Highlights

President Trump's impatience over the slow progress of US-China rewrote the parameters for the global market. Given that more than 60% of the remaining US$300 billion in products are consumer goods, the negative impact of new tariffs on US consumers and the US economy is likely to be larger than the previous round of tariffs. On a positive note, the escalation of the trade war may force the Fed to cut interest rates further which may counter the impact of the trade war on the global economy.

The latest Politburo meeting reckoned that the economy is facing increasing downward pressure. However, one of the most notable policy shifts from the meeting is that China will not use property market as short term stimulus tools to support the growth. In addition, more cities announced property tightening measures. Given property investment is expected to decelerate further in the second half, we expect China's growth to slow down though the deceleration may be countered by proactive fiscal policy and flexible monetary policy.

The latest unrest in Hong Kong has affected the cross straits relationship. China announced to ban the free and easy travel to Taiwan effective from 1 August. China has been frequently using the tourism card as a tool to penalize Tsai administration in the past few years. But a total ban is the first time. The ban on free and easy visa means the potential 10% loss of tourist arrivals for Taiwan. It could be related to the latest HK protest as some Chinese officials argue Taiwan other than the US is the supporting forces behind the protest.

Amid China's financial sector supply side reform, more default cases are likely to be uncovered. The default of the bill acceptance in North-eastern China, first in more than a decade, hit the headline last Friday. The spill over effect is likely to be contained after the PBoC clarifies that the default is not from the commercial bank but from one of the local finance companies.

RMB's weakness was not a surprise as RMB is the function of trade war. The key focus this week will be the RMB fixing. Should the USDCNY fixing was kept below 6.90, we think the USDCNY is unlikely to challenge 7 in the spot market. Alternatively, it may open the door for the pair to test 7 again.

In **Hong Kong,** 2Q GDP growth was static at 0.6% yoy, the weakest level since 3Q09, as weak external and internal demand continued to weigh. Exports fell for the eighth consecutive month while retail sales fell for the fifth straight month in June. Going forward, we are worried that the tourism-related industries will take a hit amid the ongoing political unrest in 3Q. The upcoming trade war escalation and global economic slowdown could further hit the exports of goods. Local political uncertainty and external headwinds may dent consumer/investor sentiments. Furthermore, the completion of mega infrastructure projects may continue to curb public investment while the upcoming implementation of vacancy tax would keep hindering property investment. Taken all together, despite the waning high-base effect, we expect HK's growth to remain sluggish in 2H19. We revise our 2019 GDP forecast from 2.1% to 1%-1.5%. Should social unrest persist and US-China trade war keep escalating in the rest of this year, the growth may decelerate further. Hopefully, local fiscal stimulus could support government expenditure while stimulus measures from China and major central banks could help to alleviate downward pressure on growth. **Elsewhere,** HKMA followed the Fed to cut base rate for the first time since 2008. That said, HK's commercial banks stayed put on prime rate as they have lagged far behind the Fed in the latest rate hikes and their funding pressure has been rising. Specifically, HKD loan-to-deposit ratio reached the highest level since January 2003 at 89.3% in June while the percentage share of HKD CASA deposits in total HKD deposits fell to 50.5%, a level last seen in January 2012. We expect the commercial banks to remain prime rate unchanged in the rest of this year despite Fed's rate decisions.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The US and China concluded their first post G20 face-to-face trade talk in Shanghai. According to the statement from the US that China confirmed their commitment to increase purchases of US agriculture exports. ▪ However, President Trump lost his patience and proposed to impose additional 10% tariff on the remaining US$300 billion Chinese imports effective from 1 September.	▪ President Trump's impatience has re-escalated the trade war again to the next stage. Given that more than 60% of the remaining US$300 billion in products are consumer goods, the negative impact of new tariffs on US consumers and the US economy is likely to be larger than the previous round of tariffs. ▪ The additional tariffs are clearly negative for China. However, it is difficult to quantify the impact at the current stage as the impact may depend on the method of allocation of tariffs. Based on the current observations, Trump's claim that China

