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Greater China – Week in Review

Highlights: another milestone in RMB Internationalization

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The past week was marked by a notable divergence between A-shares and Hong Kong-listed Chinese equities. Mainland markets continued to advance, with the SSE Composite rising 1.5% and the Shenzhen Component surging 7.1%, while Hong Kong equities retreated sharply, with the Hang Seng Index falling 3.2% and the HSCEI declining 4.8%.

In our view, this A/H divergence primarily reflects differences in investor composition, earnings expectations, liquidity conditions, and policy sensitivity across the two markets. A-shares have remained relatively resilient, supported by abundant domestic liquidity, improving earnings momentum in hard-technology sectors, and ongoing policy support.

By contrast, Hong Kong equities remain more exposed to external factors. Expectations of tighter global liquidity conditions, a slower-than-expected earnings recovery among internet platform companies, and a moderation in global risk appetite have weighed on market sentiment. This divergence in market positioning has become the key driver of the recent A/H performance gap.

China Foreign Exchange Trade System (CFETS) announced that six major Chinese banks—ICBC, ABC, BOC, CCB, BoCom and CITIC Bank—completed 125 offshore RMB foreign exchange transactions on 17 June, with a total turnover of RMB7.24 billion. The transactions covered both spot trading between CNH and major currencies such as the US dollar and euro, as well as derivatives including forwards and swaps.

The direct participation of Chinese banks' head offices in CNH carries two important near-term implications. First, it should improve cross-market arbitrage efficiency, structurally narrow the CNH-CNY spread, and strengthen the PBOC's influence over RMB exchange-rate dynamics. Second, it helps address a key infrastructure gap in the RMB's evolution as a reserve currency and could accelerate the next phase of RMB internationalization.

In addition, China's central bank plans to establish an overseas central bank repo facility, allowing foreign central banks and monetary authorities that hold Chinese government bonds (CGBs) to obtain RMB liquidity by temporarily pledging those bonds through repo transactions with the PBoC or its designated institutions.

The significance of this initiative extends well beyond liquidity management. By providing a standing liquidity backstop for overseas official holders, the facility enhances the liquidity profile and usability of CGBs, bringing them a step closer to the role played by U.S. Treasuries in the global financial system. Reserve managers are generally more willing to hold assets that can be readily mobilized during periods of market stress, and the repo facility directly addresses this requirement.

The objective is no longer just encouraging foreign central banks to hold RMB assets, but enabling those assets to be actively used within the global liquidity and collateral framework. Over the longer term, this could strengthen the attractiveness of RMB reserve holdings, increase foreign demand for CGBs, and reinforce the development of a more RMB-centric international monetary system. While the dollar's dominance remains firmly entrenched, the facility is an important step toward improving the infrastructure underpinning the RMB's global role.

The recently announced overseas central bank repo facility, together with direct participation by Chinese banks' head offices in offshore RMB markets, represents a coordinated effort to expand the pool of tradable, hedgeable, and financeable RMB assets. If the bilateral RMB swap network constituted the first phase of RMB internationalization, these initiatives could mark the beginning of the next phase—transforming Chinese government bonds from a reserve asset into internationally accepted reserve collateral.

On domestic monetary policy, PBOC Governor Pan Gongsheng announced at the Lujiazui Forum last week that the PBOC would narrow its interest-rate corridor from 70bp to 50bp and shift from an asymmetric to a symmetric framework. Specifically, the upper bound was lowered from the 7-day reverse repo rate plus 50bp to plus 25bp, while the lower bound was adjusted from minus 20bp to minus 25bp.

The narrower corridor effectively compresses the trading range for money-market rates such as DR001 and DR007, enhancing the precision of monetary policy implementation and strengthening the PBOC's ability to anchor short-term funding costs.

Based on the current 7-day reverse repo rate of 1.40%, the new corridor floor is set at 1.15%. Historically, even during periods of exceptionally abundant liquidity, overnight funding rates have generally bottomed out around 1.20%, rarely testing the previous lower bound. By setting the floor at 1.15%, the PBOC is signalling greater tolerance for abundant short-term liquidity conditions while retaining a clear floor for market rates.

Importantly, a narrower corridor should not be interpreted as a signal of lower policy rates. Whether the effective funding-rate centre of gravity moves lower will depend on future liquidity conditions and policy intentions. In our view, the significance of this adjustment lies less in its immediate policy stance and more in its institutional implications.

On data, China's May economic data further reinforced the K-shaped nature of the recovery, with high-tech manufacturing, AI-related industries and emerging sectors continuing to outperform, while consumption, property-related activity and traditional investment sectors remained under pressure.

Overall, the latest activity data point to a further moderation in growth momentum. While high-tech manufacturing and AI-related sectors continue to provide important support, weakness in consumption, property, manufacturing investment and infrastructure spending suggests that the broader economy remains under pressure. We expect China's GDP growth to slow to around 4.5% YoY in Q2.

