Summary

A supposedly holiday shorten quiet week in China ended with big bang after PBoC raised its interest rate for 7, 14 and 28-day reverse repo by 10bps as well as SLF rate. The entire money market interest rate curve has been shifted upwards following the rate hike of longer end MLF before Chinese New Year holiday and shorter end reverse repo and SLF last Friday. This shows that "tight bias" is clearly the attitude. The rate hike in money market may open the door for China to adjust its benchmark lending and deposit rate. However, as we argued before, it might still be too early to jump to the conclusion. Whether China will touch its benchmark lending and deposit rate depends on both inflation and growth outlook. Our current forecast does not support lending rate hike.

On currency front, RMB held up well and CNH rallied with the USDCNH tested 6.80 handle. RMB fixing was again set at a stronger than expected level in its only trading day last Friday. Our daily fixing forecast error widened again in the past few trading days. The stronger than expected RMB fixing helped slow down the decline of RMB index due to weaker dollar index. RMB index was kept marginally above 94 at 94.03 last Friday despite the fall of broad dollar during the Chinese New Year holiday. This signals that PBoC may try to stabilize RMB index. We will continue to monitor this week's fixing to gauge whether RMB fixing will be set stronger amid dollar weakness to stabilize the RMB index.

RMB deposits in Hong Kong in December 2016 registered the largest decline since record, which was mainly attributable to China's tightening measures on cross border RMB payment as well as concerns about renewed RMB depreciation in the beginning of the New Year. The development of offshore RMB market may continue to feel the pain from the recent tightening measures on capital flows.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ In the first working day of Year of Rooster, PBoC raised interest rate for 7, 14 and 28-day reverse repo by 10bps to 2.35%, 2.5% and 2.65% respectively. ▪ In addition, it was also reported that interest rate for the bottom of the interest rate corridor Standing Lending Facility (SLF) has also been increased. The overnight SLF interest rate was increased by 35bp to 3.1% while interest rates for 7-day and one-month SLF were increased by 10bps to 3.35% and 3.7% respectively.	▪ The entire money market interest rate curve has been shifted upwards following the rate hike of longer end MLF before Chinese New Year holiday and shorter end reverse repo and SLF last Friday. This shows that "tight bias" is clearly the attitude. ▪ The recent series of rate hikes in money market were mainly attributed to four factors including concerns about rapid credit expansion in January, positive growth outlook, commitment to contain financial risk and rising inflationary pressure. For details, please refer to our report <the end of easing cycle> sent out on 24 January. ▪ The rate hike in money market may open the door for China to adjust its benchmark lending and deposit rate. However, as we argued before, it might still be too early to jump to the conclusion. Whether China will touch its benchmark lending and deposit rate depends on both inflation and growth outlook. Our current forecast does not support lending rate hike. Focusing on the money market rate is still the safe way to strike the balance between containing financial risk and economic growth. ▪ In terms of implications, both bond and equity market fell as the knee jerk reaction to tight bias monetary policy. We should still expect higher volatility in the coming weeks. However, the expectation on higher interest rate and tighter monetary policy may be supportive of RMB.

Key Economic News	
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▪ China's official PMI fell slightly to 51.3 in January 2017 from 51.4 in December 2016.	▪ Both production and new orders fell slightly to 53.1 and 52.8 from 53.3 and 53.2 respectively, partly due to Chinese New Year holiday as factories closed down to celebrate the festival.

