Highlights

US President Trump and China President Xi agreed on a trade truce at the G20 summit and resumed talks. On a more positive note, Trump has allowed US companies to continue selling components to Huawai and would discuss whether to remove Huawei from the backlist this Tuesday, hinting that he could still compromise to reach deal. Nevertheless, the outcome of future talks remains uncertain given Trump's flip-flop stance, the Senators' hawkishness and China's red lines. Despite that, China continued to show its commitment to open up the market with the updated negative lists for 2019.

Domestically, small banks paid record high premiums on the NCDs and their bond sales plunged to the lowest since Feb 2018 in June. Some companies delayed their plan of bond issuance amid rising costs associated with the NBFIs' sell-off of corporate bonds. This propelled the regulators to continue taking move to ease the structural liquidity constraints caused by Baoshang Bank woes by expanding some big security brokers' short-term debt quota and allowing seven big security brokers to issue financial bond. This combined with PBoC's injection of liquidity pushed short-end funding rates down to the lowest since 2009. However, the impact of Baoshang Bank incident may linger for a while due to worsening risk appetite on internal and external headwinds. Still, we see low probability of a full-blown financial risk as China's various tools may still be helpful to gradually restore confidence.

On policy, China's Premier Li Keqiang reiterated to support the micro companies with several measures. China's media points out that the target of PBoC's monetary policy is to support high-quality economic development. This indicates that universal easing is not imminent. Rather, the PBoC may keep focusing on structural easing with targeted easing measures like TMLF to guide the real funding costs of micro companies lower. However, should trade war continue to drag down China's growth and dent risk appetite, the PBoC may still have to return to universal easing like RRR cut to restore confidence and shore up growth.

RMB wiped out some gains against the dollar last week. The move was mainly driven by dollar factor and trade war-related news. After Fed's Chair Powell and dovish member Bullard downplayed the odds of 50bps rate cut in the near term, the USD rebounded. On the trade war front, the mixed headlines downplayed the hopes of a trade deal. As such, market refrained from chasing RMB higher. The positive trade war headline over the weekend may lend some support to RMB this week. However, as the trade truce has been largely priced in and the uncertainty continues to loom over future trade talks, we expect RMB to remain range bound in 6.8-6.9 depending on the dollar factor in the near term.

In Hong Kong, HIBOR rose across the curve amid half-year end effect. Elevated HIBOR together with the concerns about impact of virtual bank launches have prompted commercial banks to scramble for HKD fixed deposits with higher rates. Given the persistently compressed mortgage NIM and the higher funding costs, some commercial bank also raised remortgage rates and cut rebate for remortgage. After end of Jun, HIBOR is expected to come off a bit. Still, given the large amount of dividend payment by HK-listed Chinese companies and the potential large IPOs in Jul, market players will likely remain cautious and in turn keep 1M and longer-tenor HIBORs elevated above 2% in the coming month. As such, the commercial banks may keep HKD fixed deposit rates high and probably follow suit with regard to the adjustment to new remortgage. This suggests that the funding pressure (HKD loan-to-deposit ratio reached a 16-year high of 88.3% while the percentage share of HKD CASA deposits in total HKD deposits held steady at the lowest since Feb 2009 at 57.3%) on the commercial banks may remain high for some time. However, after the seasonal factor and IPO effect wane, we expect HKD exchange rate and local rates to come off gradually as outflow risks will be contained by global monetary easing and HK's sizeable FX assets. Elsewhere, we believe that virtual banks will not add much upside risks to HKD rates as they may not divert much deposits from traditional banks (see below for details). **In Macau,** China MOF is set to sell RMB2bn of bonds in the city on 4th July. Going forward, as one of the two SARs in the Greater Bay Area, Macau may also help to support the RMB internationalization, leveraging on its close relationship with the Portuguese-speaking countries.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US President Trump and China President Xi agreed on a trade truce at the G20 summit and resumed talks. On a more positive note, Trump has allowed US companies to continue selling components to Huawai and would discuss whether to remove Huawei from the backlist this Tuesday, hinting that he could still compromise to reach deal.	▪ The mixed headlines ahead of Trump-Xi meeting downplayed the hopes of both sides reaching any material deal. As such, market turned cautious ahead of the G20 summit. ▪ With US and China agreeing on a trace truce over the weekend and the former trying to lift the ban on Huawei, market sentiments may improve this week.

