Summary

Last Wednesday, the overnight CNH HIBOR reached the highest point since February, reflecting the worsened liquidity which might be caused by PBoC's intervention. As a result, the cost of speculation was pushed up and the gap between the yuan across the border was narrowed, eliminating arbitrage opportunities. Similarly in January, the overnight CNH HIBOR was driven to a record high of 66.8%. Although RMB is trapped in gradual depreciation, market sentiments currently remained relatively stable. Also, rising RMB index and two-way movements of USDCNY may allow PBoC to further stabilise the market expectations' on RMB, relieving the depreciation pressure.

The majority of key economic data released last week were better than expected. Driven by infrastructure and property markets, GDP grew 6.7% yoy in 2Q. Under the economic transformation, the acceleration of retail sales growth is considered positive. However, there are risks remaining in the next half of the year. The growth of fixed assets investment and real estate investment slowed down. Private investment continued to be weak because of the low rate of return on real economy. As such, the low participation of private investment may hinder the sustainability of economic growth. Also, the increase in new yuan loan was mainly because of the increase in mid-to-long term household borrowing. At the turning point of the property market, the increase in household leverage level is risky. Besides, the fall in both exports and imports in dollar term signalled the weak domestic and foreign demands, which may continue to harm China's trade in the next half of the year. Therefore, we would like to slightly lower the forecast of GDP from 6.7% to 6.6% for this year.

For this week, focus will be placed on ECB monetary policy. No major change is expected. Instead, more attention should be placed towards ECB's response post-Brexit. Besides, UK's economic data releases and Australia RBA July Meeting Minutes will be closely monitored.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ Residential mortgage rates were cut further to 1-month HIBOR plus 1.5% by some banks in Hong Kong.	▪ Given the bleak economic outlook and increased job insecurity, housing transaction volume dropped 38% yoy to 19921 units in 1H. Due to the property market correction and concerns about the Fed's rate hikes, number of new mortgage loans approved edged down significantly by 34% yoy to 26,276 over the first five months. ▪ In order to attract more applications for mortgage loans, several banks in Hong Kong further cut the mortgage rates from 1-month HIBOR plus 1.6% to 1-month HIBOR plus 1.5%. The Fed likely to slow its rate hike pace post Brexit is the main support for the banks to offer lower mortgage rates. The Fed's slower tightening will also ease the capital outflow from Hong Kong, allowing HIBOR to stabilize at historical low for some time. ▪ As such, borrowing costs might remain low and in turn underpin a rebound in housing transaction which rose for the third straight month on monthly basis. However, with the housing cooling measure in place, the upward risks on the housing market are very limited. Instead, as the Fed may still continue to tighten its policy albeit at a gradual pace, coupled with more housing supply ahead, renewed downward risks are expected to drag down the housing market again after recent short-lived pick-up.

Key Economic News	
Facts	**OCBC Opinions**
▪ Macau housing transaction volumes rose for the third straight month, up by 73% yoy to 1067 units in May. As a result, new residential mortgage loans (RML) approved started to reverse its downward trend, jumping by 45% yoy (91.1% mom) to MOP5.4 billion.	▪ The upbeat housing sentiment was due to the stable labour market, banks' loosening rules on mortgage loans and signs of recovery in both tourism and gaming sectors. Looking ahead, new hotel openings in 2H will bode well for the labour market. More importantly, after the U.K. voted to leave the EU, the Fed is more likely to delay its rate hike schedules. As such, borrowing costs are expected remain low and in turn fuel demand in the housing market, underpinning the rebound in housing transactions in near term. Average housing prices as a result may also stabilize at current level of MOP77,203/sq. m. over 2H 2016. However, the expected slower wage growth and increasing supply ahead are likely to rebuild downward risks on the housing market in a longer term.
▪ Foreign direct investment grew by 9.7% to CNY98.2 billion in June.	▪ Growth of FDI in June reversed mild decline in May. FDI rose by 5.1% yoy in the first half of 2016. 70% of FDI went to service sector with the investment in the high tech services almost doubled.
▪ Exports in dollar term fell by 4.8% yoy in June while import fell by 8.4% yoy in dollar term.	▪ Both re-export and general recorded the negative growth, signalling the still-weak external demand. This is also in line with the decline in new export orders as shown by PMI. The impact of Brexit on trade may not have been fully priced in. As such, export may remain pressure in the coming months. Elsewhere, drop in imports was because commodity rally slowed in June. Import from Hong Kong moderated to 70% from 242% in May. The Chinese customs said the strong import from Hong Kong in the past few months was mainly due to demand for gold. However, apart from safe haven demand, onshore investors also tend to leverage on gold import to move money across the border. We will closely monitor the growth of imports from Hong Kong in the coming months, to see whether it will accelerate again due to the heightened depreciation pressure on the yuan post Brexit. Trade surplus remained stable at around US$48.1 billion, which helped slow the pace of depreciation in the RMB.
▪ China's 2Q GDP grew faster than expectations while further slowdown of private investment is building up risks onto China's growth in 2H.	▪ China's GDP grew 6.7% yoy in Q2, slightly better than forecast. China's economy sustained its growth despite the global uncertainty and domestic economic headwind. What worth noticing is national disposable income per capita rose by 8.7% yoy but increased only by 6.5% yoy excluding price factor. It signals that real growth in national disposable income per capita underperformed economic growth. Also, the figure shows that impact of the new method of calculating GDP is not significant. ▪ Elsewhere, growth in industrial production increased mildly to 6.2% in June, 0.2 percentage points higher than last month and better than forecast. Retail sales growth also accelerated notably to 10.6% in June, reflecting that domestic demand may not be as sluggish as expected. But growth in fixed asset investment continued to slow down over the first 6 months, growing at a much slower pace by 9% compared with 9.6% during January to May. Soft fixed asset investment was mainly dragged down by the subdued investment in manufacturing sector as well as lackluster private investment. This signaled that enterprises remained cautious of spending while

