Highlights

It is getting increasingly clear that the possible outcome from the G20 meeting is not about whether we are going to see a trade deal between US and China, it is about whether there will be a meeting between President Xi and President Trump.

As there is no further development from the trade talk, investors shifted their focus to China's domestic issues. The ripple effect from the Baoshang bank incident lasted much longer than initial expected. The structural issues rose significantly with smaller banks and non-bank financial institutions are unable to access to funding markets even though the interbank bank repo rate remained stable.

China's central bank stepped up its support last week to calm down the market via guaranteeing the issuance of CD by one of the smaller lenders through Credit Risk Mitigation Warrant as well as increasing the re-discount and SLF quota for smaller banks by aggregate CNY300 billion.

On economic data, the overall weak economic activities in May were the result of two changing factors including the rising uncertainty from the re-escalation of US-China trade war and the unexpected shift of monetary policy from easing to neutral from April.

The deceleration of infrastructure investment was a disappointment despite proactive fiscal policy. In order to support the growth, China unveiled a new guidance to support the issuance of local government special purpose bonds. Proceeds from the issuance of special purpose bonds will be allowed to use as seed capital for major projects. Meanwhile, local government funding vehicles are also allowed to renegotiate the financing terms with financial institutions to support the existing projects and contain the risk. We think it may help address the funding concerns of local government, which may boost the infrastructure investment in the second half of 2019.

On currencies, although market has prepared for the scenario that China may eventually let the USDCNY drift above 7, the recent tightly controlled RMB daily fixing showed that China has no intension to give up the line in the near term without new proper catalyst. RMB is likely to stay within the tight range ahead of G20 meeting.

For this week, market will watch out for the USTR hearing on the new tariff to tax remaining US$300 billion Chinese goods. The hearing will end on 25 June, just ahead of G20 meeting. Meanwhile, the global index provider FTSE Russel is expected to include China's A-shares into its global equity index effective from 21 June.

In **Hong Kong,** all eyes were on the highly volatile HKD and HIBOR last week. Against the backdrop of low aggregate balance, HKD liquidity tightened notably on a combination of half-year end, concentrated dividend payment, upcoming large IPOs and concerns about capital outflows on political risk. As a result, 1M HIBOR rose sharply to the highest since 2008 at 2.63%, surpassing its USD counterpart. Going ahead, with seasonal factors and IPO effect to linger for a while, we expect 1M and 3M HIBOR to remain elevated albeit with limited upside in the coming month. Given manageable outflow risks on global monetary easing and HK's sizeable FX reserve, HIBORs are set to come off after the short-term factors abate. On the housing market front, CCL index which tracks secondary housing prices dropped for the second consecutive week as of 9th June. This confirms that the renewed housing frenzy from early this year started to cool down due to negative wealth effect from stock market correction, increasing short-term supply and elevated mortgage rates. As we expect local rates to stay relatively high in the near term, should trade war risks heighten, it is likely for the housing market to slow down further. Nevertheless, any housing market correction is expected to be capped by the tight labor market, housing shortage in the long term and eased concerns about local rate hikes. In **Macau**, though April's housing data showed some growth, we expect the property market to cool down in the coming months. First, the subdued performance of the crucial gaming sector and the re-escalation of US-China trade war may cloud Macau's economic outlook while reducing wealth effect. Second, the control measures may continue to tame speculative demand. Third, the effect of those measures supporting local first-home buyers may abate gradually.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US Commerce Secretary Ross said on Sunday that "the most that will come out of the G20 might be an agreement to actively resume talks."	▪ The chance of a trade deal in the upcoming G20 meeting fell to almost zero. It seems that the market sentiment may depend on whether there will be meeting between President Trump and President Xi, which is not confirmed yet as of now.