	has paid for most of the tariffs is clearly wrong. There are lots of examples of US companies paying for more than half of the tariffs, which they may eventually pass to end consumers. ▪ At 10% of additional tariffs, we think both sides may be able to absorb the impact. The impact on the global economy may mainly be felt via worsening risk-off sentiment. ▪ On a positive note, the escalation of the trade war may force the Fed to cut interest rates further which may counter the impact of the trade war on the global economy.
▪ China announced to ban the free and easy travel to Taiwan effective from 1 August.	▪ China's tourist to Taiwan on free and easy visa was at 1.07 million in 2018, accounting for 56% of total visitor arrivals from mainland China and 9.7% of total visitor arrivals. China has been frequently using the tourism card as a tool to penalize Tsai administration in the past few years. But a total ban is the first time. The ban on free and easy visa means the potential 10% loss of tourist arrivals for Taiwan. It could be related to the latest HK protest as some Chinese officials argue Taiwan other than the US is the supporting forces to the protest.
▪ The latest Politburo meeting reckoned that the economy is facing increasing downward pressure. The top policy makers reiterated the "six stability" to counter the impact of external headwinds.	▪ However, the most notable policy shift from the meeting is that China will not use property market as short term stimulus tools to support the growth. This is in line with the recent tightening tone in China's property market. Given property investment is expected to decelerate further in the second half, we expect China's growth to slow down though the deceleration may be countered by proactive fiscal policy and flexible monetary policy. We maintained our view that China may cut the reserve requirement ratio to support the growth.
▪ China unveiled 21 measures to lower the corporate leverage.	▪ The equity financing will be the focus via the debt for equity swap or broadening channel for equity investment by savings and private capital.
▪ China's Angang Steel said its CNY338 million bill acceptance was not paid. ▪ PBoC Shenyang branch said the bill was issued by one of the finance companies not commercial banks.	▪ Under China's financial supply side reform, more default cases are likely to be uncovered. The default of bill financing could be the first time in more than a decade. The spillover effect is likely to be contained after the PBoC clarifies that the default is not from the commercial bank.
▪ After Moody's, another credit rating agency Fitch also warns the impact of recurring protests on HK's economy and the possibility of downgrading HK's GDP growth forecasts.	▪ Fitch believes that HK's strong fiscal reserve would provide buffer in the near term. However, Fitch warns that the latest social unrest and the rising public distrust in government could hurt business confidence and undermine the effectiveness of governance, in turn threatening HK's AA+ sovereign rating. Fitch is also concerned that the political uncertainty would curb the development of the Greater Bay Area and change the view of foreign countries about HK as a stable business hub. ▪ That said, it seems unlikely for the rating agencies to downgrade HK's sovereign rating at this juncture as the political uncertainty so far has been mainly affected the tourism-related industries, retail sector and the housing market. Even if HK's sovereign rating were downgraded, the downgrade itself may only have limited impact on government or corporate funding costs as the main buyers of HKD bonds are commercial banks or insurance companies in HK will not be easily swayed by the mild change in sovereign rating. Rather, the reasons behind the downgrade, such as worsening effectiveness of governance and rule of law or change to the US-HK Policy Act, would be more worrying.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's July PMI rebounded slightly to 49.7 from 49.4 in June, but still below the threshold line of 50 for three consecutive months.	▪ Demand improved slightly with both new orders and new export orders rose to 49.8 and 46.9 respectively from 49.6 and 46.3. In addition, supply also rebounded with production increased from 51.3 to 52.1.
▪ Hong Kong's 2Q GDP growth surprised on the downside at 0.6% yoy, the weakest level since 3Q09, as weak external and internal demand continued to weigh. The seasonally adjusted GDP unexpectedly contracted by 0.3% qoq in 2Q.	▪ Externally, exports dropped for the eighth consecutive month in July. On top of the existing tariff and the persistent global economic slowdown, trade war escalation in September may further drag down the exports of goods (-5.4% yoy in 2Q) in the coming quarters. Meanwhile, exports of services grew at the slowest pace since 3Q16 by 0.2% yoy in 2Q. Given HK's ongoing political unrest, we are worried that the tourism-related industries will take a hit in the third quarter. On a positive note, the percentage share of value added of inbound tourism took up merely 3.6% in GDP in 2017 and the exports of travel services only represented 11% of total GDP in 1Q19. Any weaker performance of tourism-related industries may only have moderate impact on HK's economic growth. ▪ Internally, the growth of private consumption (taking up over 60% of total GDP) rebounded from 0.4% yoy in 1Q to 1.2% yoy in 2Q, probably due to the wealth effect from housing market rally, tight labor market and abated high base effect. However, the growth was still weaker as compared to the previous years, indicating that local consumers remained cautious amid global uncertainties. Worse still, fixed investment tumbled for the third consecutive quarter by 12.1% yoy in 2Q as external headwinds dented business sentiments. Meanwhile, the upcoming implementation of vacancy tax weighed on property investment (housing starts dropped by 70.5% yoy in the first five months of 2019) while the completion of mega infrastructure projects resulted in weak public investment. Going forward, public investment and property investment may remain subdued. Besides, the rising local political uncertainty and the external headwinds may continue to dent consumer/investor sentiments. ▪ Taken all together, despite the waning high-base effect, we expect HK's growth to remain sluggish in 2H19. We revise our 2019 GDP forecast from 2.1% to 1%-1.5%. Should HK's social unrest persist and US-China trade war keep escalating in the rest of this year, the growth may decelerate further. Hopefully, local fiscal stimulus could support government expenditure while stimulus measures from China and major central banks could help to alleviate downward pressure on growth.
▪ HK's total loans growth rebounded by 1.1% mom or 3.3% yoy in June.	▪ Dragged by trade war, trade finance dropped for the tenth consecutive month by 8.5% yoy in June. Loans for use in HK (excluding trade finance) rebounded by 1.3% mom or grew by 4.2% yoy in June, mainly supported by the increased expectations of US-China trade war de-escalation and Fed's easing in June. Moving into the coming months, however, the growth of loans for use in HK may remain subdued as the boost from global monetary easing may be overshadowed by renewed trade tensions, dimming global growth outlook and rising political uncertainty. The upcoming implementation of

