## Highlights

Risk sentiment unexpectedly improved last week globally as a result of diminishing marginal impact of trade war. Meanwhile, the Chinese government's efforts to improve policy consistency via a quick response to address the concerns regarding social security contribution also helps stabilize the domestic sentiment. PBoC also bolstered the market sentiment via surprising 1-year MLF conduction as a pre-emptive move to alleviate the liquidity pressure ahead of the massive local government special bond issuance as well as upcoming quarter-end and National Day holiday week.

On trade war, China retaliated as planned. Meanwhile, China put the invitation for trade talk on hold and will not send the delegation to Washington this month. China is unlikely to restart any meaningful talk with the US till the mid-term election. The Chinese government unveiled a new guidance to improve the income distribution mechanism to unlock the consumption potential.

On currency, RMB was under pressure initially last week as a result of the escalation of trade war and more than expected liquidity injection by PBoC. However, RMB received the support from Premier Li's reassurance that China will not join the competitive devaluation. With the RMB index slipped to 92 again, market should watch out for any possible intervention from China to defend the band. The introduction of issuance of PBoC bill in Hong Kong is likely to be additional tool for China to manage offshore liquidity which in turn help stabilize the currency.

In **Hong Kong,** HKD jumped by the most since September 2003 last Friday as concerns about tighter liquidity triggered stop losses and unwinding of long USDHKD positions. The over HK$3 billion locked up for Haidilao IPO will only be released this week. Adding on upcoming quarter-end, Mid-Autumn Festival and National Daily Holiday, front-end liquidity may remain tight in the near term. As such, we expect 1M HIBOR and 3M HIBOR to move higher towards 2% and 2.2% respectively by end of this month. This may keep carry trade on the sidelines and allow USDHKD to stay below 7.85 for some time. Without any further liquidity withdrawal, aggregate balance may stabilize at HK$76.3 billion. Despite that, banks are still facing rising pressure to hike prime rate due to higher cost of funds. Since June, HIBOR's uptrend has prompted Hong Kong commercial banks to lift HKD fixed deposit rates with smaller banks paying higher. As a result, smaller banks might have attracted new money at the expense of larger banks' decreasing CASA. In July, HKD fixed deposits increased at the fastest pace since Aug 2017 by 14.1% yoy while HKD CASA dropped for the first time since May 2012 by 1.2% yoy. Besides, the share of HKD fixed deposits in total HKD deposits rose to the highest since Jun 2014 at 38.1%. In order to prevent clients from transferring any more money to smaller banks, larger banks further raised HKD new fixed deposit rates last week. This may urge smaller banks to pay more aggressively to attract retail money, especially given the rising borrowing costs in the interbank market. All in all, we expect the rising cost of funds will prompt banks to raise prime rate by 25bps this year.

| Key Events and Market Talk | |
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| **Facts** | **OCBC Opinions** |
| ▪ China retaliated as previously planned to impose 5-10% additional tariff on US$60 billion US imports.<br>▪ Meanwhile, China put the invitation for trade talk on hold and will not send the delegation to Washington this month. | ▪ As a result of slightly lower than expected additional tariff rate from both sides, market sentiment improved last week.<br>▪ Nevertheless, as consensus has been formed in China that compromise is not going to solve the problem, China is unlikely to compromise unilaterally. As such, the impact may be dragged into 2019. Meanwhile, China is unlikely to restart any meaningful talk with the US till the mid-term election. |
| ▪ The Chinese government unveiled the guidance to improve the income distribution mechanism to unlock the consumption potential. | ▪ One of the most effective ways to counter the impact of trade war is via boosting domestic demand. Income distribution is an essential way to boost domestic demand. China's income distribution reform is also part of China's SOE reform to allow the income to be decided by market force rather than planned economy. |
| ▪ PBoC signed a "Memorandum of Co-operation on Using Central Moneymarkets unit for issuance of PBoC Bills" with HKMA. The details of issuance has not been announced but PBoC is able to issue PBoC bill via CMU BID to manage RMB liquidity in the offshore market. | ▪ The establishment of new facility will help China improve the yield curve of offshore RMB market and meet the demand for shorter tenor high quality RMB assets in Hong Kong, which will reinforce HK's role as global RMB hub.<br>▪ The PBoC bill was initially launched back in 2003 in the onshore market as a tool to sterilize the excessive liquidity due to massive capital inflows after China joined the WTO. It could also |

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| | be used in the offshore market as a liquidity management tool to sterilize the offshore RMB liquidity. This will help stabilize the RMB in the offshore market. As such, the latest move could also be read as a gesture from China to stabilize RMB outlook. |
| ▪ PBoC surprised the market with the conduction of CNY265 billion 1-year MLF to inject the liquidity into the system last Monday. | ▪ It is a pre-emptive move to alleviate the liquidity pressure ahead of the massive local government special bond issuance as well as upcoming quarter-end and National Day holiday week. |
| ▪ Premier Li Keqiang said in summer World Economic Forum that China will not go back to old path of excessive easing. Meanwhile, he also denied the speculation that the recent RMB depreciation is engineered by Chinese government. He said the cost of one-way depreciation is higher than benefit and China will not consider competitive devaluation as the option. | ▪ From cost benefit analysis perspective, we agree that cost of RMB depreciation has been higher tremendously. With the reassurance from China's top leaders, we think the marginal impact of trade war on RMB is likely to be lower. |
| ▪ Premier Li reiterated last week to keep social security contribution policy stable. | ▪ The quick reaction from the State Council to address the concern is positive showing that China commits to policy consistency. |
| ▪ HKD jumped by the most since September 2003 during last Friday as concerns about tighter liquidity triggered stop losses and unwinding of long USDHKD positions.<br>▪ One-month HIBOR rose from 1.7% on 14 September to 1.89% on 21 September. | ▪ Though the money locked up for Meituan IPO returned to the market last week, the over HK$3 billion reserved for Haidilao IPO will only be released this week. Adding on upcoming quarter-end, Mid-Autumn Festival and National Daily Holiday, front-end liquidity is likely to remain tight in the near term. As such, we expect 1M HIBOR and 3M HIBOR (currently 2.125%) to move higher towards 2% and 2.2% respectively by end of this month. This may keep carry trade activities on the sidelines and allow the HKD to stay away from the weak end of the trading band for some time.<br>▪ Nevertheless, it may be risky to chase USDHKD lower. Specifically, USD LIBOR is set to tick up following the highly possible rate hike by the Fed in September FOMC. In contrast, given the relatively sizeable aggregate balance (HK$76.3 billion), HIBOR may come off as the HKD liquidity may improve after the seasonality abates and the IPO money returns to the market. Should US-HK yield differential widen again, it is still possible for the return of carry trade to push down HKD. |