As expected, the HKMA held base rate unchanged at 4%, following Fed's decision to stay put. In parallel, local commerical banks also kept the Hong Kong Dollar prime rate unchanged. On the other hand, HKD rates continued to trend higher, ahead of the dividend payout, fund raising activities and quarter-end settlement.

HIBORs were fixed broadly higher in past few sessions, in particular in the short-end. HKD IRS were paid up across curve in a flattening manner, tracking but underperforming the US rates. The cut-off yields of most recent Exchange Fund Bills tender were also at multi-week highs, at 2.61% for 91-day bills and 2.58% for 182-day bills.

HKD liquidity will likely stay on tight side, until the passing of half-year settlement. For the rest of the year, we see limited downside for HKD rates as the Fed is expected to hold rate unchanged in periods ahead. With the rate spreads having become less negative and USD rates appearing sticky downward near term, we do not expect the upward move in HKD-USD rate spreads to be much extended. That said, should there be any triggering of FX intervention, we expect to see abrupt tightening of HKD liquidity and more room for HKD-USD rate spread compression. We pitch one-month and three-month HIBORs at 2.80% and 2.95% respectively at end-2026.

On data front, Hong Kong's seasonally adjusted unemployment rate and underemployment rate were unchanged at 3.7% and 1.5% respectively in March – May 2026. However, details pointed to further slack in the labour market. On sequential term, the number of unemployed persons rose for the third straight month by 1.4%, while labour force declined further by 0.2%, to the lowest level since early 2023. The labour force participation rate set another record low at 56.1%.

Policy-wise, following the review of the Enhanced Supplementary Labour Scheme, the government proposed to tighten hiring rules and impose harsher penalties for non-compliance under the scheme. The local-to-importer ratio in food and beverage businesses will be changed from the current setting of two-to-one, to three-to-one.

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- On 17 June 2026, PBOC Governor Pan Gongsheng announced at the Lujiazui Forum that the PBOC would narrow its interest-rate corridor from 70bp to 50bp and shift from an asymmetric to a symmetric framework.
- Specifically, the upper bound was lowered from the 7-day reverse repo rate plus 50bp to plus 25bp, while the lower bound was adjusted from minus 20bp to minus 25bp.

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- In recent years, the PBOC has repeatedly emphasized the 7-day reverse repo rate as the sole short-term policy rate, while gradually reducing the signalling role of quantitative liquidity operations and short-term fluctuations in money-market rates.
- The narrower corridor effectively compresses the trading range for money-market rates such as DR001 and DR007, enhancing the precision of monetary policy implementation and strengthening the PBOC's ability to anchor short-term funding costs. Given that liquidity management has become increasingly refined since 2Q25 and volatility in money-market rates has already declined materially, the move largely formalizes developments that have already taken place in practice.
- Based on the current 7-day reverse repo rate of 1.40%, the new corridor floor is set at 1.15%. Historically, even during periods of exceptionally abundant liquidity, overnight funding rates have generally bottomed out around 1.20%, rarely testing the previous lower bound. By setting the floor at 1.15%, the PBOC is signalling greater tolerance for abundant short-term liquidity conditions while retaining a clear floor for market rates.
- Importantly, a narrower corridor should not be interpreted as a signal of lower policy rates. Whether the effective funding-rate centre of gravity moves lower will depend on future liquidity conditions and policy intentions. In our view, the significance of this adjustment lies less in its immediate policy stance and more in its institutional implications.
- Overall, the corridor narrowing represents a further step in China's monetary policy framework reform. By establishing a narrower and fully symmetric corridor around the policy rate (±25bp), the PBOC is reinforcing the role of the 7-day reverse repo rate—and potentially, over time, the overnight reverse repo rate—as the primary policy anchor. The move should enhance the transparency, precision and credibility of interest-rate management, while advancing China's transition from a quantity-based to a price-based monetary policy framework.

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- The transactions covered both spot trading between CNH and major currencies such as the US dollar and euro, as well as derivatives including forwards and swaps. The first day of trading demonstrated that participating banks have established the operational capability to support cross-border and CNH trading and settlement. The direct participation of these banks' head offices marks an important milestone in the integration of China's onshore and offshore RMB markets and the continued development of RMB market infrastructure.
- In our view, the direct participation of Chinese banks' head offices in CNH carries two important near-term implications.
- First, it should improve cross-market arbitrage efficiency, structurally narrow the CNH-CNY spread, and strengthen the PBOC's influence over RMB exchange-rate dynamics.