	In addition, some smaller factories were also reported to closes earlier due to squeezed profit margin as a result of surging raw material prices. ▪ On price level, input price index eased to 64.5 in January from the peak of 69.6 in December. However, PPI is expected to increase further to test above 7% in January from 5.5% in December due to base effect. The widening gap between PPI and CPI is likely to continue to press on profit margin. ▪ External demand improved slightly with the new export order increased to 50.3 from 50.1. ▪ The difference between new orders and finished goods remained high at 7.8 after it reached the six-year high of 8.8 in December 2016, suggesting room for restock. As such, we expect the economy to remain stable in the first quarter and 1Q GDP is likely to go higher to around 6.9% due to base effect.
▪ Hong Kong's housing total transactions grew significantly by 61% yoy to 3286. The growth was mainly driven by the notable increase in transactions of homes priced above HKD5 million.	▪ Nevertheless, total transactions dropped for the second straight month by 7.4% on a monthly basis. This reinforces that the housing cooling measures from November continued to take effect and in particular, hit the demand for smaller flats. As tightening measures have also dampened home supply in the secondary market, housing prices appeared to remain resilient with the home price index refreshing its record high in December. Moving forward, given our expectations on a rate hike by banks in HK around mid-June combined with China's tightening grip on capital outflows, housing transactions are likely to retreat further while housing prices may also drop from their highest levels.
▪ HK's RMB deposits in December 2016 registered the largest decrease since record and were down by 35.8% yoy to the lowest level CNY546.7 billion since September 2012.	▪ The sharp decline of RMB deposit in Hong Kong was mainly due to China's tightening measures on cross border RMB payment as well as concerns about renewed RMB depreciation in the beginning of the New Year. Adding on the tightening bias of the PBOC, CNH liquidity will likely remain volatile this year. If this is the case, the gap between CNH and CNY may persist.
▪ Loans for use outside Hong Kong rose by 4.5% yoy to HKD2.38 trillion in December.	▪ Given the tightening bias of the PBOC and its intension to control credit expansion in onshore market, some Mainland corporates might have been prompted to raise funds abroad. In fact, Chinese top levels also encourage offshore financing, in an effort to ease the risks of capital outflows. Therefore, despite the narrowing interest rate differentials across the border, HK loan businesses related to Mainland activities may pick up some momentum in coming months.
▪ HK's retail sales value dipped by 2.9% yoy in December, marking the 22th straight month of negative annual growth. Specifically, sales value of clothing and footwear dropped 3.7% yoy due to winter sales season. In addition, sales value of consumer durable goods tumbled for the 14th straight month and was down by 20% yoy. Moreover, sales of goods in department stores fell by 3.2% yoy.	▪ The disappointing data indicates sour local consumer sentiment. Though total visitor arrivals (+5.4% yoy) in last December rose for the first time since July 2016, tourists' spending appeared to have been tepid. On a positive note, sales of jewelry, watches and clocks rose by 2.3% yoy, probably due to the effect of Christmas Holiday. However, we still believe that a stronger HKD is likely to suppress tourists' consumption. In contrast, a relatively stable labor market may warrant moderate growth in private consumption. Combined with the effect of low base, retail sales may rose by around 3% yoy over 2017.
▪ **Macau:** During the first six days of the Chinese New Year Holiday, visitor arrivals increased by 6.7% from the same period last year and those from Mainland	▪ A stronger HKD might have trimmed some upward pressure on mass-market segment as casual gamblers were reluctant to increase their battling amount. Despite that, junket operators

China grew by 8.5% yoy. Despite strong hotel bookings during the Chinese New Year Holiday, gross gaming revenue was up by merely 3.1% yoy to MOP19.26 billion in January, missing expectations.	may hold some events as usual following the Chinese New Year Holiday, in order to attract VIP gamblers. Therefore, February's gaming revenue growth looks set to regain pace. However, the VIP segment which has benefited from the return of high-rollers could be hit again by the lingering policy risks. As such, we only expect a single-digit annual growth in gaming revenue over 2017.

RMB	
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▪ RMB held up well against the dollar in the first trading day of the Year of Rooster after coming back from one-week Chinese New Year holiday. The USDCNY ended at 6.8672, however, CNH rallied with the USDCNH closed near the 6.80 handle.	▪ RMB fixing was again set at a stronger than expected level in its only trading day last Friday. Our daily fixing forecast error widened again in the past few trading days. The stronger than expected RMB fixing helped slow down the decline of RMB index due to weaker dollar index. RMB index was kept marginally above 94 at 94.03 last Friday despite the fall of broad dollar during the Chinese New Year holiday. This signals that PBoC may try to stabilize RMB index. ▪ We will continue to monitor this week's fixing to gauge whether RMB fixing will be set stronger amid dollar weakness to stabilize the RMB index.

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