| Key Economic News | |
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| **Facts** | **OCBC Opinions** |
| ▪ China's local governments increased the issuance of local government debt in August with total issuance hit CNY882.97 billion. Local governments issued CNY526.6 billion special bonds in August.<br>▪ Total outstanding of local government debt increased to CNY17.67 trillion in August. | ▪ As a result of the constraints to easing monetary policy, China will increasingly rely more on fiscal policy to strike the balance between steady growth and financial stability. The local governments are expected to further step up their issuance of special bond to support growth. |
| ▪ Macau gaming centers closed for 33-hour amid Typhoon MangKhut. We estimate this to reduce the casino operators' revenue by about MOP1.15 billion. | ▪ Macau government estimated MOP12.5 billion economic loss as a result of Typhoon Hato. In comparison, Typhoon Mangkhut's impact on Macau's overall economy is expected to be milder thanks to improved communication and some precautions. Despite that, gaming revenue may still grow at a slower pace in the coming months due to several reasons. First, a weaker RMB and China's economic slowdown may slow down Macau's tourism activities and reduce the gambling amount of Chinese visitors who account for over 70% of total inbound visitors. Second, we may also see fewer tourists from other major |

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| | sources as Asia's muted economic outlook is clouded by US-China trade war and emerging market turmoil. Third, policy risks regarding anti-monety laundering as well as higher borrowing costs may tame the VIP segment. All in all, we expect gaming revenue to grow by about 15% yoy in 2018 and 2%-5% yoy in 2019. On a positive note, Mid-Autum Festival and National Day Holiday may lend some support to the city's gaming and toursim activities. With HK-Zhuhai-Macau Bridge to commence operation this year, it may also help to ease the slowdown of gaming revenue growth. |
| ▪ According to the HKMA, the composite interest rate, which is a measure of the average cost of funds of banks, rose for the sixth consecutive month to 0.66% at the end of August 2018 from 0.37% at the end of February 2018. | ▪ Since June, HIBOR's uptrend has prompted Hong Kong commercial banks to lift HKD fixed deposit rates with smaller banks paying higher. As a result, smaller banks might have attracted new money at the expense of larger banks' decreasing CASA. In July, HKD fixed deposits increased at the fastest pace since Aug 2017 by 14.1% yoy while HKD CASA dropped for the first time since May 2012 by 1.2% yoy. Besides, the share of HKD fixed deposits in total HKD deposits rose to the highest since Jun 2014 at 38.1%.<br>▪ In order to prevent clients from transferring any more money to smaller banks, larger banks further raised HKD new fixed deposit rates last week. This may urge smaller banks to pay more aggressively to attract retail money, especially given the rising borrowing costs in the interbank market. All in all, we expect the rising cost of funds will prompt banks to raise prime rate by 25bps this year. |
| ▪ HK's jobless rate stabilized at an over twenty-year low of 2.8% during June to August. | ▪ Despite that, the employment situation was mixed across different industries. The unemployment rate of retail sector decreased from 4% to 3.9%, the lowest since early 2012. Nevertheless, the improvement may not sustain as a weaker RMB and Asia's muted economic growth have weighed down HK's tourism activities. Housing market slowdown and stock market correction would also hurt local consumer sentiment. In addition, the jobless rate of trade sector which increased from 2.3% to 2.5% may edge higher amid trade tensions. With regard to the financial sector (unemployment rate rose from 2% to 2.1%), the hiring sentiment could take a further hit due to the bearish stock market and slowing financial activities on trade war fear and emerging market turmoil. Moving forward, a combination of global monetary tightening, trade tensions and China's economic slowdown may cloud HK's economic outlook, in turn denting the overall hiring sentiment. We expect jobless rate will climb to 2.9% in the coming quarter. |

| RMB | |
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| **Facts** | **OCBC Opinions** |
| ▪ RMB continued to be stuck in the range of 6.8-6.9. RMB failed to outperform despite the retreat of broad dollar. As such, RMB index slipped to 92.65 last Friday. | ▪ RMB was under pressure initially last week as a result of the escalation of trade war and more than expected liquidity injection by PBoC. However, RMB received the support from Premier Li's reassurance that China will not join the competitive devaluation.<br>▪ With the RMB index slipped to 92 again, market should watch out for any possible intervention from China to defend the band. The introduction of issuance of PBoC bill is likely to be additional |

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| | tool for China to manage offshore liquidity which in turn help stabilize the currency. |

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