Highlights:

In a data and event light week, rating agency S&P's decision to downgrade China's sovereign rating caught market attention. But ironically, RMB's recent mini depreciation trend in the past two weeks, driven by profit taking, has been broken by this announcement. RMB recouped some losses last Thursday and Friday. Judging by RMB assets' performance almost four months ago following another rating agency Moody's downgrade, it is not so difficult to understand why RMB appreciated after the downgrade as Chinese investors tried to signal that they don't really care. We think RMB may have entered two-way movement phase, which is expected to trade within the range of 6.40-6.70 for rest of the year.

The rating downgrade ahead of 19th Party Congress could be a disappointment to Chinese government as they have been making efforts to keep financial risks at bay. Nevertheless, it is unlikely to demoralize China's commitment to safeguard its financial stability. China stepped up its property tightening further last week. Mortgage rate for the first-time purchasers has been increased by 5-10% in Beijing. In addition, some tier-2 cities also tightened their administrative measures. For example, residential property is not allowed to sell within two years from receiving property deeds in Chongqing. As we mentioned last week, the recent slowdown as shown by August data was mainly the result of tightening policies in local government funding as well as property market. Those measures are expected to continue to weigh down the growth in the coming quarters.

The correction of commodity prices last week reinforce our view that the recent spike of inflation driven by supply side factor is not sustainable. This might be the good news for bond traders.

In Hong Kong, HKD and local interest rates surged following HKMA's announcement of the second batch of bill sales. Due to fears of more bill sales plans ahead, rising expectations on Fed's third rate hike and the huge funding demand associated with the IPO deal from ZhongAn Insurance, one-month HIBOR jumped to 0.549% on Sep 22. However, after ZhongAn Insurance's IPO and the end of 3Q, HKD rates may retreat slightly amid flush liquidity. A wide interest rates gap means that HKD's rally may be unsustainable. As such, we expect the HKMA to issue more bills to mop up excess liquidity, though HKMA's further moves may merely add moderate upward pressure onto the HIBOR in the near term. Whether HIBOR could catch up with LIBOR at a faster rate depends on Fed's rate hike pace. Should the Fed proceed with a third rate hike in December, 3-month HIBOR is expected to approach 1% by end of this year. Elsewhere, we do not believe that the HKD will give much response to HK rating cut by S&P as the move has already been priced in.

Key Events and Market Talk

Facts	OCBC Opinions
▪ The rating agency S&P announced to lower China's long term sovereign credit ratings by one notch to A+ from AA-, citing rising economic and financial risks after a prolonged period of strong credit growth. ▪ However, S&P raise the outlook to stable, suggesting that the rating agency expects still robust economic performance in the next three to four years.	▪ Although the rating agency reckon China's efforts to curb corporate leverage, which may stabilize the trend of financial risk in the medium term, the expected rapid credit growth for the next few years is still one of the key catalysts for the agency to downgrade China. ▪ The downgrade is not totally surprising to the market, in our view, as market has speculated S&P may follow through after another rating agency Moody's downgraded China in May as both rating agency lowered China's rating outlook to negative back in March 2016. ▪ The impact of downgrade on RMB assets is unlikely to be significant as Chinese investors are less sensitive to the rating. CNH appreciated after the announcement of downgrade last Thursday while the similar movement was also spotted in late May after Moody's downgrade.
▪ China continued to tighten its property market. Mortgage rate for the first time purchasers has been increased by 5-10% in Beijing. In addition, some tier-2 cities also stepped up their administrative measures. For example, residential property is not allowed to sell within two years from receiving property deeds in Chongqing.	▪ As we mentioned last week, the recent slowdown as shown by August data was mainly the result of tightening policies in local government funding as well as property market. Those measures are expected to continue to weigh down the growth in the coming quarters. ▪ Nevertheless, as a result of higher tolerance for slower growth, we think China will keep its tight bias intact as part of campaign to contain the financial risk.

