Highlights

In the finale episode of Game of Thrones, Tyrion told imprisoned Jon Snow that "they understand our new king needs to make peace, no one is very happy, which means it is a good compromise, I suppose." This line probably applies to trade talk as well. If President Trump wants to take all the happiness, then the trade talk probably goes nowhere in particular after China draws its three red lines clearly.

The initial positive sentiment from the unofficial window after China announced the retaliation package will only take effect from June was shadowed by President Trump's target at Huawei sparking the volatility in the global financial market. It looks costly for the US to target an unlisted company at the expense of its domestic listed suppliers' share prices stability. Whether Trump's attack on Huawei is a miscalculation remains to be seen. However, one thing clear is that the move has sparked the nationalism sentiment in China, which is not helpful for the trade talk.

In a lose-lose stall, RMB has been the victim, depreciating against the dollar by more than 2.5% month-to-date. China's deputy central bank governor said over the weekend that China has enough tools in its toolbox and will use counter cyclical measures if necessary, to deal with the currency volatility. This may help slow down the pace of depreciation. However, the risk for the USDCNY to break an important psychological level of 7 is increasing should hope of trade deal in the near term fade away.

China's April growth data disappointed last week. The deceleration of major growth data in April signals two things. First, March's recovery may not be sustainable. Second, March's data was also distorted by inventory buildup ahead of April's VAT cut. However, PBoC said in its 1Q monetary policy report that China's output gap is close to zero. Despite the re-escalation of US China trade war, the tone from the 1Q monetary policy report signalled that the central bank remains patience to maintain the balance between the structural de-leverage and safeguard the financial stability. This may help cool down market speculation that PBoC may step up its monetary easing to counter the possible impact of trade war on economy.

In **Hong Kong,** USDHKD moved to the highest since early April at 7.8499 amid stock market correction, weaker RMB, and the return of carry trade on flushed front-end HKD liquidity. Nevertheless, we believe that USDHKD will not easily touch 7.85 or trigger any HKMA withdrawal in the near term. Even if there is any intervention, the intervention is expected to stay moderate and could probably cause panic funding squeezing once again which may soon sideline carry trade. There are three reasons behind our view. First, market remains cautious about the potential liquidity squeezing events including dividend payment in Jun-Jul, the half-year end and any further HKMA withdrawal. As such, we do not see much room for HIBORs to edge lower. In comparison, USD LIBOR edged lower in tandem with the drop in US Treasury Yield. As the LIBOR/HIBOR spread looks unlikely to widen much further in the near term, carry trade may not be very aggressive. Second, as the volatility of HIBOR and HKD rose following the gradual reduction in aggregate balance, carry trade has been increasingly cautious. Third, against the backdrop of dovish central banks, China's economic stabilization and the on-going trade talks, we believe that HK's equity outflow risks will remain contained at this juncture. Elsewhere, 1Q GDP growth was revised up from the initial reading of 0.5% yoy to 0.6% yoy. Moving ahead, the recent escalation of US-China trade war may continue to drag on HK's exports of goods while keeping the household spending and corporate investment cautious. However, the ongoing US-China trade talk and any further monetary and fiscal stimulus in China may help to ease some downside risks on HK's economy. Adding on the gradually abating high base effect, we expect GDP growth for 2019 will reach 2.1%-2.2%.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ On 13 May, China announced the US$60 billion retaliation package while the USTR also started to collect the public opinion and feedback on the plan to impose tariff on the remaining US$325 billion Chinese products. ▪ President Trump said it plans to meet President Xi in the upcoming G20 meeting in Japan at the end of June though there is no official confirmation from China side. ▪ On 15 May, Trump signed an executive order declaring a national emergency banning the US companies from using any telecommunication equipment that the Commerce department declares to be a security risk. At the same day, the	▪ The initial positive sentiment from the unofficial windows for negotiation (as China's retaliation package will only be effective from 1 June and US will not start to impose new tariff until end of June) was shadowed by the Trump Administration's target at Huawei. ▪ President Trump may want to use Huawei as a leverage in his trade talk and buy more time for the US companies to lead the 5G race via capping Huawei's capacity in the 5G race. The move has sparked the volatility in the global market in particular in the semiconductor sectors. However, it looks costly for the US to target an unlisted company at the expense of its domestic listed share prices stability. ▪ Whether Trump's attack on Huawei is a miscalculation remains to be seen. However, one thing clear is that the move

