Summary
It was all about RMB for the first week trading of the New Year. Instead of depreciation expected by market due to refill of FX conversion quota, RMB strengthened against both dollar and its basket of currencies in both offshore and onshore market. The rally of CNH on Wednesday and Thursday due to short covering as a result of funding squeeze has been fairly technical. The heavy negative carry forced investors to liquidate their long USDCNH position, which triggered wave of loss cutting. However, it is still too early to say the outlook on RMB has changed. In fact, the roller-coaster move of CNY on last Friday shows that buy-on-dip remains the strategy for onshore investors. The spike of 4:30 closing price for USDCNY last Friday does not bode well for this morning's fixing. We expect the USDCNY fixing to jump to 6.9288 this morning based on our fixing model.

The spike of fixing this morning together with the fall of December FX reserve to US$3.01 trillion implies that expectations on RMB depreciation may resume this week. Nevertheless, we think last week's movement has taught investors three important lessons. In particular, the disastrous result of unwinding the consensus trade sent the warning signal to RMB bear that shorting RMB may not be a no-brainer bet anymore.

The offshore RMB liquidity is expected to remain tight ahead of Chinese New Year holiday. As such, the gap between USDCNY and USDCNH is likely to remain. For this week, this morning's RMB fixing will be important. In addition, China will start to release the December economic data.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The RMB market kicked off the New Year with heightening volatility. Instead of depreciation expected by market due to refill of FX conversion quota, RMB strengthened against both dollar and basket currency in both offshore and onshore market though CNY pared most gains on Friday in the onshore market.	▪ CNH appreciated against the dollar by almost 2.5% on Wednesday and Thursday due to short covering as a result of funding squeeze. The offshore RMB liquidity has been tighter since late November 2016 after PBoC tightened its grip on cross border RMB payment. The liquidity situation worsened in the beginning of 2017 which led to the increase of RMB funding costs in both RMB money market and swap market. The CNH overnight HIBOR fixing rate spiked to 61.33% on 6 Jan while the implied yield from the swap market for T+2 hovering around 50%. The heavy negative carry forced investors to liquidate their long USDCNH position, which triggered wave of loss cutting. ▪ The strong rally in the offshore RMB market also has a feedback impact on the onshore RMB market. The USDCNY fell below 6.9 at one stage on Thursday. In addition, CNY also received the support from the stronger than expected RMB fixing from Tuesday to Thursday as well as less demand for dollar from individuals after PBoC tightened its supervision on individual's foreign currency purchase. ▪ However, the rally in CNY failed to sustain with the USDCNY recouped most losses on Friday after China fixed the CNY weaker than expected at 6.8668. As a result, the USDCNH follow suits and ended the week about 6.8500. We expect the USDCNY fixing to jump to 6.9288 this morning based on our fixing model. ▪ Although RMB depreciation pressure may accumulate again after RMB gave up most gains in the onshore market on Friday, we think the first week's movement has taught investors three important lessons. First, the unwind of consensus trade is always disastrous. When every one expects RMB to weaken in January, it might be the time for us to be alert. Second, China is likely to continue to sacrifice the development of offshore RMB market in order to purse financial stability. As such, we think the liquidity is likely to remain tight ahead of Chinese New Year holiday. Third, the