▪ However, before that, US White House downplayed hopes of reaching a trade deal with China while President Trump also threatened to lift tariff on additional imports from China if the talk with China President Xi fails to make any progress. ▪ On China's side, it is reported that China has prepared a list of conditions including lifting the Huawei ban, removing all tariffs, withdrawing the request for China to increase purchases of US goods.	▪ Nevertheless, the outcome of future talks remains uncertain given Trump's flip-flop stance, the Senators' hawkishness and China's red lines.
▪ China's President Xi announced to further open up the market, proactively increase the imports, continuously improve the business environment, fully implement equal treatment and promote economic and trade talks. ▪ The China Banking and Insurance Regulatory Commission (CBIRC) also stated to further open up the financial market by encouraging qualified foreign institutions to collaborate with onshore financial institutions in various areas. Meanwhile, the CBIRC also welcomes foreign institutions specializing in credit rating, wealth management, consumer finance, pension insurance, etc. to enter China's market. ▪ The National Development and Reform Commission and Ministry of Commerce released two updated negative lists for 2019 on 30th June.	▪ These measures show China's commitment to continuously open up the market despite the uncertainty over US-China relationship.
▪ Three Chinese banks are reportedly facing US action for violating unilateral US sanctions against North Korea. This sparks concerns that trade war will eventually turn into financial war.	▪ The three highly suspected banks (Bank of Communications, China Merchants Bank and Shanghai Pudong Development Bank) all denied the US media report while the US authorities did not confirm to sanction any of these three banks. ▪ If taking the previous cases as example, the three banks may just get fined and keep the impact restricted to themselves. ▪ Or perhaps it could just be one of Trump administration's threats to China ahead of the Trump-Xi meeting. As both sides agreed to resume trade talks, the US may not turn things from bad to worse at this moment. ▪ However, we are still wary of escalation of sanction (like banning the banks' access to US financial system) on these Chinese banks as US law enforcement officials are increasingly willing to be more aggressive in curbing China's assistance to North Korea. On a positive note, since USD assets have represented a small portion (less than 11%) of the three companies' total assets, any sanction may only have limited impact on their businesses. ▪ In the worst case, it could even turn into a financial war, though the possibility looks low to us as it may disrupt the transaction of trillions of dollars across the globe.

▪ As a follow-up to the meeting between China's regulators, six big banks and big security brokers, the regulators expanded some big security brokers' short-term debt quota. ▪ Besides, China's security regulator CSRC allows seven big security brokers to issue financial bond. Previously, financial bonds have been mainly issued by policy banks and commercial banks. Security brokers have never issued such kind of bonds in the interbank market. ▪ The China Banking and Insurance Regulatory Commission also stated that the interbank market is back to normal and the small banks and NBFIs have adequate liquidity.	▪ The structural liquidity constraints continued to loom over the interbank market with small banks paying record high premiums on the NCDs. Worse still, the Baoshang Bank woes had spill-over effect to the corporate bond market. The bond sales of small banks plunged to the lowest since Feb 2018 in June while some companies delayed their plan of bond issuance amid rising costs associated with NBFIs' sell-off of corporate bonds. ▪ On a positive note, the move taken by the PBoC and the CSRC may help support the funding of the large security brokers which are expected to play a bridging role to ease the liquidity crunch faced by smaller non-bank financial institution. ▪ This combined with PBoC's injection of liquidity pushed short-end funding rates down to the lowest since 2009. ▪ Going forward, the impact of Baoshang Bank incident may linger for a while due to worsening risk appetite on internal and external headwinds. Nevertheless, we see low probability of a full-blown financial risk as China's various tools may still be helpful to restore confidence gradually.
▪ China Minsheng Investment's offshore USD bond was fully repaid last week, narrowly escaping from a default.	▪ This is the first time for a guarantor to repay China's offshore USD bond. It combined with the expectations of Fed rate cut may support the offshore financing of Chinese private companies.
▪ Bond sales of local governments are set to reach about CNY900bn in Jun, the highest in nearly three years.	▪ Moving ahead, with the China's Ministry of Finance probably increase the quota for local government bond issuance in 2H19 and the new guidance for issuance of local government special purpose bonds, the bond sales of local governments may increase further. This is expected to revive the growth of infrastructure investment while prompting the PBoC to shift back to traditional monetary easing, in order to support the increasing liquidity needs resulted from increasing bond sales.
▪ Hong Kong: HIBOR rose across the curve with 1-week HIBOR rising to the highest since last Sep amid half-year end effect. ▪ Elevated HIBOR together with the concerns about impact of virtual bank launches have prompted commercial banks to scramble for HKD fixed deposits with higher rates. ▪ Given the persistently compressed mortgage NIM and the higher funding costs, some commercial bank raised remortgage rates and cut rebate for remortgage.	▪ After end of Jun, HIBOR is expected to come off a bit. Still, given the large amount of dividend payment by HK-listed Chinese companies and the potential large IPOs in Jul, market players will likely remain cautious and in turn keep 1M and longer-tenor HIBORs elevated above 2% in the coming month. As such, the commercial banks may keep HKD fixed deposit rates high and probably follow suit with regard to the adjustment to new remortgage. ▪ On the currency front, the narrow USD-HKD yield differential and strong seasonal demand for HKD may allow USDHKD to hover in the range of 7.80-7.84 in the near term. ▪ After the seasonal factor and IPO effect wane, we expect HKD exchange rate and local rates to come off gradually as outflow risks will be contained by global monetary easing and HK's sizeable FX assets.