Commerce department also placed Huawei and its nearly 70 affiliates on an "entity list", which bans the US company supplied to Huawei without the license from the government.	has sparked the nationalism sentiment in China. Instead of being quiet in the past, China's main national media have turned more hawkish criticising Trump's trade policy on the daily basis. In addition, since 16 May, China has replayed a few old time Korean war movies, which was used to spark anti-American sentiment. ▪ The rise of nationalism is not helpful for the trade talk in our view, which may prolong the entire conflict. The recent clues from the official talk shows that China has been much firmer to defend its three bottom lines including the immediate removal of additional tariff, renegotiation of purchase amount and equitable deal. As such, without the compromise from Trump Administration, it seems that the trade talk may stall.
▪ In its 1Q monetary policy report, PBoC said China's output gap is close to zero and the growth rate is close to its potential growth rate. ▪ On monetary policy, PBoC reiterated that China will not open the floodgate to flush the economy. Meanwhile, structural de-leverage remains the key target for PBoC. ▪ Nevertheless, PBoC also said it will fine-tune the monetary policy depending on the change of growth and price changes. ▪ On financial reform, PBoC said that China will continue to open its financial market to deepen its integration with global markets.	▪ Despite the re-escalation of US China trade war, the tone from the 1Q monetary policy report released on 17 May signalled that the central bank remains patience to maintain the balance between the structural de-leverage and safeguard the financial stability. This may help cool down market speculation that PBoC may step up its monetary easing to counter the possible impact of trade war on economy. ▪ The sharp decline of overnight repo rate to as low as 1.1% in early May is unlikely to be sustainable as China is unlikely to switch to excessive easing monetary policy tone any time soon though the central bank keeps its option of flexibility.
▪ China's deputy central bank governor Pan Gongsheng said over the weekend that China will continue to open its domestic financial market. Meanwhile, he also said China has enough tools in its toolbox and will use counter cyclical measures if necessary, to deal with the currency volatility.	▪ Pan's comments came at the right time to serve as a reminder to keep RMB speculator in check. It may slow down the recent pace of depreciation. The prospect of RMB may depend on the progress of trade talk.
▪ USDHKD moved to the highest since early April at 7.8499 amid stock market correction, weaker RMB, and the return of carry trade on flushed front-end HKD liquidity.	▪ Nevertheless, we believe that USDHKD will not easily touch 7.85 or trigger any HKMA withdrawal in the near term. Even if there is any intervention, the intervention is expected to stay moderate and could probably cause panic funding squeezing once again which may soon sideline carry trade. ▪ There are three reasons behind our view. First, market remains cautious about the potential liquidity squeezing events including dividend payment in Jun-Jul, the half-year end and any further HKMA withdrawal. As such, we do not see much room for HIBORs to edge lower. 1M and 3M HIBORs are expected to stay above 1.5% and 1.8% respectively. In comparison, USD LIBOR edged lower in tandem with the drop in US Treasury Yield. As the LIBOR/HIBOR spread looks unlikely to widen much further in the near term, carry trade may not be very aggressive. Second, as the volatility of HIBOR and HKD rose following the gradual reduction in aggregate balance, carry trade has been increasingly cautious. Third, against the backdrop of dovish central banks, China's economic stabilization and the on-going trade talks, we believe that HK's equity outflow risks will remain contained at this juncture.
▪ Hong Kong's stock market attracted net inflows of HK$10.05 billion whereas China's stock market saw net outflows of RMB19 billion last week under stock connects.	▪ Northbound equity flows marked net outflows for the second consecutive month while southbound equity flows saw net inflows for the third straight month so far in May. This suggests that though MSCI raised the weight of A-shares, foreign investors were still sidelined from onshore stock

