Highlights

Forget about the psychological important level, RMB has entered into a new era. With the clean break of 7 for USDCNY fixing and 92 for RMB index, it shows that RMB is likely to move towards a more clean floating system. The latest observation shows that China's individual and corporates have been more rational with less foreign currency hoarding activities. This may create the window for China to test the new currency regime.

In the near term, RMB's volatility is likely to go up to absorb the external shock. However, that does not mean China will let RMB freely float. As all the counter cyclical measures are still in place, we think China will not hesitate to intervene should RMB deviate too much from its fundamental level.

China's July credit data show that credit expansion remained weak reflecting the overall weak demand. Given China has tightened its property financing; we think China's off-balance sheet lending may remain weak in the coming months. Together with the cap in local government special bond issuance, we think China's aggregate social financing may remain weak in the coming months. This suggests that China may have to lean towards the easing monetary policy to keep the money supply supported above 8%.

The tone from the 2Q monetary policy report shows that China's central bank remains alert against the backdrop of rising global uncertainty. However, PBoC is expected to exercise restraint and is unlikely to be very stimulative as it has been preparing for the long march in time of uncertainty and will take a wait-and-see approach to see the impact of global easing on the respective economies first. Nevertheless, China's bond market has reacted with the 10-year government bond yield fell below 3%.

We think an outright interest rate is unlikely at this stage for two reasons. First, the interest rate cut may jeopardize China's effort to tighten its property market. Second, China is working on its interest rate liberalization. There is probably no rush for China to cut its outdated benchmark interest rate.

In Hong Kong, the FX and money markets were very volatile last week. USDHKD surged to the highest since May at 7.8487 before retracing lower to around 7.8400. 1M HIBOR jumped by around 50bps on 6th Aug to 2.515% and came off soon on the following day by 55.8bps to 1.96%. Early last week, a combination of trade war re-escalation, RMB depreciation and local social unrest sparked concerns about capital outflows. Against the backdrop of low aggregate balance, market players have become more proactive in preparing for potential liquidity draining events. This as a result pushed up HIBOR across the curve. Despite tight HKD liquidity, HKD depreciated in tandem with the RMB. On the positive front, with the stabilization of RMB, the fret about capital outflows eased and pushed HIBOR down across the curve. Moving ahead, in the absence of huge dividend payment and large IPO, we expect HIBOR to edge lower gradually. However, the lingering internal and external headwinds may keep market players cautious about potential outflow risks. This combined with the upcoming quarter-end and Alibaba's IPO will likely limit the downside of HIBORs with 1M HIBOR to find support at 1.5%. Meanwhile, USD LIBOR looks set to fall gradually on the renewed expectations of Fed's further rate cuts. As such, a narrower USD-HKD yield differential coupled with the high volatility of HIBOR/HKD suggests that USDHKD would not easily touch 7.85 in the near term. Rather, we expect USDHKD to hover around 7.84. **Elsewhere,** the property market showed signs of slowdown. The ongoing social unrest combined with the re-escalation of trade war may undermine the support from global monetary easing, in turn weighing on the housing market. As such, housing prices are expected to edge down gradually in the coming months.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In its 2Q monetary policy report, PBoC said the average interest rate for small and micro companies fell by 58bps in the first half of 2019 to 6.82%. Meanwhile, the average funding costs for small and micro companies lent by big five banks fell by 66bps to 4.78%. ▪ PBoC said it will be new normal to issue PBoC bill in Hong Kong in a regular basis. ▪ Meanwhile, PBoC said it will deepen China's financial sector supply side reform.	▪ The tone from the 2Q monetary policy report shows that China's central bank remains alert against the backdrop of rising global uncertainty. However, PBoC is expected to exercise restraint and is unlikely to be very stimulative as it has been preparing for the long march in time of uncertainty and will take a wait-and-see approach to see the impact of global easing on the respective economies first. ▪ Nevertheless, given China is on track to deliver 100bps funding cost cut for the small and micro companies, we think China is likely to lean towards easing monetary policy overall. PBoC is expected to more rely on reserve requirement ratio policy to guide the liquidity to support the funding demand of small

