recovery in China.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China eased RQFII rules to open door for more foreign investors.	▪ Offshore institutional investors will receive a base investment quota, which is no greater than certain portion of asset size. This will ease the approval procedure for RQFII quota. However, for investors who want additional quota on top of base quota, they will still need seek approval from the SAFE.
▪ China's banking regulator issued guideline to allow banks to set up debt committee for troubled borrowers who met certain conditions such as the development of the company is in line with government macro policies and products and services of this company has good prospect etc.	▪ The new guidance is designed to provide more financial support to real economy. Banks are unlikely to cut off financing support unilaterally prior to the setup of debt committee. This will prevent from disorderly debt restructuring.
▪ PBoC injected CNY275 billion liquidity via MLF last week after CNY123 billion matured.	▪ The tenors of MLF were extended to 6-month and 1-year from previous 3-month. This is in line with the re-launch of longer tenor reverse repo to increase funding costs for leverage trade to curb leverage.
▪ PBoC was reported to gauge market demand for 28-day reverse repo on 12 Sep.	▪ The enquiry was ahead of October National Day golden week, which should provide banks liquidity to cover funding needs during the golden week holiday. ▪ However, market considers this as another signal to curb leverage in China's bond market after the re-launch of 14-day reverse repo in August.
▪ China's insurance regulator allowed insurers to invest in Hong Kong equity market under Shanghai Hong Kong connect.	▪ The new announcement opened new investment channels for insurers. This could further increase the capital flows from onshore to offshore and thereby boost Hong Kong stock market. ▪ From capital flow perspective, this is one of the only few new channels for capital outflows allowed since China has tightened cross border flows to fight against RMB volatility in 2015. This shows increasing confidence of Chinese regulators on managing capital flows.
▪ CNH liquidity tightened in the spot market with USDCNH forward points climbing. Also, CNH	▪ USDCNH T/N forward points rose notably from a nearly two-month low of 1 on 6 Sep to 27.5 on 8 Sep. Meanwhile,

overnight HIBOR surged to the highest since Feb, marking 5.446% on 8 Sep.	USDCNH 12-month forward points surged to an over 1-month high of 1380 on 8 Sep. Besides that, USDCNH 1-month forward implied yield jumped to the highest since March to over 3%. The spike of short end swap points reminded market memory of early January this year, when PBoC moped up CNH liquidity to increase funding costs for short sellers. This suggests PBoC may remain visible in defending 6.70 even post-G20 meeting. The spike of long end swap points may be the result of speculation that China may not roll over its 1-year swap transaction

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve fell below US$3.2 trillion to US$3.185 trillion in August, lowest since December 2011.	▪ FX reserve denominated in SDR fell to 2.28 trillion SDR, the first decline for five months. This signals the renewed pressure for capital outflow albeit at a manageable pace. The informal administrative measures implemented by China's various regulators to curb capital outflows have managed to slow the pace of outflows, however, it did not eliminate the pressure. Instead, those admin measures may have prolonged the outflows. As such, we expect China's FX reserve to continue to drift lower at a manageable pace in the coming months.
▪ China's CPI growth decelerated to lower than expected 1.3% yoy in August. ▪ The contraction of PPI growth narrowed to 0.8% in August from 1.7% in July.	▪ The lower than expected CPI was mainly the result of falling pork prices, which overshadowing the increase of vegetable prices due to flood. ▪ The CPI is expected to remain low at around 1.5% in September in particular after vegetable prices fell in the first part of September. However, we expect the CPI to recover to around 2% level in the last quarter due to base effect. As such, we think it might be too early to worry about the disinflationary risk in China and the current CPI reading does not warrant additional easing in our view. ▪ The contraction of PPI narrowed further, in line with the improvement of input prices of PMI. Although the recovery of commodity prices seem to be capped in the near term, the PPI reading may continue to benefit from the low base. As such, we think PPI may return to positive yoy growth for the first time since ***
▪ Imports in dollar term unexpectedly rebounded by 1.5% in August. ▪ The contraction of export also narrowed to 2.5% in August from 5.4% in July.	▪ The rebound of imports was the result of increasing demand for commodity and booming property market. This is also in line with stronger than expected PMI data, signalling the emergence of green shoots as the result of supportive fiscal policy.
▪ Residential property transaction volume surged to 5,821 units in August, the highest since March 2015.	▪ Decline of overall residential property price narrowed again from 8.33% yoy to 7.46% in July, the smallest decline on yearly basis since March. This may signal that property price is oscillating in the near term. The growth in the prices of smaller residential units (below 100 sq.m.) contracted 7.57% yoy while those belonging to the larger units (above 100 sq.m.) dipped 4.91% yoy. Residential property transaction volume surged to 5,821 units in August, the highest since March 2015. On a yearly basis, residential property transactions increased significantly by 49%, the first positive growth since April 2015. Though Hong Kong's dimmer economic outlook amid weak

	inbound tourism continued to cloud the property market and dent investor's sentiment, the slower pace of a rate hike in the US has resulted in the unlikely pick up in borrowing costs this year, leaving room for the property market to see a more gradual correction. By segment, transaction volumes for housing units priced between HKD 3 million and HKD 10 million were mainly responsible for the rebound, which surged from 3,229 units to 4,458 units, up 38% mom. In the longer term, HK government is striving to increase housing supply, which will also depress the housing price. In addition, we believe that the interest rate in HK would climb up progressively amid the tightening cycle of US to maintain the stability of HKD exchange rate, which would also translate to downside risk in HK property market.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY has kept track of the broad dollar movement for the past week. RMB strengthened to test 6.6600 following the dollar weakness but subsequently weakened to 6.6800 after dollar rebounded in the global market. ▪ RMB index softened to 94.02 on 12 Sep.	▪ Although RMB continued to demonstrate its two-way movement to the market, we feel that risk remains towards the downside with investors are more sensitive to negative news than positive news. ▪ For now, PBoC continued to show interest in capping the USDCNY below 6.70. However, should dollar rally in the global market, the pressure for the USDCNY fixing, which is still driven by market, to break above 6.7 may exert pressure on the spot market.

OCBC Greater China research

Tommy Xie Xied@ocbc.com

Carie Li Carierli@ocbcwh.com

Kam Liu Kamyyliu@ocbcwh.com

Co.Reg.no.:193200032W