Highlights:

The stronger than expected May economic data was encouraging, but probably not good news for bond bull, which hoped slowing growth to lend some support to their biddish tone. China's bond gave up some gains in the second half of last week despite PBoC kept its reverse repo rate unchanged on Thursday after the Fed rate hike. The May economic data showed the extended growth momentum with contained financial risk. That's probably the best pictures for China's policy makers. The sharp deceleration of M2 growth and decline of off-balance sheet lending activities showed that financial de-leverage started to take effect. However, the impact on the real economy has been largely balanced by improving manufacturing activity and stable private confidence. Nevertheless, we still expect the growth to slow down as we believe the impact of higher funding costs and regulatory tightening may eventually be felt by the real economy in the second half of the year though the pace of decline may be slower than initially expected. IMF has recently upgraded China's 2017 forecast to 6.7% from 6.6%. Our 6.4% forecast remained intact for now but with upside risk.

China's yield curve remained inverted last week as we are approaching the end of June assessment. Nevertheless, the policy flexibly demonstrated by PBoC and CBRC recently will prevent China from any policy induced crisis. PBoC did not conduct another round of MLF last week to offset the maturing of CNY207 billion MLF. Instead, PBoC has net injected liquidity via 7-day to 28-day reverse repo. The net liquidity injection accompanied by stable reverse repo rate is likely to reinforce market expectation on flexible PBoC policy, which may further support market sentiment.

On currency, the stronger than expected fixing of 6.7995 on Friday was probably the result of counter cyclical factor. Although we have been able to estimate the contribution of counter cyclical factor to daily fixing in our way, the rising discrepancy last Friday reinforces our previous concern that the forecast error could be bigger under the new regime as the counter cyclical factor may give PBoC more discretionary power to set the USDCNY fixing.

In Hong Kong, the recent rapid move of Hong Kong dollar was impressive with the USDHKD broke up 7.8 last week, first time since Jan 2016. Unlike previous two times in early 2016 and 2011, the break of 7.8 was accompanied by weaker equity market, this round of HK dollar weakness happened when HK equity market performed and liquidity remained abundant. The move was mainly the result of widening yield differential between HK and US. Meanwhile, the return of interest in CNH deposit and rotation of equity investment back to mainland also did not bode well for HKD. Given the Fed is still in tightening cycle, we think this round of HKD weakness may last longer.

For this week, market will wait for MSCI's decision on whether it will include China's A-share into its benchmark index on Tuesday. We see the chances for A-share to be included, but given it could be only a token move, the impact is unlikely to be significant. In addition, market will be also find out more about China's decision to issue its dollar denominated sovereign bond since 2004 despite recent downgrade by Moody's.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's Ministry of Finance unveiled the plan to issue CNY14 billion worth of dim sum bond in Hong Kong and CNY2 billion worth of dollar denominated sovereign bond in the second half of 2017.	▪ It will be the first dollar denominated sovereign issuance in the offshore market since October 2004. The move is probably to celebrate 20-year anniversary of Hong Kong's return to mainland. We think the issuance is unlikely to be affected by Moody's downgrade.
▪ PBoC kept its reverse repo rate unchanged on Thursday despite 25bps rate hike by the Fed. ▪ China did not conduct another round of MLF last week to offset the maturing of CNY207 billion MLF. Instead, PBoC has net injected liquidity via 7-day to 28-day reverse repo.	▪ PBoC hiked its reverse repo rate in March, a few hours after the Fed fund rate hike. As such, market has watched closely whether PBoC would follow suit this time. The stable short end reverse repo rate, together with liquidity injection reinforces market expectation that PBoC has turned more flexible in terms of monetary policy. This is likely to further support market sentiment.
▪ The HKMA followed the FOMC to raise the base rate by 25 bps on last Thursday. ▪ The USDHKD broke up 7.8 last week, first time since Jan 2016.	▪ Unlike previous two times in early 2016 and 2011, the break of 7.8 was accompanied by weaker equity market, this round of HK dollar weakness happened when HK equity market performed and liquidity remained abundant. ▪ We think the recent HKD weakness was mainly attributable to the rising yield differential between HKD and USD as a result of Fed tightening cycle. The increasing arbitrage opportunities