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	▪ Historically, during periods of market stress, the gap between CNH and CNY often widened significantly, providing an important channel for investors to express bearish views on the currency. With major Chinese banks now able to participate directly in CNH, connectivity between the onshore and offshore markets is likely to improve substantially. This should enhance arbitrage efficiency, facilitate faster price transmission across markets, and lead to a structural narrowing of the CNH-CNY spread. ▪ From a policy perspective, a smaller CNH-CNY gap reduces the scope for offshore pricing to diverge from onshore fundamentals, raises the cost of speculative short-selling, and strengthens the stability of the RMB exchange-rate formation mechanism. This should enhance the PBOC's ability to guide exchange-rate expectations and manage offshore RMB liquidity conditions when necessary. ▪ Second, it helps address a key infrastructure gap in the RMB's evolution as a reserve currency and could accelerate the next phase of RMB internationalization. ▪ The recently announced overseas central bank repo facility, together with direct participation by Chinese banks' head offices in offshore RMB markets, represents a coordinated effort to expand the pool of tradable, hedgeable, and financeable RMB assets. If the bilateral RMB swap network constituted the first phase of RMB internationalization, these initiatives could mark the beginning of the next phase—transforming Chinese government bonds from a reserve asset into internationally accepted reserve collateral. ▪ A global reserve currency requires more than liquidity. It also needs deep funding markets, efficient hedging instruments, and credible collateral frameworks. By improving offshore RMB liquidity, strengthening links between onshore and offshore financial markets, and expanding the range of RMB funding and risk-management tools, China is gradually building the institutional architecture expected by global reserve managers. ▪ Importantly, this process does not imply a wholesale opening of the capital account. Rather, China appears to be pursuing a controlled expansion of RMB internationalization—adding more participating banks, increasing market capacity, and broadening geographical reach while retaining macroprudential tools that allow policymakers to manage capital-flow risks. The direction of travel is clear: the RMB is gradually evolving from a trade settlement currency into an investment, funding, and reserve currency. The latest measures represent another meaningful step along that path.
▪ China's central bank plans to establish an overseas central bank repo facility, allowing foreign central banks and monetary authorities that hold Chinese government bonds (CGBs) to obtain RMB liquidity by temporarily pledging those	▪ The significance of this initiative extends well beyond liquidity management. By providing a standing liquidity backstop for overseas official holders, the facility enhances the liquidity profile and usability of CGBs, bringing them a step closer to the role played by U.S. Treasuries in the global financial system. Reserve managers are generally more willing to hold assets that

bonds through repo transactions with the PBoC or its designated institutions.	can be readily mobilized during periods of market stress, and the repo facility directly addresses this requirement. ▪ More importantly, the move marks another milestone in RMB internationalization. If the bilateral RMB swap network represented the first phase of RMB internationalization—facilitating access to RMB liquidity for trade settlement and financial stability purposes—then the overseas central bank repo facility could represent the next phase. It elevates Chinese government bonds from being merely a reserve asset to becoming internationally recognized reserve collateral. ▪ In other words, the objective is no longer just encouraging foreign central banks to hold RMB assets, but enabling those assets to be actively used within the global liquidity and collateral framework. ▪ Over the longer term, this could strengthen the attractiveness of RMB reserve holdings, increase foreign demand for CGBs, and reinforce the development of a more RMB-centric international monetary system. While the dollar's dominance remains firmly entrenched, the facility is an important step toward improving the infrastructure underpinning the RMB's global role.
▪ Hong Kong: As expected, the HKMA held base rate unchanged at 4%, following Fed's decision to stay put. In parallel, local commerical banks also kept the Hong Kong Dollar prime rate unchanged. On the other hand, HKD rates continued to trend higher, ahead of the dividend payout, fund raising activities and quarter-end settlement.	▪ HIBORs were fixed broadly higher in past few sessions, in particular in the short-end. HKD IRS were paid up across curve in a flattening manner, tracking but underperforming the US rates. The cut-off yields of most recent Exchange Fund Bills tender were also at multi-week highs, at 2.61% for 91-day bills and 2.58% for 182-day bills. ▪ HKD liquidity will likely stay on tight side, until the passing of half-year settlement. For the rest of the year, we see limited downside for HKD rates as the Fed is expected to hold rate unchanged in periods ahead. With the rate spreads having become less negative and USD rates appearing sticky downward near term, we do not expect the upward move in HKD-USD rate spreads to be much extended. That said, should there be any triggering of FX intervention, we expect to see abrupt tightening of HKD liquidity and more room for HKD-USD rate spread compression. We pitch one-month and three-month HIBORs at 2.80% and 2.95% respectively at end-2026.