	vacancy tax may also curb property investment and dent the corresponding loan demand. ▪ Externally, the growth in loans for use outside of HK rallied from 2.6% yoy (the weakest since Nov 2016) in May to 3.5% yoy in June. This was probably due to the widened USD-RMB yield differential and the stabilized RMB. However, as compared to the double-digit growth seen last year, the growth for the coming months may remain sluggish amid the PBOC's expected monetary easing, China's curb on offshore financing of property developers and Mainland companies' preference for bond issuance over bank loans in the offshore market. In conclusion, we expect total loans to see single-digit growth this year.
▪ HKD loan-to-deposit ratio rose further to the highest since January 2003 at 89.3% in June as HKD loans (+1.6% mom) grew faster than HKD deposits (+0.5% mom). ▪ The HKMA followed the Fed to cut base rate for the first time since 2008.	▪ HKD CASA deposits dropped for the second consecutive month by 2.1% mom, probably due to the cautious investor sentiment and the increased attractiveness of fixed deposits. Commercial banks have lifted HKD fixed deposits rates given the sharp increase in interbank funding rates amid large IPO and half-year end effect. This drove HKD fixed deposits up notably by 3.9% mom in June. As a result, the percentage share of HKD CASA deposits in total HKD deposits fell further to 50.5%, a level last seen in January 2012. ▪ With commercial banks continuing to offer high fixed deposit rates in July, we expect HKD fixed deposits to sustain the strong growth. This means that commercial banks have continued to bear high funding costs in July. As such, though the Fed cut rates by 25bps last week, HK's commercial banks chose to stay put on prime rate. ▪ Going forward, however, we believe that HKD rates including HIBOR and HKD fixed deposit rates has already peaked and will come off gradually in tandem with its USD counterpart. Besides, a combination of contained capital outflow risks, limited impact of virtual bank and subdued loan demand may also help to cap the upside of the HKD rates. This suggests that the funding pressure on the commercial banks may not intensify much further. Still, given rising social unrest and external headwinds, both HKD CASA growth and HKD loan growth will likely remain subdued. As such, both HKD loan-to-deposit ratio and the percentage share of HKD CASA deposits in HKD deposits may hover around the current levels in the near term.
▪ HK's RMB deposits retreated by 3.2% mom to RMB604 billion in June.	▪ Specifically, RMB fixed deposits dropped by 4.5% mom to the lowest since last February, probably due to the increased attractiveness of HKD fixed deposits after commercial banks lifted rates to scramble for HKD liquidity. As HKD fixed deposit rates remained high in July, it might have continued to drag on RMB deposits. ▪ Nevertheless, after July, HKD fixed deposits rates are expected to be adjusted lower. If this is the case, we expect RMB deposits to hover above RMB600 billion in the coming months, supported by RMB's stabilization and the relatively high yield of RMB owing to the PBOC's relatively neutral stance.
▪ HK's retail sales dropped for the fifth month in a row by 6.7% yoy in June.	▪ Apart from high base effect, cautious consumption sentiments remained to be the main drag on the retail sector. The sales value of food, alcohol and tobacco (-1.3% yoy), consumer durable goods (down for the eighth consecutive month by