	market due to China's weak April data and US-China trade war escalation. Meanwhile, with heightened trade war risks and weaker RMB, onshore investors increasingly stepped into offshore stock market to meet their safe-haven demand. On the other hand, the net inflows from China to HK under stock connects will likely help to ease the equity outflow risks of HK. This reinforces our view that the upside risks for HKD rates are limited in the near term.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's main growth data disappointed in April. ▪ Industrial production growth slowed down to 5.4% yoy after growing by 8.5% in March. ▪ Retail sales growth decelerated to 7.2% yoy in April from 8.7% yoy. ▪ Fixed asset investment growth in the first four months also slowed down to 6.1%.	▪ The deceleration of major growth data in April signals two things. First, March's recovery may not be sustainable. Second, March's data was also distorted by inventory buildup ahead of April's VAT cut. ▪ One of the observations we made last month is that March's supply data was not matched by the demand side data. As such, the deceleration of industrial production was in line with expectation though the pace of slowdown was above expectation. ▪ The deceleration of retail sales was partially due to the weak car sales data, which fell by 16.8% yoy in April. However, China's National Bureau of Statistics also argued that the weak sales data was distorted by the holiday as number of holiday was 2 days lesser as compared to last April. Meanwhile, NBS also said the retail sales will grow 8.7% after adjusting for the holiday effect. ▪ On investment, despite still solid property investment data, infrastructure investment continued to disappoint, which only grew by 4.4% in the first four months. With more issuance of local government special bond, we think infrastructure investment may reaccelerate.
▪ HK's 1Q GDP growth was revised up from the initial reading of 0.5% yoy to 0.6% yoy.	▪ The further slowdown in GDP growth was attributed to high base effect, global economic slowdown and lingering trade war risks. Moving ahead, the recent escalation of US-China trade war may continue to drag on HK's exports of goods while keeping the household spending and corporate investment cautious. The disappointing April data out of China also indicates that China's economic rebound lacks strong momentum and may not have much spill-over effect to buoy HK's growth. As such, HK's growth for the coming quarters may not be able to surpass the average quarterly growth of 3% yoy during 2Q 2009 to 1Q 2019. However, the ongoing US-China trade talk (Trump and Xi will likely meet in G20 summit in late June) and any further monetary and fiscal stimulus in China may help to ease some downside risks on HK's economy. With the high base effect to abate, GDP growth may also be allowed to rebound moderately in the coming quarters. In conclusion, we expect GDP growth for 2019 will reach 2.1%-2.2% while the government also keeps their forecast for 2019 GDP growth unchanged at 2%-3%.
▪ Hong Kong: as housing market rebounded strongly, the total value of buyer's stamp duty (BSD), double stamp duty (DSD) and seller's stamp duty (SSD) increased by 85% month-on-month to the highest since last June at HK$2.929 billion. Also, the volume	▪ Specifically, the total value of BSD and DSD surged by 90.2% and 87.6% respectively from the previous month. The total transaction involving these two types of stamp duty also jumped by 36.2% and 12% month-on-month to 168 deals and 2,461 deals respectively. This suggests that investment

of housing transactions which involved these three types of stamp duty rose for the second consecutive month by 33.2% month-on-month to 2,672 deals.	sentiments of local buyers and Mainland buyers both improved on eased concerns about rate hikes, China's economic stabilization and wealth effect from stock market rally. However, housing market's upside may be capped by the renewed US-China trade tensions, increasing short-term supply, limited downside of mortgage rates and the risk of government announcing new housing control measures. As such, we believe that housing price will only see single digit growth this year. In other words, government's revenue from stamp duty may only rebound slightly during the fiscal year 2019/20.

RMB	
Facts	**OCBC Opinions**
▪ RMB weakened further against both dollar and its major trading partners last week. RMB index softened to 93.63 on Monday.	▪ RMB depreciation accelerated following Trump's attack on Huawei. The rise of nationalism may potentially stall the talk creating more uncertainty for the development. The risk for the USDCNY to eventually break 7 cannot be ruled out should the prospect of a trade deal worsen.

OCBC Greater China research

Tommy Xie
Xied@ocbc.com

Carie Li
Carierli@ocbcwh.com

Co.Reg.no.:193200032W