	companies. ▪ We think an outright interest rate is unlikely at this stage for two reasons. First, the interest rate cut may jeopardize China's effort to tighten its property market. Second, China is working on its interest rate liberalization. There is probably no rush for China to cut its outdated benchmark interest rate.
▪ IMF said RMB was broadly stable against the basket for the past one year and estimates suggest little FX intervention by the central bank in its latest Article IV consultation paper.	▪ The report from the IMF was a relief for China, which has been used as China's argument to reject US's call to label China as the currency manipulator. ▪ This will also help reinforce China's move towards a floating currency system for RMB. ▪ China's currency regulator Pan Gongsheng wrote over the weekend that personal currency purchase has been more stable and foreign exchange hoarding behaviour has been declining. This show's China's corporates and individuals are more rational, which creates the window for China to try the new regime for its currency system.
▪ HK's FX and money markets were very volatile last week. USDHKD surged to the highest since May at 7.8487 before retracing lower to around 7.8400. 1M HIBOR jumped by around 50bps on 6th Aug to 2.515% and came off soon on the following day by 55.8bps to 1.96%.	▪ Early last week, a combination of trade war re-escalation, RMB depreciation and local social unrest sparked concerns about capital outflows. Against the backdrop of low aggregate balance, market players have become more proactive in preparing for potential liquidity draining events including potential outflows. This as a result pushed up HIBOR across the curve. Despite tight HKD liquidity, HKD depreciated in tandem with the RMB. On the positive front, with the stabilization of RMB, the fret about capital outflows eased and pushed HIBOR down across the curve. ▪ Moving ahead, in the absence of huge dividend payment and large IPO, we expect HIBOR to edge lower gradually. However, the lingering internal and external headwinds may keep market players cautious about potential outflow risks. This combined with the upcoming quarter-end and Alibaba's IPO will likely cap the downside of HIBORs with 1M HIBOR to find support at 1.5%. Meanwhile, USD LIBOR looks set to fall gradually on the renewed expectations of Fed's further rate cuts. As such, a narrower USD-HKD yield differential coupled with the high volatility of HIBOR/HKD suggests that USDHKD would not easily touch 7.85 in the near term. Rather, we expect USDHKD to hover around 7.84.
▪ HK: Southbound equity flows have seen net inflows of HK$15.7 billion month-to-date in August after marking five consecutive months of net inflows. In contrast, northbound equity flows have registered net outflows of RMB13.5 billion month-to-date in August after seeing two straight months of net inflows.	▪ Though the ongoing social unrest continues to raise concerns about capital outflows, we so far have not seen massive outflows yet. Instead, with USDCNY breaking above 7 and US-China trade war re-escalating, investors might have shifted from China's onshore market to HK's market, probably to hedge against RMB's depreciation risk. AH premium index rose to the highest since early 2018 at 130, indicating increasing attractiveness of H-shares as compared to the A-shares. This also helps to explain the continuous southbound net equity inflows. ▪ On top of the resilient southbound net equity inflows, global monetary easing and a relatively strong HKD may help to ease the outflow risks as well. More importantly, in HK's banking system, the liquidity coverage ratio and capital adequacy ratio respectively averaged about 160% and 20%, both higher than the required levels. Finally, we believe that HK's strong foreign currency reserve assets (amounted to US$445.6 billion as at the end of June 2019 and represented about seven times the

	currency in circulation or 46% of Hong Kong dollar M3) and fiscal reserve (HK$1.16 trillion by the end of March 2019) could also allow HK to well contain the outflow risks.
▪ HK: Twenty-two countries or regions including Ireland, Japan, Singapore issued travel warnings for Hong Kong or warned their citizens the risk of violence.	▪ This reinforces our concerns about the outlook of the tourism-related industry and the retail sectors amid ongoing protests. The tourism functional constituency lawmaker estimates that the hotel occupancy rate will drop by 5 to 8 percentage points in July and by 10 percentage points in August. On the positive front, as what we mentioned in previous week's week-in-review report, the contribution of inbound tourism to the GDP has been relatively small. This means that any weakness in the tourism-related industry sector may have limited impact on the economic growth. However, any sharp decrease in inbound tourists combined with a stronger HKD against other currencies especially RMB may add further downward pressure to the retail sector (about 30%-40% of retail shops' revenue has been generated from visitor spending). We expect the decline in retail sales to worsen in July and August. This may feed through to further slowdown in domestic economic growth in 3Q19.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's aggregate social financing increased by CNY1.01 trillion in July, CNY215.4 billion below last July's level. ▪ The growth of total outstanding of aggregate financing decelerated to 10.7% yoy in July from 10.9% yoy. Meanwhile, broad money supply M2 growth also decelerated to 8.1% yoy from 8.5% yoy. ▪ New Yuan loan increased by CNY1.06 trillion, CNY390 billion below last July's level.	▪ The weaker than expected aggregate social financing was mainly the result of shrink of off-balance sheet financing led by the sharp decline of bill financing. Entrusted loan and trust loan fell by CNY98.7 billion and CNY67.6 billion respectively in July while bill financing fell by CNY456.3 billion. The weak bill financing was partly attributable to pay back of strong bill financing growth in January. Given China has tightened the property financing, we think China's off-balance sheet lending may remain weak in the coming months. ▪ The issuance of local government special bond was the main supporting items to aggregate social financing in July. Nevertheless, with the special bond quota declining in the second half, we think the support from the local government bond issuance to social financing is likely to decline. ▪ On the positive note, loan structure improved in July. Medium to long term loan increased by CNY809.5 billion, accounting for 76.4% of total new Yuan loan. This was probably due to the window guidance by the government to guide the money to support the real economy. ▪ Overall, we think the July credit data show that credit expansion remained weak reflecting the overall weak demand. This suggests that China may have to lean towards the easing monetary policy to keep the money supply supported above 8%.
▪ China's July CPI accelerated to 2.8% yoy from 2.7% yoy, highest since Feb 2018. ▪ PPI fell to negative reading for the first time since August 2016, down by 0.3% yoy.	▪ CPI grew by 0.4% mom in July. The rise of CPI was mainly the result of higher food prices, which grew by 0.9% mom, led by the rise of pork prices due to the spread of pork virus. Among 2.8% yoy growth in July, pork prices alone contributed 0.7% yoy. ▪ Non-food prices also rebounded by 0.3% mom in line with seasonal pattern as service costs rose during the school holiday season. ▪ Looking ahead, the rising pork prices may continue to support

