Summary

The official approval of Shenzhen-Hong Kong stock connects by the State Council last week dominated the headline news. It is widely expected that the link will kick off as early as December this year. This will give offshore investors the opportunity to access to China's "new economy" sectors as Shenzhen exchange is more concentrated in high growth companies. The removal of aggregate quota for both Shanghai-Hong Kong connect and upcoming Shenzhen-Hong Kong connect, though maintaining the daily quota unchanged, is encouraging as it shows China's willingness to re-open its capital account to allow certain level of capital outflows. However, we don't expect any significant impact judging by the poor utilization of Shanghai-Hong Kong stock connects.

The latest data from the SAFE show that capital outflow risk remains alive despite recent stabilization of RMB exchange rate. However, the current pace of outflows is still controllable in our view as long as China's fundamental will not deteriorate further. On currency front, it is kind of a disappointment to us that RMB failed to sustain its gain against the dollar despite stronger Yen and Euro last week. This shows the strong interest in buying dollar on dip when the USDCNY approaches 6.60 level. The further depreciation of RMB index to 94.11 may fuel renewed concerns about the market sentiment. The fixing is expected to test 6.6600 this morning. Nevertheless, we expect the dollar selling interest to re-emerge when the pair moves towards 6.7000. We expect the pair to be traded in a wide range of 6.6-6.7 in the near term. The focus will shift towards Jackson hole meeting this week.

<table>
<tr><th colspan="2">Key Events and Market Talk</th></tr>
<tr><th>Facts</th><th>OCBC Opinions</th></tr>
<tr><td>The State Council approved the long-awaited Shenzhen-Hong Kong exchange link. The Hong Kong Exchanges & Clearing Ltd. stated that the link should be launched in about four months.</td><td>The new features of the second stock connect as compared to the first one include: (1) no aggregate quota (also applies to the Shanghai-Hong Kong stock connect) (2) southbound access to small-cap companies included in Hang Seng HK Small-Cap Index that have a market value of more than HK$5 billion as well as the stocks of companies dual listed in Shenzhen and Hong Kong (3) northbound access to any stock with a market value of more than 6 billion yuan in the Shenzhen Stock Exchange Component Index and Shenzhen Stock Exchange Small/Mid Cap Innovation Index (access to Shenzhen's ChiNext small-cap gauge will be open only to institutional investors at the early stage of the stock link).
Unlike the companies listed in Shanghai, those listed in Shenzhen are more concentrated in "new economy" sectors, such as technology. However, the P/E ratios are higher for the Shenzhen stocks as compared to Shanghai stocks. Given the concern about different regulation of onshore stock market and China's slowdown, we think offshore investors may remain cautious in the near term.
On the other hand, market raises expectations that the lifting of aggregate quota will increase the chance of A-share's inclusion into the MSCI index as the limited access to the onshore stock market was one of the reasons for the failure of inclusion in mid-June. Nonetheless, it looks to us that the removal of aggregate quota does little help to urge the MSCI to include the A shares as the more imminent issue to be addressed is the monthly repatriation limits of QFII and the pre-approval restriction on introducing A-share related financial products. As the authorities are unlikely to loosen the capital control in the near term, the difficulty of A-share being recognized as components of the MSCI index remains high.
Also, the abolition of aggregate quota is expected to show limited impact on the cross-border flows as the daily quota has never been filled. Still, it signals the authorities' willingness to open up its capital account. Elsewhere, given the limited investment channels onshore and the increasing</td></tr>
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	needs for diversification, we expect more outflows to Hong Kong, especially to the Chinese names paying high dividends.
▪ Demand for Hong Kong dollar has picked up recently. USD/HKD 12-month forward points have remained below -200 since 4 Aug and hit the lowest (-250) since Nov 2011 on 9 Aug.	▪ This signals the return of expectation on a stronger HKD. Recently, given global easing and investors' searching for high yields, capital continues to flow into Hong Kong market with the Hang Seng Index jumping by 13.44% since June 24, the date of Brexit referendum. Adding continuous flows from Mainland market via Shanghai-Hong Kong stock connect, the demand for HKD has been increasing. Should the Fed remain dovish on its interest rate decisions, the HKD will stabilize at the strong side of 7.75 against the USD, making the de-peg risk even more remote.

Key Economic News

Facts	OCBC Opinions
▪ Chinese banks net purchased US$19.7 billion for clients in July, widened from US$17.6 billion in June, signalling the renewed capital outflow risks. ▪ In addition, sale of foreign currency forward position was at US$4.4 billion in July, down from US$8.4 billion in June. ▪ SAFE said the jump of foreign currency demand was mainly attributable to short term impact of Brexit and seasonal factors. But the impact has moderated and is controllable according to SAFE.	▪ RMB was very volatile in July. RMB depreciation accelerated in the first half of July due to weak sentiment following the Brexit. However, RMB regained in the second half on the back of policy intervention after the USDCNY touched 6.7 on 18 July. ▪ The sale and purchase of foreign currency data reported by SAFE was in line with forex purchase data reported by PBoC, signalling the renewed capital outflow risk following the Brexit shock. ▪ The corporate's willingness to sell foreign currency fell in July as evidenced by the decline of sale of foreign currency forward position as well as the drop of ratio of sale of foreign currency to foreign currency receipts. ▪ Nevertheless, we agree with SAFE's assessment that the situation is controllable. The mild capital outflow is likely to continue, however, it is unlikely to be detrimental given China has tightly controlled the channels of capital outflow. ▪ Meanwhile, sentiment is expected to improve in August after RMB regained in early August, demonstrating the two-way movement.
▪ HK's unemployment rate remained high at 3.4% in July.	▪ The labor market held largely stable in overall terms but the retail sector was still hit hard by the slackened inbound tourism and weakening local consumption. Unemployment rate in the retail sector edged up by 1.5% yoy to 5.5% and employment of the consumption and tourism-related sectors witnessed the 15th consecutive year-on-year decline in July. Though decline in visitor arrivals became milder recently (-3.5% yoy in 2Q vs -10.9% yoy in 1Q), whether performance in tourism-related sector will improve still needs to be watched closely. ▪ Unemployment rate in trade and wholesale sector decreased further from 2.9% to 2.8%, still hovering around high level amid tepid external demand. What is worth noticing is that Shenzhen-Hong Kong connect was approved by the State Council on 16th August and is expected to be launched at the end of this year. This means that the capital flow across the border is going to surge in the near term and the offshore RMB business will expand from banking industry to the capital market. Shenzhen-Hong Kong connect may create more employment opportunities in security firms and fund houses

	as there will be increasing need for brokerage and asset management from mainland investors. Looking ahead, corporate hiring sentiment could remain weak given the slow-growing domestic economy and dimmer business performance.

RMB	
Facts	**OCBC Opinions**
▪ RMB failed to sustain its rally against the dollar after the USDCNY fixing hit two-month low of 6.6056 on 17 August. The USDCNY spot ended the week above 6.65. ▪ As a result, RMB continued to depreciate against the currency basket with the RMB index hit the record low of 94.11 since the launch of index from Dec2014.	▪ RMB fixing rallied thanks to stronger Yen and Euro, however, the spot failed to catch up, which in turn drove the pair's fixing higher again. ▪ The short term double bottom technical pattern was not in RMB's favour. This shows that market is biased towards buying dollar on dip when the USDCNY approaches 6.60. The sell dollar interest may emerge when the USDCNY reaches the top side of 6.70. We expect the USDCNY to be traded within a wider range between 6.60-6.70 in the near term.

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