Highlights

The US-China trade talk continued to progress after China's deputy negotiator went to Washington last Thursday for negotiation ahead of the October meeting. Global risk sentiment remains sensitive to the headline of US-China trade talk. The US equity market fell on Friday in reaction to the news about the unexpected cancellation of the Chinese delegation's visit to US farms.

Although China has denied that the cancellation was the result of negotiation, Trump's flipflop on an interim deal may keep risk sentiment in check this week after he moved away from the consideration of an interim deal to looking for a complete deal.

The concerns about the weak economic data and China's reluctance to roll out aggressive monetary easing overtook the positive trade news last week in China, which led to the selloff in Chinese equity, bond and currencies. China rolled over the MLF last week but leaving its interest rate intact. Although the liquidity injection via both RRR cut MLF rollover shows China's flexibility to support growth, it failed to comfort market which looked for a rate cut.

On the positive note, the September 1-year LPR fixing fell by another 5bps thanks to narrowing credit premium after the liquidity injection. However, the 5-year LPR was kept unchanged, signalling China will not loosen its property tightening any time soon.

In **Hong Kong,** Moody's followed Fitch's step to downgrade the city's rating outlook from stable to negative while affirming its Aa2 rating. Now, it looks possible for S&P to downgrade HK's rating outlook as well. However, Moody's and S&P, which already cut HK's rating by one notch in 2017, may not downgrade the rating again so soon unless there is any structural change to HK's status as a stable and safe business hub with separate customs territory and independent regulatory system. BIS' latest report shows that the daily average foreign exchange turnover in HK increased by 45% to US$632 billion in April 2019 from the same period in 2016, which makes HK the second biggest foreign exchange currency hub in Asia. Clearly, HK's role as an international financial hub has been enhanced over the past few years and may not be easily undermined by the recent headwinds. The still sizeable foreign currency reserves, a relatively stable HKD coupled with the rebound in Hang Seng Index from August's lows also suggest that the financial market has felt a milder pain from the political turmoil. Therefore, though trade war and social unrest could risk a technical recession in HK in 3Q, we believe that this will not translate into a shock to HK's long-term outlook. Elsewhere, as the impact of the recent headwinds varies from industry to industry and even the most affected sectors prefer to let employees have unpaid leaves given cost concerns, the overall unemployment rate (remaining unchanged at 2.9% in Aug) may only go up gradually. Having said that, concerns about retrenchment may still grow and in turn further hit local consumer sentiments and housing demand. Finally, HKMA cut base rate by 25bps whereas commercial banks stayed put amid high funding costs and the margin compression on mortgages.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The risk sentiment in China deteriorated last week again with Chinese equity, bond and currencies ended the week lower despite the positive headlines from the trade talk.	▪ The trade news took the back seat after a good risk rally last week. ▪ What's new last week was the weak economic data. Usually, the impact of China's data on market is quite short-lived as China has a good track record to achieve their growth target at whatever cost and in whatever way. However, it is not the case this round. I think there are four reasons why market has been worried about this weak data. ▪ First, it showed the negative impact of trade war is more visible judging by the manufacturing output and investment. What's more worrying is the divergence between the global growth and Chinese growth. Recently, we start to see kind of stabilization of global growth while China's slowdown started to accelerate. ▪ Second, there is divergence between the high frequency data and monthly data. Looking at high frequency electricity consumption data and coal consumption data as well as PMI earlier, it showed that IP should have been better. ▪ Third, the outlook remains murky. Given some of the productions have been suspended in September ahead of

