Highlights:

Both CPI and PPI fell further on month-on-month basis. We expect China's inflationary pressure to remain muted in the coming months and the gap between PPI and CPI to narrow further. The overall easing inflationary pressure is likely to help ease concern on hawkish risk from PBoC. Indeed, both China's central bank and banking regulator, which are the main drivers of the current de-leverage campaign, showed signs of flexibility last week. PBoC injected CNY498 billion MLF last week while there is market talk that some banks may be allowed to extend their deadline for self-regulatory check by another 3 months. Those show that China's policy makers are likely to try to find a balance between de-leverage and financial stability as well as stable growth. As such, we see low probability of policy induced crisis in China.

Nevertheless, liquidity remained tight as we are approaching end of June assessment. China's Ministry of Finance sold its 1-year and 10-year government bonds at 3.6695% and 3.6985% on 7 June, highest since 2014, above market expectation. Meanwhile, yield curve inverted slightly in the secondary market for tenor below 10 years with 1-year government yield rose further to about 3.66% while 10-year government bond yield stabilized around 3.65%. The inverted yield curve has nothing related to expectation on potential crisis in China. Instead, it was mainly the result of rising demand for medium term funding as banks are preparing for the upcoming regulatory check as well as quarter-end macro prudential assessment. Meanwhile, the recent pickup of yields for government bond ranging from 1-year to 5-year was probably also attributable to the unwind of leverage and wealth management after government tightened grip on those products.

For this week, given more MLF will expire this week, PBoC liquidity operation is likely to be watched closely. On RMB, both USDCNY and RMB index remained relatively stable despite the rebound of dollar index. It seems to us that introduction of counter cyclical factor has helped smooth volatility of RMB. Meanwhile it also broke down the correlation between dollar index and RMB index. RMB index fell slightly last week despite stronger dollar. For today, we expect counter cyclical factor to contribute negatively to daily fixing, meaning it may lead to higher daily fixing as compared to old mechanism without the factor.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's Ministry of Finance sold its 1-year and 10-year government bonds at 3.6695% and 3.6985% on 7 June, highest since 2014, above market expectation. ▪ Meanwhile, yield curve inverted slightly in the secondary market for tenor below 10 years with 1-year government yield rose further to about 3.66% while 10-year government bond yield stabilized around 3.65%.	▪ The higher than expected auction yield shows the concerns about tight liquidity ahead of semi-annual end assessment as well as impact of de-leverage campaign remains. ▪ However, the yields in the secondary market came off for the 10-year after the auction, showing improving sentiment in the market. ▪ The inverted yield curve has nothing related to expectation on potential crisis in China. Instead, it was mainly the result of rising demand for medium term funding as banks are preparing for the upcoming regulatory check as well as quarter-end macro prudential assessment. Meanwhile, the recent pickup of yields for government bond ranging from 1-year to 5-year was probably also attributable to the unwind of leverage and wealth management after government tightened grip on those products.
▪ According to media quoting sources that some banks may be allowed to extend their deadline for self-regulatory check by another 3 months.	▪ Since late March, China's regulatory tightening has taken the front seat driving China's de-leverage campaign. The shift from soft deleverage to hard deleverage has dampened market sentiment and fuelled concern about the potential policy risk in the coming months. Nevertheless, since May, China's banking regulator has started to show signs of flexibility, hinting the flexible deadline. The latest market talk should confirmed is likely to reinforce our view that China's policy makers are likely to try to find a balance between de-leverage and financial stability as well as stable growth. As such, we see low probability of policy induced crisis in China.
▪ China's central bank injected CNY498 billion liquidity via medium term lending facility (MLF) last	▪ The liquidity injection was mainly designed to offset the expiration of MLF last week. As such, it failed to prevent 1-