	▪ Elsewhere, we believe that virtual banks will not add much upside risks to HKD rates as they may not divert much deposits from traditional banks. The reasons are as below. First, as virtual banks may offer loans at lower rates to attract customers, concerns about compressed interest rate margin may prevent them from lifting deposit rates to an unreasonably high level. Second, with the focus being the promotion of financial inclusion, the target customers of the virtual banks may be different from those of traditional banks which offers comprehensive services. Third, traditional banks have taken various countermeasures such as scrapping fees and improving online banking services. Fourth, for the older generation who are not very adapted to online services, they may still choose traditional banks.
▪ Macau: China MOF is set to sell RMB2billion of bonds in Macau on 4th July. The MOF believes that selling dim sum bond in Macau will help Macau's "diversified and sustainable development," and encourage more yuan bond sales by other institutions and support further financial cooperation with China.	▪ Lately, Macau has been studying to set a RMB-denominated securities market. The issuance of dim sum bond by the MOF will help to increase the variety of RMB assets in the city. ▪ Due to the small size and low liquidity of RMB pool in Macau, issuing dim sum bond in Macau may not be attractive. The MOF's move may set a benchmark for the other institutions and ease their concerns. ▪ Going forward, as one of the two SARs in the Greater Bay Area, Macau may also help to support the RMB internationalization, leveraging on its close relationship with the Portuguese-speaking countries.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's official PMI was static at 49.4 in Jun.	▪ New export order index fell to the lowest since Feb at 46.3, reflecting the impact of trade war re-escalation. Internal demand also remained weak with new order index falling further to 49.6, probably due to the shift of monetary policy to neutral from Apr. ▪ Employment index refreshed its lowest level since Global Financial Crisis at 46.9, signaling the rising pressure on job market amid external headwinds. ▪ Purchasing price index dropped below 50 once again and printed 49 in Jun. Given the abating high base effect, it is possible for PPI growth to decelerate towards 0% in the coming months.
▪ The PBoC stated that the NPL ratio of micro companies (with credit line below CNY10million) reached 5.9% as of end-May. This was 4.5 percentage points higher than that of large companies and 3.3 percentage points higher than that of medium companies. ▪ As of end-May, five state-owned banks' loan to micro companies increased by 23.7% YTD with the	▪ China's Premier Li Keqiang reiterated to support the micro companies with several measures. The measures include 1) further reducing the real funding costs of the micro companies which hints merging China's two interest rate tracks; 2) aiming to increase the size of the financial bond issuance for micro companies to over CNY180bn; 3) replacing the subsidy with reward to support financial services for micro companies; 4) exempting the loans with NPL ratio higher than 3 percentage