	national Day celebration. It looks like the September data will remain ugly due to base effect. ▪ Fourth, PBoC's reluctance to cut MLF rate also weighed down the market sentiment. ▪ Outlook of the economy? Things may turn worse before getting better in 4Q. There are two favorable factors supporting the 4Q growth in my view. First, the base effect. To recall, the base is relatively low in 4Q last year due to the escalation of trade war. This may support the growth this year mathematically. Second, China has officially confirmed that some of the local government special bond quota will be used this year. This may help boost the infrastructure investment further if not property investment.
▪ The PBoC injected CNY200 billion liquidity via 1-year MLF last week.	▪ The CNY200bn liquidity injection is higher than my expectation. The additional liquidity injection one day after RRR took effect was probably the reaction to China's weak economic data. It shows that China remains flexible to support the growth. ▪ China will try to refrain from cutting RRR and MLF rate together to follow its prudent monetary policy narrative. However, liquidity injection via both RRR and MLF at the same time shows China's intention to boost confidence and stabilize the growth.
▪ The 1-year September LPR was lowered by 5bps to 4.2% while 5-year LPR was kept unchanged at 4.85%.	▪ The mixed LPR fixing result shows China's current monetary easing will still be conducted within the prudent monetary policy framework though it has returned to the conventional way. The intact of 5-year LPR showed that China will not loosen its tightening on property market to stimulate the economy despite the economic slowdown.
▪ The US-China trade talk continued to progress after China's deputy negotiator went to Washington last Thursday for negotiation ahead of the October meeting. ▪ The USTR said in its statement on Friday that the talk is productive and the department is looking forward to principal level meeting in October. China's Commerce Ministry also said the talk is constructive. ▪ The US unveiled a new list of tariff exemption on more than 400 Chinese products at the requests from US companies. ▪ However, the cancellations of previously planned visit to farms in Montana and Nebraska as a good gesture caught the market attention. The spokesperson from China's agriculture Ministry said on Sunday that the change of schedule has nothing to do with the negotiation.	▪ Global risk sentiment remains sensitive to the headline of US-China trade talk. The US equity market fell on Friday in reaction to the news about the unexpected cancellation of the Chinese delegation's visit to US farms. ▪ Although China has denied that the cancellation was the result of negotiation, market is expected to remain jittery with the focus shifts to whether there is any interim deal. ▪ President Trump's flipflop on the consideration of an interim deal may keep market sentiment in check this week. President Trump said last Friday that he wants a complete deal moving away from his consideration about an interim deal one week after. Meanwhile, he also said he does not need a trade deal before the 2020 election as he thought people understood the government is doing a great job.
▪ Moody's changed the outlook on Hong Kong's Aa2 rating to negative from stable while keeping the rating unchanged.	▪ The change is mainly attributed to the rising risk that the ongoing protests reveal an erosion in the strength of HK's institutions and undermine HK's credit fundamentals by damaging its attractiveness as a trade and financial hub. Besides, the government and policy effectiveness are lower than that previously assessed by Moody's. In the meantime, Moody's affirmed Hong Kong's Aa2 rating based on the city's minimal government debt burden, large fiscal reserves and ample foreign exchange reserves, all of which offer resilience to shocks and negative long-term trends.

	▪ Following Fitch and Moody's, it is also possible for S&P to downgrade HK's rating outlook from stable to negative. However, for both Moody's and S&P which already cut HK's rating by one notch due to closer integration between China and HK in 2017, they may not downgrade the rating again so soon unless there is any structural change to HK's status as a stable and safe business hub with separate customs territory and independent regulatory system. So far, the impact of social unrest has been restricted to the retail, property and tourism sectors. In comparison, the financial sector has felt a milder pain with no massive outflow in sight. HK government's sizeable fiscal reserves and foreign currency reserves also point to strong fundamentals. As the market did not react much to Fitch's recent downgrade, we believe that the same will be true to Moody's change in outlook which may only have limited impact on HK companies' funding costs.
▪ HKMA followed the Fed's step to cut the base rate by 25bps to 2.25% whereas commercial banks stayed put once again.	▪ This is mainly due to the high funding costs burdened by commercial banks and the margin compression on mortgages. Specifically, despite sluggish loan demand, slow growth of deposits led to elevated HKD loan-to-deposit ratio (88.9% in July, just a tad below June's 89.3% which is the highest since January 2003). Besides, due to low HKD CASA deposit ratio (56.5% in July as compared to over 60% in the previous years), high interbank rates (amid low aggregate balance and uneven distribution of HKD liquidity across the banking system) and upcoming virtual bank launches, commercial banks have been competing for fixed deposits at high interest rates. Furthermore, with over 80% of mortgage loans referring to one-month HIBOR, the mortgage rate has long been capped by the prime cap amid high HIBOR. As such, some commercial banks have cut the cash rebate for mortgage loans and lifted the prime cap. Taken all together, we hold onto our view that HK's commercial banks will continue to hold prime rate unchanged despite the Fed's future rate decisions. ▪ Elsewhere, the response for Budweiser's IPO has been subdued. Therefore, neither HKD rates nor HKD went up further. Still, as we approach quarter-end and the money locked up by the IPO will not return to the market until late September, we expect front-end liquidity to tighten and USDHKD to hover well below 7.84 in the coming sessions. We hold onto our view that 1M HIBOR and 3M HIBOR will test 2.1% and 2.3% respectively by end of this month.
▪ The daily average foreign exchange turnover in Hong Kong increased by 45% to US$632 billion in April 2019 from the same period in 2016, according to the Bank for International Settlements (BIS). This makes Hong Kong the second biggest foreign exchange currency hub in Asia, just behind Singapore.	▪ According to BIS, the Hong Kong Dollar was the world's ninth most traded currency in April 2019, accounting for 3.5% (up from 1.7% during the same period in 2016) of global daily average transactions in all currencies. ▪ The increasing prominence of HKD as a popular traded currency could be attributed to the active carry trade activities on the back of wide USD-HKD yield differential. On the other hand, the fast growth of HK as a foreign exchange currency hub is mainly due to the closer integration of China and Hong Kong which has enhanced HK's role as the major overseas funding and risk hedging hub for Mainland companies, the major channel for cross-border investments between HK and Mainland China and the major offshore RMB hub. According to the HKMA, the