	have translated into upward pressure on the USDHKD spot rate. However, with a bullish stock market and robust housing market, capital outflows were unseen lately. Therefore, banking system remained flushed with liquidity as aggregate balance held static at around HKD260 billion. ▪ In addition, the returning interest in CNH deposits following recent spike of CNH interest rate and improving currency outlook as well as the rotation of funds back to mainland from HK under Shanghai Hong Kong connect did not yield support for HKD. ▪ Overall speaking, as long as US rate hike expectation remains, we think this round of HKD weakness may persist.
▪ Mainland developers issued merely 9 offshore dollar bonds totalling USD2.9 billion during April 1 to June 15, much fewer as compared to the issuance of 23 USD-denominated bonds totalling USD10.1 billion in 1Q.	▪ This is due to Chinese authorities' effort to tighten liquidity of property developers, in order to cool the housing frenzy in Mainland China. Muted data out of China's housing market reinforces that the tightening started to take effect. On the other hand, as the funding channels for Mainland developers are blocked, they may be less aggressive in land purchases in HK. We believe that this will be one of the many factors leading to a moderate housing correction in HK in 2H.
▪ According to Hong Kong Housing Department, Hong Kong government is expected to offer around 25,400 public housing units in 2017-2018, a 25% decrease from 33,800 units in 2016-2017, a third record low in 10 years.	▪ As a result, the relatively lower income households may be propelled to rent a private home or buy small size flats. Though banks have been increasing the mortgage spread on HIBOR-based loans, lower income households who do not have enough money for down payment could simply turn to developers for mortgages with high loan to value ratio. This possibly helps to explain the strong demand for smaller flats in the primary market despite a slew of new cooling measures.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's May growth data shows the economic recovery remains on track despite volatile money market as a result of financial de-leverage. ▪ Industrial production grew by 6.5% yoy in May, slightly above market expectation of 6.4% yoy. ▪ Retail sales growth remains intact at 10.7% yoy in May. ▪ However, fixed asset investment decelerated further to 8.6% yoy in the first five months from 8.9% yoy in the first four months.	▪ The stable industry production was partly driven by the rebound of mining production, which grew by 0.5%, first positive growth since Sep2016. Manufacturing production remained relatively stable at 6.9% yoy. In addition, fixed asset investment in manufacturing accelerated to 5.1% in the first five months. ▪ The deceleration of fixed asset investment was mainly the result of slowdown in infrastructure investment as well as property investment. Investment in real estate decelerated to 8.8%, down from 9.3% while property sales also slowed down to 18.6% from 20.1% due to tightening property measures. However, on the positive note, private investment remains stable expanding by 6.8% in the first five months. ▪ The stable private investment, together with improving manufacturing activities, shows that the recent recovery is genuine and the momentum is likely to last longer than initially expected despite rising volatility in the money market as a result of financial de-leverage. ▪ Nevertheless, our view on the growth has peaked in 1Q has not changed. We still expect the growth to slow in the coming quarters for two reasons. First, the higher funding costs in the money market will be partially passed to the real economy, which will slow the growth down. Second, the tug of war between driving financial de-leverage and ensuring the financial stability will continue which may lead to volatility in

	both capital market and real economy periodically.
▪ China's new Yuan loan still grew at a stronger than expected pace while aggregate social financing and M2 growth missed the forecast as a result of financial de-leverage. ▪ New Yuan loan grew by CNY1.11 trillion in May beating market expectation of CNY900 billion. ▪ Aggregate social financing increased by CNY1.06 trillion in May, down from CNY1.39 trillion in April. ▪ M2 decelerated to a record low of 9.6% yoy.	▪ New Yuan loan growth looks healthy with medium to long term demand from household and corporate remains strong. Medium to long term loan to household sector increased by CNY432.6 billion, less affected by property tightening measures while medium to long term loan to corporate increased by CNY439.6 billion. ▪ The stronger than expected on-balance sheet loan expansion was probably the result of China's de-leverage efforts to curb the off balance sheet and shadow banking activity, which may drive loan demand back to traditional loan. This explains why aggregate social financing is lower than new Yuan loan in May. Although trust loan remain sizable at CNY181.2 billion, entrusted loan and undiscounted bankers' acceptance fell by CNY27.8 billion and CNY124.5 billion. The decline of entrusted loan, in particular, was at its record high level. This is probably due to China's de-leverage push. ▪ The bond market became the unintended victim of recent financial de-leverage. As a result of sharp surge in yields, which resulted in the cancellation of bond issuance in May, total net issuance of corporate bond in May fell by record high of CNY246.2 billion. ▪ It seems that China's financial de-leverage has started to take effect. China's M2 growth is another witness. The rapid decline of M2 growth to 9.6%, below 10% for the first time in history. According to PBoC, the entire lending chain has been shortened significantly in May as a result of de-leverage. M2 from financial sector only grew by 0.7% while M2 from non-financial sector grew steadily by 10.5%. The lower M2 growth is likely to be the new normal going forwards.
▪ China's foreign direct investment fell by 3.7% yoy in May to CNY54.67 billion.	▪ China's Ministry of Commerce said that it will publish revised foreign investment list to encourage more foreign investments but without giving more details.
▪ HK: the number of residential property transaction deals which involved Double Stamp Duty (DSD) and Buyer Stamp Duty (BSD) ended their upward trend and dropped by 44% and 16.6% on a monthly basis respectively in May.	▪ Housing market appears to have been cooling down due to a wave of new cooling measures. We believe that housing transactions in the secondary market will continue to shrink amid higher borrowing costs. We hold on to our view that housing prices growth will decelerated in 2H.

RMB	
Facts	**OCBC Opinions**
▪ RMB's strength against dollar paused last week after dollar rebounded on the back of more hawkish than expected FOMC meeting. ▪ RMB index, however, strengthened slightly as China set the daily fixing stronger than expected at 6.7995 on Friday.	▪ The stronger than expected daily fixing last Friday after dollar rebounded on Thursday was probably the result of counter cyclical factor. Although we have been able to estimate the contribution of counter cyclical factor to daily fixing in our way, the rising discrepancy last Friday reinforces our previous concern that the forecast error could be bigger under the new regime as the counter cyclical factor may give PBoC more discretionary power to set the USDCNY fixing.

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