average interest rate printing 4.79%, 0.65 percentage point lower than the average level in 2018.	points than the overall ratio from regulation; 5) encouraging micro companies to get funding through bond or bill sales. ▪ Meanwhile, Li reiterated to keep monetary policy stable and remain a neutral stance. China's media also points out that the target of PBoC's monetary policy is to support high-quality economic development. The PBoC also reiterated that they will not roll out excessive easing. ▪ This indicates that universal easing is not imminent. Rather, the PBoC may keep focusing on structural easing with targeted easing measures like TMLF to guide the real funding costs of micro companies lower. ▪ However, should trade war continue to drag down China's economic growth and dent risk appetite, the PBoC may still have to return to universal easing like RRR cut to restore confidence and shore up growth.
▪ According to the June housing market report issued by Chinese Academy of Social Sciences, the housing price of China's first-tier cities were largely stable while that of second-tier cities continued to go up. The housing prices growth (+0.81% mom) in Shenzhen outpaced that in other first-tier cities. In contrast, the housing price growth of third- and fourth-tier cities continued to slow down. ▪ On 24th Jun, Shenzhen sold five plots of residential land at record prices to the top players in the real estate industry, exceeding the minimum bids by 45%.	▪ In fact, Shenzhen government bans the buyers of the homes built on these five parcels of land from selling the property within three years after getting the property ownership certificate. Given the rebound in the property market, it is also likely for Shenzhen government to tighten the grip on the market. However, these factors did not prevent over eighty property developers from actively competing for a piece of land in Shenzhen where residential land is very scarce. ▪ This signals that the property developers are still optimistic about the property market outlook of Shenzhen, probably pinning hopes on the Greater Bay Area development. ▪ Besides, it confirms that China's curb on the funding of property developments has little impact on the large property development with strong liquidity. ▪ Also, it is possible that the developers are betting on universal easing from the PBoC.
▪ China's industrial profit growth rebounded to 1.1% yoy in May from -3.7% yoy in April.	▪ The recent rebound in PPI growth might have helped to revive industrial profit growth. However, with US-China trade war escalating in May and PBoC's monetary policy shifting to neutral from April, the manufacturing sector showed signs of renewed weakness with Manufacturing PMI falling below 50 once again. The fall in purchasing price index also signalled that PPI might have peaked. As such, we doubt the sustainability of the rebound in industrial profit in the coming months.
▪ HK's total loans growth printed 0% mom or 3.1% yoy in May.	▪ Internally, trade finance dropped for the ninth consecutive month by 7.6% yoy amid shrinking trade activities. Loans use in HK (excluding trade finance) fell by 0.2% mom as renewed trade tension dented investor sentiments and seasonal factors pushed up local rates. Moving into the coming months, a combination of lingering trade war risks, domestic economic slowdown and high borrowing costs may continue to hurt local loan demand. ▪ Externally, the growth in loans for use outside of HK decelerated further to 2.7% yoy in May, the weakest since Nov 2016. This was probably due to the renewed slowdown in China's growth and RMB's depreciation. Nevertheless, loan demand from Mainland companies may rebound in the near

