Summary
What a shock! Global risk sentiment was switched off following the surprising Brexit referendum result last Friday. At the current stage, every country is thinking about the same question that what is the impact on them. The impact of Brexit on China may not be straight forward in our view. The fact that China's CSI300 index recovered in the afternoon trading session, outperforming most of regional counterparties, shows that Chinese investors are not particularly worry about the impact on its relatively isolated financial market. Nevertheless, RMB felt the first wave of shock with the USDCNY lost the handle of 6.60 despite stronger than expected fixing at 6.5776 last Friday. Should China follow its current fixing mechanism closely, there is the risk that the USDCNY fixing may test 6.65 this morning. In response to the Brexit result, the PBoC said in its social media account that China will use various of tools to keep liquidity stable as well as its currency at relatively stable level. As such, China's fixing will be closely watched this week.

China continued to rolled out various reforms ahead of Brexit referendum last week including open of interbank deposit to offshore investors as well as starting the direct trading between CNY and KRW. This means that KRW is likely to be added in to CFETs RMB index soon. **However, 2.5% fall of KRW last Friday, the most among Asian currencies, shows that RMB index is likely to be more volatile after including KRW.** The announcement from the Monetary Authority of Singapore to include RMB in its official reserve assets served as the timely confidence vote after RMB sentiment stabilized**. As such, after lopsided capital account liberalization for the past half year, which mostly attracted capital inflows, PBoC started to talk about two-way flows last week.** For example, PBoC openly said they are studying option to allow onshore banks to trade CNH, which may pave the way to close the gap between CNY and CNH though the gap unfortunately widened after the Brexit event last week. In addition, the idea of QDII2, which allows individual to invest in the offshore financial market directly, also resurfaced in its latest 2015 annual report published last week. Nevertheless, given the renewed global volatility after Brexit vote, it remains the question mark that whether the PBoC may have to postpone the two-way flows again.

For this week, nothing is more than important than the development of Brexit drama. PBoC Governor Zhou Xiaochuan will appear in Switzerland and Portugal this week. Whether global central banks will react together to contain volatility and reassure market will be the key to focus on.

Key Events and market talk	
Facts	**OCBC Opinions**
▪ In its 2015 annual report published by PBoC last week, the central bank said it will roll out the trial of QDII2 to allow individuals to invest in the offshore financial market at an appropriate time. Meanwhile the PBoC will also allow qualified foreign companies to issue equity in China's onshore market.	▪ Although the trial of QDII2 has been mentioned by PBoC mid-2015 in its RMB Internationalization report, China has largely shut down outflow channels as well as suspended most opening measures since late 2015 in the wake of rising RMB volatility. ▪ Given the recent stabilized sentiment, the re-highlight of the trial of outflow channels suggests that PBoC may be more confident in their handling of current RMB policy. China may eventually re-open its outflow channel in a prudent manner.
▪ PBoC said in its social media account that it is studying the option to allow onshore banks to trade CNH.	▪ The gap between onshore CNY and offshore CNH has created numerous opportunities for offshore players to take advantage of the price differential. However, the persistent gap also created the additional cost for China to manage RMB expectation. As such, it is in China's interest to narrow the gap. The most efficient way to narrow the gap is to allow more participants to access to both markets. China has opened its onshore interbank FX market to some offshore commercial players. In return, China will also allow onshore banks to participate in the offshore market. ▪ Although the CNY-CNH gap widened again last Friday due to unexpected Brexit referendum result, we think the gap will

	eventually be narrowed following the further opening of both market to more participants.
▪ China further opened its onshore interbank bond market to allow offshore investors to invest in interbank deposit.	▪ The move will provide more RMB denominated assets to foreign investors, which may make RMB internationalization more appealing to international investors. In addition, with more investors in China's interbank deposit market, it will also give banks more flexibility to manage their liability.
▪ The Monetary Authority of Singapore (MAS) announced to include RMB financial investments as part of its official foreign reserves from June 2016 onwards.	▪ The MAS has already started to invest in RMB denominated assets via QFII and CIBM quota since 2012. However, those part of investments were not considered as official foreign reserves due to prior restrictions on the repatriation of these funds. However, those restrictions have been eased in the past few years, which paved the way for MAS eventually added RMB into official reserve assets. ▪ On the other hand, RMB has already been the reserve assets globally even before IMF's decision to include RMB into its SDR basket. ▪ The announcement is more symbolic of the close bilateral ties, and the growing economic significance of both the Chinese economy and CNY-denominated investment assets. Timing-wise, it comes ahead of the announced inclusion of the CNY in the IMF SDR currency basket from 1 Oct 2016. ▪ From the market perspective, it is a timely vote of confidence as broad CNY sentiments are soft right now. As such, it could help bolster bilateral relations.
▪ China held its first joint press conference about China's debt problem by top regulators including NDRC, CBRC, PBoC and NAFMII.	▪ A few interesting highlights as below: ▪ First, a stable growth is the precondition to China's mission of de-leverage. As such, China will continue to act in a prudent manner to balance between de-leverage and reasonable growth. Therefore, it is unlikely for us to see a swift de-leverage pace. ▪ Second, the local government's contingent liability fell to CNY7 trillion from CNY8.6 trillion at end of 2014. ▪ Third, the estimation about China's total debt to GDP ratio at 254.8% may have overestimated China's debt level according to PBoC as it may include double counting. ▪ Fourth, China is unlikely to lower its total leverage significantly, the most practical way is to shift leverage from corporate sectors to household and government sectors. How shall household sectors help corporate sectors to lower the leverage ratio? In addition to property market, allowing employees to hold equities as well as the development of financial products such as cash flow linked notes to help corporate lower leverage. ▪ Fifth, China is still studying the debt for equity swap to lower the leverage ratio. Different from previous policy driven debt for equity swap, the current debt for equity swap program will be mainly driven by market supply and demand. Meanwhile, a negative list may be imposed to exclude zombie companies and low credibility companies from the list for qualified companies. Meanwhile, as it is driven by market factors, there won't be any implicit guarantee from government.

