Highlights

Global risk sentiment deteriorated last week when the Chinese market is closed for golden week holiday. In order to cushion the impact from the external shocks, China announced the fourth reserve requirement ratio cut (RRR) yesterday with effective from 15 Oct. The net injection will be about CNY750 billion and CNY450 billion from RRR cut will be used to swap the maturing MLF operation.

Although PBoC said the latest RRR cut will not create the renewed pressure for RMB in its policy QnA, we expect RMB to face mounting pressure at the start of new trading week due to narrowing interest rate differential expectation as a result of rising US yields and possible decline of longer end Chinese yields due to RRR cut. We think China may rely more on administrative measures to keep RMB exchange rate in check.

The US-China relationship turned from bad to worse after US Vice President Mike Pence delivered his most hawkish criticism against China. It looks like the recent US-China trade war is the skirmish of the whole saga. It has moved beyond the trade issue. There is the risk that US may turn its unhappiness into actionable policies such as show of force in South China Sea as well as complicated Taiwan issues. This may inject more uncertainties into the market in the coming weeks. Market should closely watch out for two events including the APEC meeting in mid-November and G20 meeting in late November to see whether President Xi will meet his US counterparty such as Pence in APEC or Trump in G20 to de-escalate the tensions.

In **Hong Kong,** one-month HIBOR subsided by over 50bps in one week to 1.76% on 5 Oct as liquidity condition improved after quarter-end and holidays. In the coming sessions, if one-month HIBOR and three-month HIBOR find support at 1.7% and 2.1% respectively, it may suggest that further liquidity improvement is unlikely and therefore USDHKD may not touch 7.85 in the near term. In the medium term, we expect HIBOR to move up gradually due to two factors. First, either wider USD-HKD yield differential or global monetary tightening may trigger further capital flight from HK. Second, short-term factors including month-end, year-end and large IPOs could also tighten HKD liquidity. All in all, one-month HIBOR and three-month HIBOR are expected to test 2.45% and 2.5% respectively by end of 2018. Due to higher interest rates, housing market has been cooling down. In August, Hong Kong's housing price index dropped by 0.1% mom from all-time high, the first time since 2016. In September, housing transaction volume dropped by 37.8% yoy to the lowest since January 2017. In the near term, other than rising borrowing costs, there are still several downside risks facing the housing market. First, wealth effect subsided amid tepid stock market. Second, new housing measures from late June have accelerated new home supply and shifted some housing demand to the public market. Finally, salary prospect becomes less positive as domestic economic outlook is clouded by China's slowdown and trade war. However, any correction in the housing market is unlikely to turn into a collapse given the demand-supply imbalance, macro-prudential measures and gradual rate hikes. All in all, we hold onto our view that housing transaction will remain sluggish while housing prices will drop by 5% and 5%-8% respectively in 2H18 and 2019.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The US-China relationship turned from bad to worse after US Vice President Mike Pence delivered his most hawkish criticism against China on a broad range of topics such as China's alleged meddling on US elections, China's unfair trade practices, Taiwan issues as well as freedom of religion etc.	▪ It looks like the recent US-China trade war is the skirmish of the whole saga. It has moved beyond the trade issue. Whether Pence's speech marked the official start of new "cold war" in the 21st century is still too early to say. ▪ Nevertheless, as China has shown no interest in restarting the meaningful negotiation with the US before the US mid-term election, it seems the bilateral relationship between US and China could only turn worse. ▪ There is the risk that US may turn its unhappiness into actionable policies such as show of force in South China Sea as well as complicating Taiwan issues. This may inject more uncertainties into the market in the coming weeks. ▪ Market should closely watch out for two events including the APEC meeting in mid-November and G20 meeting in late November to see whether President Xi will meet his US counterparty such as Pence in APEC or Trump in G20 to de-escalate the tensions.
▪ PBoC announced on Sunday it will cut the reserve requirement ratio by 100bps for most banks effective from 15 Oct.	▪ According to PBoC, the RRR cut is expected to unlock about CNY1.2 trillion, however, CNY450 billion will be used to swap the maturing MLF in October. As such, the net liquidity injection is