	term due to widening USD-RMB yield differential and stabilizing RMB. ▪ In conclusion, we expect total loan growth to remain subdued and see low single-digit growth in 2019.
▪ HKD loan-to-deposit ratio reached a 16-year high of 88.3% in May as HKD loans showed no month-on-month growth while HKD deposits fell by 1% mom.	▪ The decline in HKD deposits may be attributed to weaker loan demand. Last year, HKD deposits also showed negative mom growth in Aug and Oct when HKD loans dropped on a monthly basis. Specifically, HKD CASA deposits dropped by 1.5% mom while HKD fixed deposits shrank by 0.8% mom in May. As a result, the percentage share of HKD CASA deposits in total HKD deposits held steady at the lowest since Feb 2009 at 57.3%. ▪ Starting from Jun, the fierce fight for HKD fixed deposits is expected to drive the percentage share of HKD CASA deposits down further during Jun and Jul. ▪ However, we believe that HIBOR will come off from highs after seasonal factor and IPO effect wane and the impact of virtual banks will be limited. Besides, overall loan demand is expected to remain subdued. As such, the growing funding pressure on the commercial banks is set to ease later this year.
▪ HK's RMB deposits increase by 4% yoy or 2% mom to RMB624 billion in May 2019.	▪ This confirms that market was relatively calm about RMB's decline and still interested in RMB assets. In fact, China also saw strong inflows to its bond market in May. ▪ With RMB rebounding on positive trade war headline in Jun and A-shares to be included in global indexes, equity inflows to China increased in Jun. Also, the relatively high yield of RMB assets might have helped to continue luring offshore investors. ▪ In conclusion, we expect RMB deposits to hover above RMB600 billion in the coming months before any negative trade war headline poses renewed downside risks to the RMB.
▪ HK's exports dropped for the seventh consecutive month by 2.4% yoy in May but the decline was milder the expected. This may be partially due to the front-loading of exports ahead of US-China trade war re-escalation. ▪ Imports fell for the sixth month in a row by 4.3% yoy in May.	▪ Despite the possible front-loading of some exports, overseas shipments to Thailand (-14% yoy), Malaysia (-11.6% yoy), Singapore (-9.5% yoy), Mainland China (-4.1% yoy) and the US (-15% yoy) still dropped notably as trade war continued to materialize. On the other hand, imports from major trading partners declined on a broad basis with those from Mainland China down by 4% yoy. This indicates that internal demand remained sluggish. ▪ On commodities, import of electrical machinery and office machines shrank by 5.3% yoy and 14.3% yoy respectively while exports of these two items dropped by 2.0% yoy and 15.7% yoy respectively. It reflected that Asia's electronic value-chain has continued to be negatively affected by the trade war. ▪ Moving forward, since trade war escalated and extended into a technology war from early May, we expect HK's trade sector which mainly ships high-tech products will continue to take a hit. The high base effect, amid front-loading of trade activities during last July to October, may also keep trade growth subdued in the coming months. ▪ On a positive note, should the trade truce between US and China and the global monetary easing revive demand, this may alleviate some downward pressure on HK's trade sector.
▪ Macau's unemployment rate was unchanged at a more than four-year low of 1.7% during the three months through May 2019. Besides, employed population increased to 387,200 from 385,300 while	▪ Despite that, the employment of different industries varied largely. The employed population of gaming industry increased by 1.1% mom to the highest level since early-2015. The casino operators probably added jobs to support the expected growth of mass market segment on resilient inbound tourism. During

labor force participation rate rebounded to 70.4% from 70%.	the same period, strong inbound tourism also encouraged the hotel, restaurants and similar activities sector to expand its employed population by 1.3% mom. ▪ On the flip side, the employed population of construction sector dropped for the forth three-month period by 4.4% mom, due to the successive completion of large projects. Also, the employed population of retail sector decreased by 2.3% mom as the sector's growth has been curbed by cautious consumption sentiments. ▪ Moving into the coming months, total unemployment rate may be sticky at 1.7%, mainly supported by the flourishing tourism. In the medium term, however, we are concerned that the labor market would weaken should trade war and global economic slowdown cloud the outlook of Macau's gaming and tourism-related sectors.

RMB	
Facts	**OCBC Opinions**
▪ RMB wiped out some gains against the dollar last week amid the rebound of USD and the uncertainty over Trump-Xi meeting. The USDCNY ended the week above 6.86. RMB index also retreated to 92.66.	▪ Last week, RMB's move was mainly driven by dollar factor and trade war-related news. After Fed's Chair Powell and dovish member Bullard downplayed the odds of a 50bps rate cut in the near term, the USD rebounded. On the trade war front, the mixed headlines downplayed the hopes of a trade deal. As such, market refrained from chasing RMB higher. ▪ The positive trade war headline over the weekend may lend some support to RMB this week. However, as the trade truce has been largely priced in and the uncertainty continues to loom over future trade talks, we expect RMB to remain range bound in 6.8-6.9 depending on the dollar factor in the near term.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W