▪ HKD surged against the greenback by as much as 0.26% after the HKMA announced to issue HK$40 billion of additional exchange fund bills (EFB) on Sep 19, as market frets that the HKMA may continue to drain cash from the banking system. Adding on the rising expectations that Fed will raise rates again this year and the funding demand associated with the upcoming mega IPO deal from ZhongAn Insurance, 1-month HIBOR jumped from 0.425% to 0.549% over last week.	▪ However, even after the second round of bill sales, aggregate balance may still remain sizeable at around HK$180 billion. Therefore, after ZhongAn Insurance's IPO and the end of 3Q, HKD rates may retreat slightly amid flush liquidity and in turn reinforce market expectations on a wide yield differential. Therefore, we expect the rally in HKD to be unsustainable as investors are likely to buy USD/HKD on dips. HKMA's Yue also stated that "interest rate gap may suppress HKD down to 7.85 against the USD". As such, the HKMA is likely to issue more EFBs in the foreseeable future as hinted by Yue and allow the HKD to find strong supports before 7.8250 against the USD. However, HKMA's further moves may merely add moderate upward pressure onto the HIBOR in the near term. ▪ Whether HIBOR could catch up with LIBOR at a faster rate depends on Fed's rate hike pace. Should the Fed proceed with a third rate hike in December, 3-month HIBOR is expected to approach 1% by end of this year. Moving forward, if the Fed raises rates three times and expands the size of balance sheet cut as scheduled next year, capital may gradually flow out of HK and in turn bring the HIBOR up further in the medium term. A resultant narrowing of yield differential may ease some downward pressure on the HKD. ▪ Elsewhere, we do not believe that the HKD will give much response to HK downgrade by S&P as the move has already been priced in.

Key Economic News	
Facts	**OCBC Opinions**
▪ Chinese banks still net purchased foreign currency on behalf of clients in August despite rapid appreciation of RMB. Nevertheless, the net purchase amount fell to US$4.1 billion, lowest since August 2016.Retail sales growth also slowed down to 10.1% yoy in August.	▪ Looking at the breakdown of the data, there have been a few positive signals showing sentiment over RMB has improved. For example, willingness to sell foreign currency, which measured by the ratio of settlement of foreign currency to foreign currency receipts, improved to 62.2% from 62%. Meanwhile, willingness to buy foreign currency fell to 61.5% , lowest since Feb 2014. We expect China to record net settlement of foreign currency in September after the rapid appreciation of RMB in the beginning of the month.
▪ HK's seasonally adjusted jobless rate remained unchanged at 3.1% over the three months through August.	▪ First, the trade sector's unemployment rate decreased from 3.1% in 2Q to 2.8%. Though we are wary of US trade protectionism and an expected slowdown in US economy, HK's trade sector may not face much downward pressure in the coming months given huge external demand associated with Christmas Holiday. Therefore, we expect the sector's jobless rate to oscillate around its current strong level. Second, the unemployment rate of the consumption- and tourism-related sector stabilized at its two-year low at 4.6% amid improved tourism activities. Also, wealth effect stemming from a bullish stock market and a resilient housing market has been supporting household spending. Third, financial sector's jobless rate printed 2.1%, a level unseen since September 2014, thanks to a bullish stock market and increasing job opportunities associated with various cross-border investment schemes. All in all, we expect a tight labour market to sustain and continue to bolster domestic

	consumption.
▪ Macau's visitor arrivals decreased by 0.56% yoy in August as two typhoons scared tourists away, despite the effect of summer holidays. Same-day visitors decreased further by 6.2% yoy while the increase in overnight visitors slowed notably to 4.8% yoy as typhoons disrupted the operations of hotels and the government required travel agencies to suspend group tour arrangements.	▪ Specifically, the number of visitors from Mainland China increased by 1.9% yoy after growing by 9.6% yoy in the previous month. Besides, tourists from Hong Kong and Taiwan decreased further by 10.5% yoy and 1.9% yoy respectively. Even the tourists from South Korea, who have been highly interested in visiting Macau, increased at a slower pace by 30.8% yoy as compared to an average of 41% in the first seven months. As September is normally considered the off-season month while the city was still struggling to recover from the typhoon's destruction in early September, we believe that revival of the tourism sector will be rather moderate in September but may accelerate in October when Golden Week Holiday is set to bring more tourists back to the gambling hub.

RMB	
Facts	**OCBC Opinions**
▪ RMB extended its weakness last week till S&P's rating downgrade. RMB recouped some losses on Thursday and Friday. ▪ RMB index, however, also weakened slightly to 94.54 from 94.86.	▪ The recent correction of RMB was partially driven by profit taking after market consolidated signals from PBoC and market data. Ironically, the mini depreciation trend was broken by S&P's decision to downgrade China's sovereign rating. Judging by RMB assets' performance almost four months ago following another rating agency Moody's downgrade, it is not so difficult to understand why RMB appreciated after downgrade as Chinese investors tried to signal that they don't care about the rating.

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