	11.9% yoy) and goods in department stores (-6% yoy) all decreased. This indicates that local consumption remained sluggish amid faltering global growth outlook and lingering trade war risks. These two factors combined with a relatively strong HKD against the RMB have continued to sour the visitors' appetite for spending as well. The sales value of clothing, footwear and related products as well as that of jewelry, clocks and watches both declined for the fifth consecutive month and fell by 7.1% yoy and 17.1% yoy respectively. ▪ Moving forward, we are wary that social unrest which intensified in July would have added downward pressure on the retail sector. Due to the ongoing protests, we may see slower growth or even negative growth of visitor arrivals (+8.5% yoy in June) in the coming months. On the other hand, as the protests disrupted the normal operation of some retail and department stores, local consumption might have been curbed as well. For the rest of the year, internal and external uncertainties may continue to cloud the outlook of the retail sector. As such, we expect retail sales to show single-digit negative growth in 2019.
▪ Macau's gross gaming revenue missed expectations and fell 3.5% yoy to MOP24.45 billion in July.	▪ Back in 2Q, supported by the burgeoning inbound tourism, mass market revenue surged by 21.3% yoy and took up a larger proportion of total gaming revenue than the VIP revenue for the first time since record. However, due to the relatively low betting among of casual gamblers, the strong growth of mass-market segment failed to offset the drag from weaker high-roller demand. Moving ahead, the outlook of the VIP segment may remain clouded by several unfavorable factors including the slow growth of overnight visitors (the number of guests of hotels and guesthouses dropped for the third consecutive month by 3.4% yoy in June), stronger MOP against the RMB, China's economic slowdown and the lingering policy risks related to anti-money laundering. As such, we hold onto our view that the growth of gross gaming revenue will be flat this year.

RMB	
Facts	**OCBC Opinions**
▪ RMB tumbled after Trump threatened to impose additional tariff in almost all Chinese imports from 1 September. The USDCNY rose to above 6.97 in the offshore market. RMB also weakened against its major trading partners with RMB index fell to about 92.70.	▪ RMB's weakness was not a surprise as RMB is the function of trade war. The key focus this week will be the RMB fixing. Should the USDCNY fixing was kept below 6.90, we think the USDCNY is unlikely to challenge 7 in the spot market. Alternatively, it may open the door for the pair to test 7 again.

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