	investment in manufacturing sector was dent due to overcapacity. The difficulty of financing and the tepid return of investment are also reasons behind the persistently sluggish private investment. In this case, despite fast growth of infrastructure investment (+20.9% in the first 6 months), China's growth still face downward risks in the 2H. Given private investment remains weak, we revise our GDP forecast for China down slightly to 6.6% from previously expected 6.7%. ▪ And as the monetary policy's marginal effect may have been diminishing, we believe the PBoC will continue to rely on non-traditional monetary policy tool and expansionary fiscal policy to boost China's growth.
▪ China's new Yuan loan and aggregate social financing both beat market expectations.	▪ China's new Yuan loan and aggregate social financing greatly rebounded in June, beating market expectations. This is mainly because the PBoC changed its stance from "strengthening supervision and tightening lending" to "easing fiscal policy and neutral monetary policy". Total new Yuan loan printed CNY1380 billion or 40% higher from last month, reaching the highest since February. Data indicate that enterprises were more accessible to funds because the PBoC continued to increase lending to stabilize the economy. Banks tend to increase loans at the end of 1H, which also helped push up the credit growth. Elsewhere, despite recent decrease in property transaction volume, the medium to long term loans to household sector still increased, reflecting strong demand for property mortgage. However, given correction in the property market, surge in leverage of households might translate into risks to the economy. Looking forward, as infrastructure investment will continue to support the economic growth, needs for new yuan loan may mainly come from infrastructure projects. However, contraction in property investment amid property market correction is expected to weigh on new Yuan loan in 2H. ▪ Aggregate social financing expanded to CNY1630 billion, 2.5 times that in last month. The contraction in the scale of off-balance-sheet financing showed that the increase in aggregate social financing mainly relied on the direct financing amid tighter scrutiny. Meanwhile, M2 growth remained unchanged at 11.8% given the base effect of large non-bank deposits last year. Besides, fiscal deposit slumped significantly by CNY1329.6 billion, signalling accommodative fiscal policy.

RMB	
Facts	**OCBC Opinions**
▪ Overnight CNH HIBOR jumped by 2.46 percentage points to 4.83%, the highest since February, comfortable with the current gradual depreciation trend.	▪ Due to the heightening concerns about prolonged depreciation risks on the RMB, the gap between CNY and CNH widened, especially after the UK voted to withdraw from the EU. To narrow the gap between the yuan across the border, the PBOC might have intervened in the offshore market by decreasing the offshore yuan liquidity and thereby pushing up the costs of speculation as it did in January when overnight CNH HIBOR was driven to a record high of 66.8%. On a positive note, unlike in January, where investors were worried about any disorderly depreciation of the Yuan, investor sentiment

	over the Yuan has stabilized given PBoC's commitment to better communication with the markets. Moreover, with Theresa May in line to be the next British PM, the political situation in the West has also calmed. Coupled with the fact that many central banks have pledged to continue their accommodative monetary policies at least for the medium term, markets seems to have shifted back onto risk-on mode. As such, the PBOC will have more time to stabilize market expectations of the Yuan, indicating that overnight CNH HIBOR is unlikely to retest its all-time high (66.8% reached in January) in the near term.
▪ The RMB index rebounded gradually after touching the record low on last Monday.	▪ The PBOC's intervention in the offshore RMB market last week helped to narrow the gap between the yuan across the border. Meanwhile, the market calmed on eased UK uncertainties. More importantly, the Japanese yen retreated amid increased expectations on further easing fiscal and monetary policy in Japan, allowing the RMB index to regain some footings. In this case, the PBOC will also have more time to manage market expectations on the yuan. However, the mixed economic data out of China last week sparked market concerns over slowdown of the country's economy in 2H and raised expectations on the PBOC's further move on loosening the monetary policy, adding downward pressure to the yuan.

Liquidity	
Facts	**OCBC Opinions**
▪ The PBoC rolled over CNY259 billion medium term lending facility ahead of CNY529 billion maturing this month.	▪ We think nontraditional tools such as MLF and PSL are still preferred by PBoC over traditional tools such as RRR and interest rate. As such, we see low probability of RRR cut in the near term.

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