▪ China unveiled a new guidance to support the issuance of local government special purpose bonds. In the QnA published by PBoC on 11 June, proceeds from the issuance of special purpose bonds will be allowed to use as seed capital for major projects. ▪ Meanwhile, local government funding vehicles are also allowed to renegotiate the financing terms with financial institutions to support the existing projects and contain the risk.	▪ China's equity market rallied strongly fuelled by hopes on re-acceleration of fixed asset investment. In the first five months of 2019, China has issued about CNY859.8 billion special purpose bonds, accounting for about 40% of this year's quota. Under the new guidance, part of the CNY1.3 trillion special purpose bond quota can be used as capital for some major projects, which may provide leverage to boost China's fixed asset investment to counter the impact of trade war.
▪ China's central bank stepped up its efforts to support the issuance of certificate of deposits by Bank of Jinzhou via guaranteeing the CD though Credit Risk Mitigation Warrant (CRMW). This means China Bond Insurance, the credit insurance provider backed by PBoC, will pay should the bank fail to redeem its CDs.	▪ The shares of Hong Kong listed Bank of Jinzhou has been suspended since 1 April after the bank delayed publication of 2018 annual report. Since 28 May, the bank has failed to issue the CD after the takeover of Baoshang bank. Meanwhile, the situation was also exaggerated by the resignation of auditor Ernst & Young, which voiced its concerns about the usage of loans deviating from the original purpose. ▪ The guarantee from the PBoC shows China has become more flexible to contain the spill over risk from the Baoshang bank incident.
▪ China's central bank announced more liquidity support to medium and small banks on 14 June. Rediscount quota and standing lending facility (SLF) quota will be increased by CNY200 billion and CNY100 billion respectively. The small banks can use qualified bonds, CDs and bills as collateral to tap the liquidity facility.	▪ The spill over effect from the Baoshang incident was beyond the expectation. Although China's interbank repo rate remained stable and liquidity remained abundant, the market itself is facing rising structural issues with smaller banks and non-bank financial institutions were locked out of the funding market. ▪ The move is an important step to address the structural issues and restored the market confidence.
▪ The global index provider FTSE Russel is expected to include China's A-shares into its global equity index effective from 21 June. The inclusion, which will take place in three steps till March 2020, will increase A-share's weight in FTSE Emerging index to 5.5%.	▪ The inclusion is expected to attract about US$10 billion inflows to China's equity market in the next three quarters.
▪ Last week, it is reported that Alibaba, China's tech giant, just submitted the application for IPO to the Hong Kong Exchange. In the meantime, all eyes were on the highly volatile HKD and HIBOR.	▪ Against the backdrop of low aggregate balance (shrank 29% YTD to HK$54.3bn), HKD liquidity tightened notably on a combination of half-year end, concentrated dividend payment, upcoming large IPOs and concerns about capital outflows on political risk. As a result, 1M HIBOR rose sharply to the highest since 2008 at 2.63%, surpassing its USD counterpart. ▪ Going ahead, with seasonal factors and IPO effect to linger for a while, we expect 1M and 3M HIBOR (currently 2.42% and 2.4% respectively) to remain elevated albeit with limited upside. Lately, due to the elevated HIBORs, some commercial banks lifted the HIBOR-based mortgage rates due to the persistently compressed mortgage net interest margin. Some commercial banks also raised fixed deposit rates to scramble for funds, indicating high funding pressure. As such, the banking system is not imminent to cut prime rate despite the Fed's rate decision. ▪ Neither will the banking system raise prime rate. Given manageable outflow risks on global monetary easing and HK's sizeable FX reserve, HIBORs are set to come off after the short-term factors abate.

▪ HK: CCL index which tracks secondary housing prices dropped for the second consecutive week by 1.43% from last week as of 9th June.	▪ As a result, the YTD growth of secondary housing prices moderated from 8.6% to 6.8%. This confirms that the renewed housing frenzy from early this year started to cool down due to negative wealth effect from stock market correction, increasing short-term supply and elevated mortgage rates. As we expect local rates to stay relatively high in the coming one to two months, should trade war risks and political risk continue to heighten, it is likely for the housing market to slow down further. Nevertheless, any housing market correction is expected to be capped by the tight labor market, housing shortage in the long term and eased concerns about local rate hikes on global monetary easing.