	average daily trading of forex and OTC interest rate derivatives for CNH in Hong Kong increased 44.4% so far this year to US$120 billion. ▪ Besides, as of 20th Sep, Hang Seng Index has rebounded by 6.2% from Aug's lows while AB InBev's Asian unit came back to launch IPO in Hong Kong with an IPO size as large as US$5 billion. Alibaba is also said to delay its IPO to as early as this Oct. This reinforces our view that HK's status as an international financial hub will not be easily shocked by the latest social unrest.

Key Economic News	
Facts	**OCBC Opinions**
▪ The Chinese economy continued to decelerate in August. ▪ Industrial production growth slowed down to 4.4% yoy, lowest since Feb 2002. ▪ Fixed asset investment growth also decelerated to 5.5% for the first eight months from 5.7% in the first seven months. ▪ Retail sales growth also decelerated to 7.5% yoy, lowest since Sep 1999.	▪ The latest reading reinforced the view that the Chinese economy has felt more pain from the US-China trade war. Output in manufacturing sector decelerated to 4.3% while investment in manufacturing sector shrank in August. ▪ Ironically, property sector remained the key supporting factors to the economy with the fixed asset investment in property sector rose by 10.5% yoy in the first eight months albeit slowing down slightly from 10.6% yoy. Nevertheless, given China has mentioned quite clearly that it will not use property as short term stimulus tools, we expect the contribution from the property to fall gradually. ▪ The outlook of China's growth prospect will probably hinge on the growth of infrastructure investment. On the positive note, infrastructure investment rebounded slightly in August with total fixed asset investment in infrastructure sector reaccelerated to 4.2% yoy from 3.8% yoy. ▪ As mentioned by the spokesman from the National Bureau Statistics yesterday, China may bring forward the issuance of local government special bond quota next year to this year, this will help alleviate the funding constraint to China's infrastructure investment.
▪ Hong Kong airport handled 6 million passengers in August, a decline of 12.4% year-on-year. This is the largest decrease since June 2009. Besides, the cargo traffic handled by Hong Kong's airport shrank by 11.5% yoy to 382,000 tons in August, the largest monthly drop since February.	▪ The sharp decline reflects the impact of the protests which led to unprecedented flight cancellation in early August. It is also attributed to the ongoing political uncertainty and prolonged trade war with the former hit hard on inbound tourism and the latter continued to drag on Hong Kong's trading and logistics services. As the value-added of inbound tourism and that of freight transport and storage services took up 3.6% and 2.9% of GDP respectively in 2017, the further slowdown in these two industries will inevitably result in further weakness in Hong Kong's economy in 3Q.
▪ HK's jobless rate stabilized at 2.9% in the three months through August rather than ticking up further, despite the ongoing social unrest.	▪ The unemployment rate of the financial sector remained unchanged at 2.3% while that of the trade sector decreased further to 2.4%. This suggests that these sectors and their labour market have felt a milder pain from the local political uncertainty. However, with trade war re-escalation in August and the persistent weakness in the trade sector, we expect the trade sector's unemployment rate to go up in the coming months. The latest property market correction may also add some downward pressure to the labour market of the financial

	sector. More notably, as the retail and tourism-related sectors have taken a hard hit from local political turmoil, a weaker RMB and trade war fears, the unemployment rate of retail, accommodation and food services sector increased to 4.6% (the highest since mid-2017) and could edge higher in the coming months. ▪ In conclusion, as the impact of the recent headwinds on different industries has varied from one to another and even the most affected sectors have preferred to let their staff have unpaid leaves given cost concerns, the overall unemployment rate may not spike. In other words, even though there could be notable increase in the unemployment rate of some industries like retail sector, the overall unemployment rate may only increase gradually towards 3%. Having said that, concerns about retrenchment may still grow and in turn further hit local consumer sentiments and housing demand.
RMB	
Facts	**OCBC Opinions**
▪ RMB weakened with the USDCNH returned to above 7.10 level.	▪ The rising concerns about China's growth put the brake on RMB's rebound early last week. RMB ended the week lower due to concerns about the trade talk prospect after China cancelled the visit to US farms. Market will remain sensitive to trade news this week ahead of the planned early Oct meeting.

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