week.	year SHIBOR rate from going higher further as we are approaching end of June. However, the move is still encouraging in our view as it shows flexibility of PBoC's policy. This is likely to support market sentiment in the near term. ▪ Given more MLF will expire this week, PBoC liquidity operation is likely to be watched closely.
▪ Southbound buy and sell turnover via two stock connects accounted for 10.9% on a daily average basis of HK stock market's total turnover during May 2 to June 8, as compared to an average of 5.5% for 2016. Over the same period, daily average southbound net flows to HK's stock market was CNY1.99 billion, up significantly from an average of CNY1.15 billion in 2016.	▪ The increased participation of Mainland investors in HK's stock market and the positive effect of bullish stock markets in western countries have helped to push Hang Seng Index up to its highest level since mid-2015. As Hang Seng China AH Premium Index rebounded from its lowest level of 113.78 since mid-2012 on March 21 to 123.49 on June 9, the relatively attractive valuation of H shares will continue to lure Mainland investors. The improving economic fundamentals in HK are also likely to support the stock market. However, 26,000 appeared to have been a strong resistance for Hang Seng Index (HSI). Therefore, HSI may need to stand firm above 26,000 before bracing for more upside.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve rebounded for the fourth consecutive month to US$3.053 trillion from US$3.029 trillion. ▪ However, FX reserve in SDR term dropped 2.2058 trillion from 2.2096 trillion.	▪ The divergence between FX reserve in dollar term and FX reserve in SDR term shows that the recovery of FX reserve in May was mainly attributable to valuation effect due to the correction of dollar in the global market. However, it also shows that China's capital outflow pressure has eased further. We expect China's actual cross border flows in May to remain largely balanced.
▪ Both China's export and import in dollar term accelerated to 8.7% yoy and 14.8% yoy	▪ Demand from advanced economies remains strong despite softening demand from emerging economies. Exports to EU and Japan accelerated to 9.7% yoy and 11.7% yoy although exports to ASEAN slowed down to 3.8%. Exports to Hong Kong contracted by 10.6% yoy, third consecutive contraction since Feb, probably due to the result of China's tightening capital control. ▪ China's demand for commodity picked up again in May. Imports of crude oil and iron ore surged by 50.3% yoy and 34.1% yoy by value while by volume also increased by 15.4% and 5.5%. Commodity prices rallied after China's stronger than expected import numbers. ▪ Although China's trade surplus with US widened to US$22 billion in May from US$21.3 billion in April, China's import from US accelerated to 27.1% yoy from 1.5% yoy, signalling improving US-China trade following Trump-Xi Summit.
▪ China's CPI accelerated to 1.5% yoy in May from 1.2% yoy in April. However, CPI fell by 0.1% month-on-month. ▪ PPI decelerated further to 5.5% from 6.4%.	▪ The month-on-month decline of CPI was mainly driven by the fall of food prices due to seasonal factor. We expect CPI to hover around 1.5% in the coming months. Nevertheless, we expect CPI to stay below 2% for the remaining of the year due to muted inflationary pressure. ▪ The moderation of producer price was the result of falling commodity prices. In addition, given the low base effect is likely to fade away, we expect PPI to fall further in the second half although it may still remain above 5% in the next two months. We expect the gap between CPI and PPI to narrow in the second. The overall easing inflationary pressure is likely to help ease concern on hawkish risk from PBoC.

▪ HK's total housing transactions retreated by 18.8% mom to 5732 deals in May, marking the first month-on-month decline since January. This is due to a slew of cooling measures which hit demand in the secondary market.	▪ However, the primary market's increased supply of small-size flats and developers' provision of mortgages with high loan to value ratio helped to shield the primary market from the cooling measures. Notably, only those flats priced between HKD3-5 million exhibited both monthly and yearly growths. Given the increasing supply, higher borrowing costs and China's slowdown, overall housing price index's growth which accelerated to its highest level at 19.8% yoy since July 2015 in April is likely to decelerate in 2H.
▪ Macau's housing transaction grew for the 14th consecutive month in April but was up at a slower pace by 3.3% yoy to 1080 deals. Meanwhile, new mortgage loans approved rose by 19% yoy to MOP3.36 billion and housing prices rose by 21.7% yoy to MOP95,817 per square meter.	▪ Based on this, we believe that the housing market condition has been improving due to solid economic recovery. However, given increasing supply, higher rates ahead, a likely slowdown in economic growth in 2H and stagnant wage growth, we expected housing prices growth to decelerate in 2H. By end of this year, housing prices may retreat to around MOP85,000 per square meter.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY consolidated last week following the sharp move in the past two weeks with the pair ended down slightly below 6.80 despite stronger dollar. ▪ RMB index ended slightly lower at 93.09, down from previous week's 93.16.	▪ It seems to us that introduction of counter cyclical factor has helped smooth volatility of RMB. Meanwhile it also broke down the correlation between dollar index and RMB index. RMB index fell slightly last week despite stronger dollar. ▪ For today, we expect counter cyclical factor to contribute negatively to daily fixing, meaning it may lead to higher daily fixing as compared to old mechanism without the factor.

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