	recent volatile move was also a warning signal to RMB bear that they may not be able to generate similar comfortable return as they did in 2016 via shorting RMB. This is good for building expectation on two-way volatility for RMB.
▪ According to the HKEX, the average daily contract volume of USD/CNH Futures has jumped notably since last November and refreshed its record high in early January. Till 5 January, the average daily contract volume amounted to 9816, more than doubling the previous high of 4325 in last December.	▪ This is coincided with Trump's victory which sparked expectations on a steeper path of rate hike by the Fed and therefore more downward pressures on the RMB. However, tight CNH liquidity in HK increases the difficulty for the investors to unwind their RMB positions. As a result, the need to hedge against RMB risks has been increasing. In this case, the HKEX announced its plan to offer RMB currency options and aimed to roll out a USD/CNH contract in 1Q this year, in order to meet the increasing hedging needs. This will also pave the way for further development in the RMB internationalization, which though may continue to halt in the near term.
▪ Over the first month after the launch of Shenzhen-Hong Kong stock connect, average daily southbound inflows amounted to about RMB388 million (or 3.7% of the daily quota) while northbound inflows averaged at about RMB910 million (or 7% of the daily quota).	▪ It appears that foreign investors have been more interested in the new stock link, which allows them to invest in the promising high-tech industry in Mainland China. Additionally, favorable policies, including SOE reform, have also lured overseas investors to buy some relevant stocks. However, the fear of RMB risks is likely to constrain the growth of northbound inflows. On the flip side, as China banned individuals from using FX converted in onshore market to invest in overseas securities, onshore investors may rely more on the two stock links to tap the offshore market. We expect southbound inflows to rebound in the medium term.

Key Economic News

Facts	OCBC Opinions
▪ China's FX reserve fell further to US$3.0105 trillion in December.	▪ The decline of FX reserve in December was due to both valuation effects and capital outflows. The further correction of US Treasury and rise of USD index are likely to lead to the accounting loss for FX reserve. However, the fall of FX reserve in SDR term from 2.254 trillion to 2.239 trillion also shows that capital outflows continued in December. This also explained the tighter measures on capital outflows.
▪ HK retail sales tumbled 5.5% yoy in November, mainly due to the 14.4% yoy decline in sales of luxury items (including jewelry and watches).	▪ This could be attributed to the fourth consecutive month of decline of Mainland visitors in November. A stronger HKD may continue to suppress visitor consumption. On the other hand, the decrease in sales of consumer durable goods and goods in supermarkets reflected sluggishness in domestic consumption. This was amidst the retreat in stock market and households' fear of housing market correction following the cooling measures announced in early November. A relatively stable labor market may however vow some support for local consumer sentiments. Adding on the effect of a low base, we expect to see low single-digit growth on a yearly basis in retail sales over 2017.
▪ Led by the notable increase in prices of large-size homes, HK's overall housing price index rose by 4.5% yoy and refreshed its historical high in November.	▪ The surge was attributed to low borrowing costs and tight home supply. However, as the Fed is expecting a steeper path for rate hikes this year, the higher interest rates ahead may hit the housing market. Moreover, the cooling measures from November appeared to have taken effect in December, with total housing transactions retreating 12% yoy to 3550 units.

	Additionally, China's curb on individuals' investment in overseas property is set to suppress Chinese middle class's demand for small to medium size flats in HK. Therefore, we expect housing transactions to drop further in 1Q, with smaller flats taking a harder hit. However, the fear of RMB risks may increasingly propel the affluent Mainland investors to buy foreign luxury homes. This could partially ease the correction in HK's home prices.
▪ Gross gaming revenue (GGR) rose for the fifth consecutive month to MOP19.8 billion and was up by 8% yoy in December. Over 2016, gaming revenue dropped 3.3% yoy, in line with our expectations.	▪ December's figure reinforces that November's rosy data was mainly attributed to the pick-up in VIP demand. As such, it also increases our concern about the outlook of the gaming sector. On one hand, given (1) tight scrutiny on junket operators and money-laundering, (2) cooling measures on Mainland housing markets, as well as (3) controls on capital outflows from Mainland China, VIP segment may have limited upside. On the other hand, though Chinese New Year Holiday may attract some casual gamblers to the city, the seasonality will not help to sustain the growth of the mass-market segment. Therefore, we remain cautiously optimistic about the city's gaming sector this year and expect revenue to grow by 5% to 7% yoy for 2017. Since the recovery of this sector is more likely to be moderate, we see only gradual economic growth over 2017.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended the week at 6.9230, however, the USDCNH fell significantly to around 6.8500 due to tighter offshore liquidity. ▪ RMB also strengthened against the currency basket with the RMB Index climbed to 92.50	▪ The gap between the USDCNY and USDCNH is likely to remain wide due to tight offshore liquidity and limited channels for cross border flows. ▪ For details, please refer to our analysis above.

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