	China's CPI. However, we think CPI will be capped for two reasons. First, the wane of low base effect in the second half may bring down the CPI reading. Second, the falling oil prices may also cap the non-food prices. ▪ Overall, despite the acceleration of CPI, we think China's inflation is unlikely to be the constraints to policy makers.
▪ HK's property price index dropped by 0.8% in June from the historical high seen in the previous month. Housing transaction volume plunged for the second consecutive month by 21.1% yoy in July while CCL index which tracks secondary housing prices has decreased in four out of five weeks as of 4th August.	▪ Lately, HK sold the biggest residential plot in Kai Tak at the lowest price since Dec 2016. Meanwhile, some potential homebuyers have stayed away from the market while homeowners and property developers have struggled to lure buyers with lower price. The worsening sentiments in the housing market could be attributed to several unfavorable factors including high local borrowing costs, lingering trade war risks, dimming growth outlook, increasing short-term supply and rising political uncertainty. Going ahead, the ongoing social unrest combined with the re-escalation of trade war may undermine the support from global monetary easing, in turn weighing on the housing market. As such, housing prices are expected to edge down gradually in the coming months. ▪ However, any housing market correction will likely be capped by the persistent imbalance between long-term supply and demand. On the demand side, the result of the latest applications for subsidized housing units will be announced in mid-Aug. Those who fail to get a subsidized flat will likely return to the private housing market. Meanwhile, some potential homebuyers may be willing to enter the market should property developers and homeowners offer more sweeteners. On the supply side, though government expects that some 93,000 private housing units will be available in the coming three to four years, housing completion and housing construction dropped by 6% yoy and 72.6% yoy respectively to 5700 units and 4000 units in 1H19. Besides, government estimates that there will be about 100,000 public housing units available in the coming five years, which is set to miss the annual supply target of 31,500 public housing units. In a nutshell, we expect housing prices (+9.5% YTD as of June) to grow 8% yoy as of end-2019. As slower growth of 0%-5% is likely should social unrest persist and trade war keep escalating.
▪ Macau's average housing price rose by 0.4% mom to the highest since last October at MOP 114,126/square meter in June. During the same month, the approved new mortgage loans surged by 56.5% mom to MOP6.04 billion, the highest since last September.	▪ This was mainly attributed to a wave of new home project launches in June which mainly targeted the first-home local buyers (representing 80.6% of total local home buyers in June). As the government allows this group of buyers to apply for mortgage with loan-to-value ratio up to 90%, banks' mortgage business also benefited. ▪ However, average housing price saw the first year-on-year negative growth since February of -2.6%. Housing transaction volume tumbled 20.7% mom or 18.2% yoy to 854 deals in June. Approved new mortgage loans also showed year-on-year negative growth (-18.4% yoy) for the fifth month in a row. This suggests that the housing market was weaker than the same period last year, probably due to the elevated local rates, the prolonged trade war fears and the softening economic outlook. ▪ Going forward, despite global monetary easing, housing market will likely slow down further due to cautious

	investment sentiments on global uncertainties, the diminishing effect of the supportive housing measures and the continuous drag from housing control measures (the percentage share of local buyers holding more than one property in total local buyers stayed low at 2.5% in June). On the positive front, any correction of housing market is likely to be modest given scarce supply. With new home projects being completed successively, only about 2600 units of private flats are expected be available in 2020. Worse still, housing start plunged by 87% yoy to 122 units during 1H19, signaling low medium-term supply. In conclusion, we expect housing transaction volume and average housing price to fall gradually from the current levels.

RMB	
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▪ The USDCNY broke 7 last week in form of both spot and fixing. Meanwhile, RMB index also broke down 92 handle last Friday.	▪ Forget about the psychological important level, RMB has entered into a new era. With the clean break of 7 for USDCNY fixing and 92 for RMB index, it shows that RMB is likely to move towards a more clean floating system. RMB is likely to be more volatile in the short term to absorb the external shock. However, that does not mean China will let RMB freely float. As all the counter cyclical measures are still in place, we think China will not hesitate to intervene should RMB deviate too much from its fundamental level. Our observation shows that China is still using the CCF to slowdown the pace of depreciation in its daily USDCNY fixing. ▪ In the near term, we think market may continue to test the boundary in this unchartered territory. We expect the USDCNY to drift higher to 7.2 should there is no improvement of the US-China trade talk.

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