Key Economic News

Facts	**OCBC Opinions**
▪ China's May export rose by 1.1% yoy. However, import fell by 8.5% yoy. As a result of weak import, trade surplus widened to US$41.6 billion.	▪ The frontloading activity in May was limited as compared to last year in our view due to short notice for the new round of additional tariff to take effect. As such, China's exports to the US still fell by 4.2% yoy, albeit improving from the decline of 13.1% yoy in April. Nevertheless, demand from EU and ASEAN remains supportive with exports to EU and ASEAN rose by 6.1% yoy and 3.5% yoy respectively. In addition, exports to Japan also recovered marginally up by 0.5% after falling by 16.3% yoy in April. ▪ The weak import was mainly the result of the re-escalation of US-China trade war. Imports of electronic integrated circuit fell by 10.8% yoy in May although China's imports of crude oil remains steady up by 5.5% yoy. The re-escalation of US-China trade war may also dampen the market sentiment, which may weaken China's domestic demand. The prospect of imports may depend on the progress of US-China trade talk.
▪ China's May CPI grew by 2.7% yoy, in line with expectation. However, on month-on-month basis, CPI remained flat in May. ▪ PPI rose by 0.6% yoy, in line with expectation as well.	▪ The acceleration of CPI on year-on-year reading was mainly driven by higher food prices due to base effect. Pork prices and vegetable prices have lifted May CPI by 0.38% yoy and 0.31% yoy respectively although pork prices fell by 0.3% on month-on-month basis. ▪ Non-food prices, however, softened in May remaining flat on month-on-month, weaker than the seasonal pattern. ▪ Looking ahead, given the low base effect will peak in June; we expect China's CPI may remain high at around 2.7% for June. However, June's reading could be the highest point in 2019 and CPI is expected to decelerate in the coming months. ▪ Overall, we think despite the rise of inflation, inflationary pressure is not the concern to policy makers given it is mainly driven by food prices.
▪ Aggregate social financing increased by CNY1.4 trillion while new Yuan loan increased by CNY1.18 trillion. ▪ M2 growth remained intact at 8.5% yoy.	▪ Medium to long term loan demand remained stable in May, increasing by CNY720.1 billion, up from CNY698.8 billion in April. ▪ Off balance sheet lending continued to shrink with entrusted loan, trust loan and bill financing fell by CNY63.1billion, CNY5.2 billion and CNY77 billion respectively. ▪ Net corporate issuance only increased by CNY47.6 billion in May, down from CNY384.7 billion probably due to rising uncertainty amid US-China trade war.
▪ China's May industrial production decelerated further to 5% yoy from 5.4% yoy in April.	▪ The overall weak economic activities in May were the result of two changing factors including the rising uncertainty from the

▪ Retail sales, however, reaccelerated to 8.6% yoy from 7.2% in April, beating market expectation. ▪ Fixed asset investment in the first five month slowed further to 5.6% from 6.1%.	re-escalation of US-China trade war and the unexpected shift of monetary policy from easing to neutral from April. ▪ Nevertheless, the weaker than expected industrial production and stronger than expected retail sales showed that the May data could be distorted by holiday effect as there is less working days in 2019 as compared to 2018 due to the restart of mini May golden week. ▪ The deceleration of infrastructure investment to 4% in the first five months from 4.4% in the first four months was a disappointment despite more proactive fiscal policy. This was mainly due to the funding constraints for the local government. Nevertheless, given China relaxed the use of local government special bonds last week, we think it may help address the funding concerns, which may boost the infrastructure investment in the second half of 2019. ▪ Property investment remained resilient albeit slowing down to 11.2% from 11.9%. We still hold the same view that property is unlikely to be the weakest link for Chinese economy this year.
▪ Macau's housing transaction volume increased by 38.8% mom to the highest since Aug 2018 at 794 deals while average housing price rose for the second consecutive month by 4.9% yoy to MOP107,430/square meter in Apr.	▪ The resilient performance of the property market was mainly attributed to eased concerns about local rate hikes, attractive new home projects, limited housing supply (housing completion and start decreased by 91% yoy and 83% yoy during the first four months of 2019), wealth effect from stock market rally and measures supporting local first-home buyers (representing 84.6% of local home buyers in Apr). ▪ Nevertheless, we also note that housing transaction volume dropped for the eighth consecutive month by 18.4% yoy while average housing prices were lower than the average of MOP108,723/square meter in 2018. Besides, approved new mortgage loans shrank by 24.9% mom and 36.3% yoy to MOP2.54billion. This suggests that this round of property market growth was not very strong, probably due to housing control measures and cautious investor sentiment. Going forward, the subdued performance of the crucial gaming sector and the re-escalation of US-China trade war may cloud Macau's economic outlook while reducing wealth effect. Besides, the control measures may continue to tame speculative demand (the percentage share of local buyers holding more than one property in total local buyers slid to a record low of 2.2% in Apr). Furthermore, the effect of measures supporting local first-home buyers may abate gradually. In conclusion, we believe that the housing market may lose some momentum in the coming months.

RMB	
Facts	**OCBC Opinions**
▪ RMB stabilized around 6.93 last week. ▪ RMB index returned to above 93 as a result of dollar rebound in the latter part of the week.	▪ Although market has prepared for the scenario that China may eventually let the USDCNY drift above 7, the recent tightly controlled RMB daily fixing showed that China has no intension to give up the line in the near term. Market scaled back their bet for the higher USDCNY. It seems that RMB is likely to stay within the tight range ahead of G20 meeting.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W