▪ China started the direct trading between CNY and KRW from last Friday.	▪ KRW is likely to be added into the CFETs RMB index once the direct trading kicked off. This may create more volatility in RMB's basket currency value given KRW is more volatile.
▪ In his latest IMF speech, PBoC Governor Zhou Xiaochuan said PBoC runs multi mandate. In addition to common mandates such as price stability, economic growth and job creation, PBoC's mandate also include balanced balance of payment position, financial reform and development of financial market.	▪ Zhou Xiaochuan admitted that PBoC's independence may be compromised due to its multiple mandate system as it needs to work with various policy makers to strike the balance among all the mandates. ▪ The multiple mandate also explains that why China prefers non-traditional monetary policy rather than traditional monetary policy tools such as interest rate cut despite there is still room for China to lower its interest rate.
▪ Southbound flows to Hong Kong's stock market via Shanghai-Hong Kong stock connect surged to RMB3 billion on 22 June, the largest over the past 14 months.	▪ Since 26 April, Hong Kong's stock market has seen continuous southbound inflows via the stock connect. Given the attractive PE ratios and some H-shares' discount compared to their A-share peers, Mainland investors became more interested in Hong Kong's stock market. The lackluster performance of A-shares may also be the reason behind the surge in southbound flows. Moreover, despite the stabilization of RMB lately, individual investors, who dominate Mainland China's stock market, are still worried about potential depreciation of the currency. As such, we suggest being cautious on the capital outflow risks implied by recent flows to offshore stock market. Elsewhere, Shenzhen-Hong Kong stock connect will be tested by the HKEX this week. We believe that the new scheme will only bring limited benefits to the stocks markets across the border if there is nothing "new" as compared to the existing one.

Key Economic News	
Facts	**OCBC Opinions**
▪ Hong Kong's headline inflation decreased slightly from 2.7% to 2.6% in May.	▪ The decrease was attributed to the retreat in housing rentals and smaller increases in food price. Food inflation also retreated further from 3.8% to 3.1% amid warmer weather. On the other hand, housing rental inflation decreased slightly from 4.8% to 4.6% as sour market sentiments and the prospect of increasing supply of public housing and subsidized sales flats this year weighed on private housing rental. Also, clothing prices deflated for the 14th consecutive month to -2.8% in May. Soft data of clothing inflation was likely due to sluggish inbound tourist activities. Looking forward, we expect the upside risk of HK inflation to be moderate this year given soft external price pressures as well as a bleak economic outlook.
▪ Hong Kong continues to rank second in global FDI flows in 2015, according to the World Investment Report 2016.	▪ Hong Kong attracted USD175 billion of FDI, surging 53.5% on yearly basis, mainly thanks to the prevailing M&A activities. The increasing needs of Chinese companies to expand to the global market is expected to propel them settle in Hong Kong and make global investments as well as M&A deals with foreign companies. Moreover, Hong Kong is also attractive to foreign companies to set up their subsidiary there as a closer spot to tap the market of Mainland China. In the medium term, with China still on the track of opening up, Hong Kong will continue to play a vital role in connecting Mainland China to the world and entice more FDI.

▪ Macau: After the effect of high base amid the Easter Holiday dissipated, visitor arrivals unexpectedly dropped by 2.78% yoy in May.	▪ Without diversified entertainment facilities, coupled with the delays in completions of new hotel and casino projects, the gains obtained from last year's new hotel and casino openings on the tourism sector might not be sustainable. Additionally, though the number of overnight visitors ticked up for the 10th straight month, growth slowed to 3.76% yoy despite continuous room rate cuts. Specifically, visitors from main sources, including Mainland China, Hong Kong and South Korea all decreased, wiping out the increase in those from Taiwan and Japan. Worse, Mainland visitors travelling under the Individual Visit Scheme dropped for the fourth straight month on annual basis despite the loosened visa measures implemented starting from last July. More data should be monitored for confirmation on whether the tourism sector is losing its footing again. Nevertheless, at this juncture, we hold onto our view that the new hotel, casino and theme park openings in the coming 1-2 years will be able to lure an increasing number of overnight visitor and casual gamblers. As such, the tourism and gaming sectors may still be set for a gradual recovery.

RMB	
Facts	**OCBC Opinions**
▪ RMB's gain on the back of dovish Yellen was totally wiped out last Friday after Brexit referendum delivered a surprise "leave" result. RMB lost 6.60 handle despite a stronger than expected fixing at 6.5776.	▪ It is not China's fault to lose defence of 6.60 handle. The incredible volatility in the wake of Brexit drove RMB together with other major currencies to be weaker against the dollar and Yen. From that perspective, RMB did not really underperform other currencies. ▪ Nevertheless, based on the current fixing mechanism, there is the risk that the USDCNY fixing may have to catch up to be fixed around 6.65 this week. This may fuel another round of concerns about RMB's depreciation. ▪ It is difficult for PBoC to intervene now given the implications of Brexit is still not clear but we think PBoC may have to guard against any potential shock. As such, this week's fixing will be particular important.

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