	not as flush as the headline shows. ▪ The RRR cut is designed as the incentive to encourage banks to support the real economy in particular smaller private companies as smaller banks will benefit more from the liquidity injection as compared to MLF operation. ▪ Against the backdrop of further deceleration of Chinese economy as a result of escalation of US-China trade war and rising risk-off sentiment during the golden week holiday due to rising US Treasury yields, the announcement may also help alleviate the accumulating external shock to China's financial market during the holiday. ▪ Although PBoC said the latest RRR cut will not create the renewed pressure for RMB in its policy QnA, we expect RMB to face mounting pressure at the start of new trading week due to narrowing interest rate differential expectation as a result of rising US yields and possible decline of longer end Chinese yields due to RRR cut. We think China may rely more on administrative measures to keep RMB exchange rate in check.
▪ As expected, one-month HIBOR subsided by over 50bps in one week to 1.76% on 5 Oct while HKD also retreated by 0.3% during the past two weeks as liquidity condition improved after quarter-end and National Daily Holiday.	▪ Besides, after all commercial banks announced to raise prime rate, market expectation of narrower USD-HKD yield differential eased. As such, the return of carry trade pushed HKD down again. Since liquidity remains flushed, it reinforces our view that liquidity is not the only factor considered by the commercial banks when deciding whether to raise prime rate or not. Instead, higher funding costs due to higher HIBOR and rising fixed deposit rates were the catalyst. In the coming sessions, if one-month HIBOR and three-month HIBOR find support at 1.7% and 2.1% respectively, it may suggest that further liquidity improvement is unlikely and therefore HKD may not touch the weak end of the trading band in the near term. ▪ In the medium term, we expect HIBOR to move up gradually due to two factors. First, either wider USD-HKD yield differential or global monetary tightening may trigger further capital flight from HK. As such, HKD liquidity may shrink and in turn push up HIBOR. Second, short-term factors including month-end, year-end and large IPOs could also tighten HKD liquidity and drive up HIBOR. All in all, one-month HIBOR and three-month HIBOR are expected to move towards 2.45% and 2.5% respectively by end of this year.

Key Economic News	
Facts	**OCBC Opinions**
▪ In August, Hong Kong's housing price index dropped by 0.1% mom from all-time high, the first time since March 2016. In September, housing transaction volume dropped by 37.8% yoy or 27.4% mom to 3500 deals, the lowest since January 2017. Housing transaction value also tumbled by 18.1% yoy or 20.7% mom to HK$37 billion, the weakest since August 2017. ▪ Some Hong Kong developers offered sweeteners including cash rebases and lower mortgage rates against the backdrop of property market slowdown.	▪ The disappointing data prints indicate that the housing market has been cooling down. In the near term, there are several downside risks facing the housing market. First, wealth effect subsided amid tepid stock market. Second, new housing measures from late June have accelerated new home supply and shifted some housing demand to the public market. Third, higher borrowing costs. Over the last two months, commercial banks have raised the cap on HIBOR-based mortgage rates and lifted prime rate for the first time since 2006. As we believe that HIBOR will edge higher gradually, commercial banks may further raise prime rate by around 50bps until end of 2019. Finally, salary prospect becomes less positive as domestic economic outlook is clouded by China's slowdown and trade war. ▪ However, any correction in the housing market is unlikely to turn

	into a collapse. First, the structural imbalance between housing supply and demand. The share of owner-occupiers in total domestic households marked 49.2% in 2017, much lower than the average of 52.3% for 2000-2017. On the demand front, the number of domestic households has been growing by around 1.5% yoy. In terms of supply, during the first seven months, housing completions and housing starts dropped by 19.5% yoy and 34.5% yoy respectively to 9168 units and 8805 units. This is well below the government's target. Second, following eight rounds of macro-prudential measures unveiled by the HKMA since late 2009, the average loan-to-value ratio for newly approved mortgages declined to 45.5% in August from 64% before the measures were first introduced. During the same period, the Debt Service Ratio also fell to 34.7% from 40.8%. Third, we expect HKD interest rates will go up gradually rather than disruptively. All in all, we hold onto our view that housing transaction will remain sluggish while housing prices will drop by 5% and 5%-8% respectively in 2H18 and 2019.
▪ Hong Kong's retail sales growth rebounded to 9.5% in August.	▪ Sales of clothing, footwear and related products and those of jewelry, clocks and watches grew at a faster pace by 7% yoy and 21.6% yoy respectively. This suggests strong tourism activities and visitor spending. The number of Mainland visitors (represents 82% of total visitor arrivals) has increased consecutively for a whole year and was up by 22% yoy in August. Nevertheless, we doubt such strong growth could sustain into coming months given China's economic slowdown, a weaker RMB and Asia's muted economic outlook on trade war concerns. On the other hand, sales of goods in supermarkets rose at the slowest pace since Jan by 0.3% yoy. Sales of durable consumer orders also increased at the weakest rate since October 2017 by 0.3% yoy. This suggests that local consumer sentiment was muted, probably due to 1) subdued salary prospect on domestic economic slowdown and 2) lower wealth effect on sluggish stock market and housing market correction. Adding on high base effect, we expect retail sales growth to moderate in the coming months.
▪ Macau's gaming revenue dropped by 17.3% mom (+2.8% yoy) to one-year low of MOP21.95 billion in September.	▪ This could be attributed to two major factors. First, all gaming centers closed for 33-hour amid Typhoon MangKhut. This might have reduced gaming revenue by about MOP1.15 billion. Second, weaker VIP demand was also to blame. The combination of China's economic slowdown, a weaker RMB, policy risks and higher borrowing costs might have deterred high-rollers from the gaming hub. On a positive note, during the first four days of Golden Week Holiday, total visitor arrivals and Mainland visitors increased by 21.4% yoy and 32.8% yoy respectively. Holiday effect and the upcoming completion of HK-Zhuhai-Macau Bridge may lend some support to the tourism and gaming activities. However, we are still wary of downside risks for the mass-market sentiment amid Asia's weakening economic outlook and a stronger MOP. All in all, we expect total gaming revenue to grow by about 15% yoy in 2018 and by a slower pace of 2%-5% in 2019.

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