Summary

Chinese policy makers have worked hard in the last week of 2016 to position for 2017. Two noticeable changes have been announced on the currency front including stricter supervision on individual's foreign currency purchase and expansion of RMB index basket. The annual US$50K quota for purchase of foreign currency remains unchanged. However, banks were asked to further standardize their application form for purchase of foreign currency. Individuals are required to report their purpose of purchase as well as estimated time of usage of foreign currency. It is unlikely to affect individuals with genuine needs. However, individuals who want to game the system are running the risk of being penalized by the regulators.

The juicy headline today is probably that China banned individuals from purchasing overseas property. But we think this is not the correct reading. Anyway, purchasing overseas property and foreign securities are always not the legitimate purpose for purchase of foreign currency by individuals. The reiteration of compliance for individuals is unlikely to stop Chinese from purchasing property overseas, however, it may increase hurdle for middle class to invest in the offshore property market.

For the new CFETs RMB basket, The nominal dollar weights in the new basket has been reduced by 4%, however, after taking newly included Saudi Riyal and Emirate Dirham as well as existing Hong Kong Dollar, which all pegged to the USD, into account, the effective dollar weights fell by 2.45% to 30.54% from 32.95%. The direct impact of the new basket after including more volatile emerging market currencies is that the RMB index may hold up better amid broad dollar strength as the impact of RMB depreciation on RMB index will be partially offset by the impact of EM currency's weakness. However, the new weight also implied a possible more volatile USDCNY should China continue its basket anchor policy. For detailed analysis, readers may refer to our report.

<table>
<tr><th colspan="2">Key Events and Market Talk</th></tr>
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<tr><td>▪ China's currency regulator announced on 31 December 2016 to tighten its supervision on individual's foreign currency purchase ahead of the refill of quota in 2017.</td><td>▪ The annual US$50K quota for purchase of foreign currency remains unchanged. However, banks were asked to further standardize their application form for purchase of foreign currency. Individuals are required to report their purpose of purchase as well as estimated time of usage of foreign currency. It is unlikely to affect individuals with genuine needs. However, individuals who want to game the system are running the risk of being penalized by the regulators. The SAFE has warned to conduct the random check on the application forms and individuals caught for illegitimate purchase of foreign currency will be penalized by cancelling the foreign currency purchase quota for two years and negative mark on personal credit score.
▪ Purchasing overseas property and foreign securities are not the legitimate purpose for purchase of foreign currency. As such, the hurdle is higher for Chinese individuals to invest in the offshore property market.
▪ The move is designed to prevent from herding behaviour by individuals to purchase foreign currency without clear usage due to concerns about currency depreciation.
▪ Though the reiteration of compliance for individuals to abide by rules for foreign currency purchase may partially alleviate the demand for the dollar in the beginning of the new year when all the quotas were refilled, it is unlikely to stop capital outflows. As such, should USD remain strong in the global market, RMB is likely to weaken against the dollar further.</td></tr>
<tr><td>▪ China Foreign Exchange Trading System (CFETs) announced to expand the number of currencies in its RMB index from previously 13 to 24.</td><td>▪ The new CFETs RMB index will better reflect China's RMB value against its key trading partners.
<table><tr><th></th><th>New Weights</th><th>Old Weights</th></tr><tr><td>USD</td><td>0.2240</td><td>0.2640</td></tr><tr><td>EUR</td><td>0.1634</td><td>0.2139</td></tr></table></td></tr>
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JPY	0.1153	0.1468
HKD	0.0428	0.0655
GBP	0.0316	0.0386
AUD	0.0440	0.0627
NZD	0.0044	0.0064
SGD	0.0321	0.0382
CHF	0.0171	0.0151
CAD	0.0215	0.0253
MYR	0.0375	0.0467
RUB	0.0263	0.0436
THB	0.0291	0.0333
ZAR	0.0178	
KRW	0.1077	
AED	0.0187	
SAR	0.0199	
HUF	0.0031	
PLN	0.0066	
DKK	0.0040	
SEK	0.0052	
NOK	0.0027	
TRY	0.0083	
MXN	0.016	

- The nominal dollar weights in the new basket has been reduced by 4%, however, after taking newly included Saudi Riyal and Emirate Dirham as well as existing Hong Kong Dollar, which all pegged to the USD, into account, the effective dollar weights fell by 2.45% to 30.54% from 32.95%.
- The direct impact of the new basket after including more volatile emerging market currencies is that the RMB index may hold up amid broad dollar strength as the impact of RMB depreciation on RMB index will be offset by the impact of EM currency's weakness on RMB index. Our back test shows that from 12 Dec to 30 Dec, RMB index gained by 0.35% under the new weights while RMB index only gained by 0.1% under the old weights.
- As such, should dollar remain strong, the new weight is good to support RMB index. However, the new weight also implied a possible more volatile USDCNY should China continue its basket anchor policy. To recap, since September 2016, PBoC has maintained the RMB index relatively stable as a way to slow down the depreciation of RMB against dollar. We expect this policy to continue in 2017. However, given the new RMB index may outperform the old RMB index amid broad dollar rally, to stabilize the outperforming new RMB index suggests that there is more room for a more volatile USDCNY. This is also in line with the message from the latest Central Economic Working Conference about a more flexible currency.

▪ China's authorities further tightened their grips on the purchase of offshore insurance produces.	▪ China was said to cap the purchase of HK insurance products via VISA and MasterCard at US$5,000, and the credit cards could only be used once for the purchase.
▪ HK government's annual long-term housing strategy progress report revealed that lands will only be enough to build 236,000 flats by 2027, fewer than 255,000 units forecasted last year.	▪ The government is likely to miss its target of building 280,000 public housing units during the coming decade. The slower than expected increase in supply may cushion the negative impact of higher interest rates and cooling measures on the housing market.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's PMI fell slightly to 51.4 in December 2016 from 51.7 in November.	▪ Demand remained relatively stable in December with new orders unchanged at 53.2 though new export order slipped to 50.1 from 50.3. ▪ The decline of PMI in December was mainly attributable to the fall of output index to 53.3 from 53.9. This hints that industrial production may decelerate in December. ▪ On the price level, input prices expanded further to 69.6 from 68.3, fuelling pressure on PPI. We expect the PPI to break 4.5% in December.
▪ Unemployment rate of HK declined slightly from 3.4% to 3.3% in November.	▪ As the inbound tourism appeared to have stabilized recently, unemployment rate in the retail sector remained unchanged at 5.2% in November. However, the considerable external uncertainties and dimmer domestic outlook could continue to dampen local consumption and risk a fall in employment of the retail sector. Unemployment rate in trade and wholesale sector fell slightly from 3.0% to 2.9%. Looking ahead, labor market condition is poised to remain tight in the short term. But corporate hiring sentiments still hinges on highly uncertain external environment.

RMB	
Facts	**OCBC Opinions**
▪ RMB rebounded slightly against the dollar in the last week of trading in 2016 as a result of broad dollar correction. The USDCNY ended the year below 6.95. ▪ However, RMB index fell slightly to 94.83.	▪ Given the two noticeable changes including the stricter surveillance on individual foreign currency purchase and expansion of CFETs RMB basket, we need to assess the impact on the USDCNY. Nevertheless, as we highlight above, we think the new measures are unlikely to stop the capital outflows and pressure for RMB to weaken is still there should dollar resume its strength in the New Year.

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