Key Economic News

Facts	OCBC Opinions
▪ May industrial production remained resilient despite growing external and domestic headwinds. Value-added industrial output of large enterprises rose 4.5% YoY, accelerating from 4.1% in April, while increasing 0.4% MoM.	▪ Three factors continued to support industrial activity. First, high-tech manufacturing and equipment manufacturing remained key growth engines. Value-added output of high-tech manufacturing increased 15.1% YoY, while equipment manufacturing expanded 9.5%. ▪ Second, emerging industries continued to post strong growth. Production of lithium-ion batteries surged 40.0% YoY, while industrial robot output rose 27.9%, highlighting the continued strength of China's advanced manufacturing sector. ▪ Third, AI-related industries maintained robust momentum.

	Integrated circuit production increased 22.9% YoY, while output of computers, communications, and other electronic equipment grew 17.0%, reflecting ongoing investment across the AI supply chain. ▪ That said, industrial performance remained highly uneven. The prolonged downturn in the property sector continued to weigh on traditional industries linked to construction activity. Cement output fell 8.1% YoY, while flat glass production declined 6.3%, underscoring the persistent drag from weak real estate investment. ▪ Meanwhile, rising global oil prices are beginning to create additional cost pressures for downstream manufacturers, posing a potential headwind to industrial profitability in the coming months.
▪ Retail sales weakened further, pointing to a softer consumption backdrop. Total retail sales of consumer goods fell 0.6% YoY in May, reversing April's 0.2% increase and marking the first contraction since 2023. While automobile sales remained the primary drag, the weakness was increasingly broad-based. Excluding automobiles, retail sales still grew 1.1% YoY, but the pace slowed noticeably from previous months.	▪ Several factors appear to be weighing on consumption. ▪ First, the pull-forward effects of the consumer trade-in subsidy programme are becoming more evident. Sales of communication equipment rose only 0.7% YoY in May, slowing sharply from earlier months. Following a period of strong policy-driven demand, the sector is now entering a payback phase amid higher base effects. ▪ Second, the property downturn continues to spill over into household spending. Furniture sales declined 8.7% YoY, while sales of construction and decoration materials fell 13.6%, reflecting subdued housing-related consumption demand. ▪ Third, consumption downgrading remains a notable trend. Catering revenue grew only 0.6% YoY, while revenue at large-scale catering enterprises fell 1.7%. This suggests that consumers remain cautious and continue to trade down amid ongoing pressure on income and employment expectations.
▪ Fixed-asset investment remained under pressure, with weakness extending beyond the property sector. In January–May, fixed-asset investment totaled RMB17.85 trillion, declining 4.1% YoY. Excluding real estate, investment fell 1.2%, while property development investment contracted 16.2%, with the pace of decline continuing to widen.	▪ More importantly, signs of softening have begun to emerge in both manufacturing and infrastructure investment. ▪ Manufacturing investment was the most notable disappointment. Cumulative growth turned negative for the first time this year, falling 0.4% YoY in January–May after rising 1.2% in January–April. The deterioration suggests that corporate investment sentiment remains fragile despite the recent improvement in industrial production and producer prices. Heightened uncertainty surrounding the Iran conflict and global demand prospects may have further dampened private-sector investment appetite. ▪ Infrastructure investment also lost momentum. Growth slowed sharply to 0.6% YoY in January–May from 4.3% in January–April. This suggests that the boost from front-loaded fiscal funding and concentrated project launches in the first quarter is gradually fading, while the pace of physical construction activity has slowed noticeably since the start of the second quarter. ▪ Looking ahead, infrastructure investment is still likely to remain the most important policy lever for stabilizing growth. The key questions are whether fiscal resources can be translated into sustained physical work and whether new initiatives such as the

	"Six Networks" strategy can gradually offset the structural slowdown in traditional municipal and property-related infrastructure investment. ▪ Overall, the latest activity data point to a further moderation in growth momentum. While high-tech manufacturing and AI-related sectors continue to provide important support, weakness in consumption, property, manufacturing investment and infrastructure spending suggests that the broader economy remains under pressure. We expect China's GDP growth to slow to around 4.5% YoY in Q2.
▪ Hong Kong: The seasonally adjusted unemployment rate and underemployment rate were unchanged at 3.7% and 1.5% respectively in March – May 2026. However, details pointed further slack in the labour market. On sequential term, the number of unemployed persons rose for the third straight month by 1.4%, while labour force declined further by 0.2%, to the lowest level since early 2023. The labour force participation rate set another record low at 56.1%.	▪ Comparing March - May 2026 with February - April 2026, more sectors recorded increases in unemployment rate than those recording declines, though the magnitudes were generally not large. In particular, accommodation services, transportation, and professional and business services sectors saw the most notable increases in unemployment rates. ▪ Policy-wise, following the review of the Enhanced Supplementary Labour Scheme, the government proposed to tighten hiring rules and impose harsher penalties for non-compliance under the scheme. The local-to-importer ratio in food and beverage businesses will be changed from the current setting of two-to-one, to three-to-one. ▪ For the rest of the year, labour market slack is likely to widen slightly, with unemployment rate projected at 3.8%.