Summary

One of the most concerned political risks this year has largely been removed last week after the US President Trump reaffirmed the support for "One China" policy in his first call with China's President Xi Jinping. However, Trump's reaffirmation that Diaoyu (Senkaku) islands fall within the scope of Article 5 of the US-Japan security treaty after spending a friendly bonding weekend with PM Abe suggested the tension between the world's two largest economies is unlikely to ease. The focus is likely to shift to trade policy going forwards.

On data front, China's January FX reserve data disappointed market last week after the reading fell below US$3 trillion despite favourable valuation effect. This shows that seasonal demand for foreign currencies remained strong in the beginning of the year. Nevertheless, we think pressure for capital outflow has eased thanks to tighter measures on capital outflows. This was also proved by the 4Q flash Balance of Payment data, which outflows under the overseas direct investment fell significantly. China's export data in January was encouraging. However, given it has received support from seasonal factors, we try not to jump to the conclusion too early without having Feb data on hand.

On currency, RMB's gain against the dollar paused after China released the weaker than expected January FX reserve data. Meanwhile, the rise of USDCNY and USDCNH was further underpinned by Trump's comments about "phenomenal" tax reform, which totally turned around the dollar weakness. Nevertheless, the stable Euro despite rising political premium suggested that the downside risk for RMB may be capped. For this week, market will look at China's January credit and inflation data.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ US President Trump reaffirmed the support for "One China" policy in his first call with China's President Xi Jinping.	▪ President Trump's question over "One-China" policy previously has raised the concerns that his bargaining techniques with no boundaries may escalate the tension between the world's two largest economies to beyond trade dispute. ▪ The reassurance from President Trump is likely to ease one of the key political uncertainties globally. However, this does not change the view that the trade dispute between China and US is still inevitable.
▪ HK stock market's turnover rose to near HKD100 billion and Hang Seng China Enterprises Index surged to over one-year high. ▪ Southbound inflows via Shanghai-Hong Kong stock link have amounted to over RMB 1 billion on the daily basis for most of trading days for the past two weeks.	▪ Hong Kong stock market seems to benefit from the tighter capital control in the mainland China. There is also market talk that tighter capital controls prompted Mainland companies to invest in HK stock market instead of M&A deals with their idle capital.
▪ HKD deposit rates were raised to as high as 1.5% following the increase of HIBOR rate.	▪ We expect HK banks to lift Prime Rate around mid-June, following this year's first rate hike by the Fed. This may hit the housing market.

Key Economic News	
Facts	**OCBC Opinions**
▪ China's FX reserve fell by more than expected to US$2.9982 trillion, below psychological handle. ▪ RMB weakened against the dollar as a knee jerk reaction to the FX reserve data. ▪ It seems that the decline of FX reserve to below US$3 trillion remains a concern to global market despite easing pressure for capital outflows.	▪ The further decline of FX reserve in January despite favourable valuation factor, which may add US$10-20 billion to reserve, shows that outflow continued. FX reserve in SDR term fell from 2.2394 trillion to 2.2065 trillion. ▪ Despite tightening surveillance on individual's currency purchase in January, outflow continued due to seasonal demand from corporate and individuals in the beginning of the year. Meanwhile, given more Chinese spent their holiday overseas, the seasonal demand for foreign currency is likely to be exaggerated in January. ▪ Nevertheless, on the year-on-year base, the decline of FX

	reserve in January has fallen by about 88%. This shows the diminishing pressures on capital outflows partly thanks to tighter capital control measures as well as adjustment of dollar value. Looking ahead, we expect the pace of decline in FX reserve to moderate further in the coming months.
▪ China's current account surplus shrank to US$210.35 billion in 2016 from US$305.9 billion in 2015. As a result, the current account surplus as percentage of GDP fell to around 2% from 2.8% in 2015. ▪ Capital account deficit, however, also shrank to US$47 billion from US$111.1 billion in 2015.	▪ The decline of current account surplus despite sizable trade surplus in 2016 was mainly the result of ballooning service trade deficit due to increasing outbound travel by Chinese people. Deficit caused by travel jumped to US$223.1 billion in 2016, accounting for 92% of total service trade deficit. ▪ One of the notable changes from the 4Q Balance of Payment data is that overseas direct investment slowed down significantly, which decelerated to US$34.6 billion from US$55.2 billion in 3Q, partly due to tightening measures on capital outflows. As a result, the net direct investment returned to positive again for the first time since 4Q 2015.
▪ Both China's export and import in dollar term beat market expectation, up by 7.9% yoy and 16.7% yoy respectively in January. ▪ Trade surplus widened to US$51.35 billion from US$40.8 billion in December.	▪ The stronger than expected export was mainly attributable to three factors including low base, Chinese New Year effect as well as improving growth outlook. Chinese exporters tend to front load their exports ahead of Chinese New Year festive. Given the Chinese New Year holiday was at the end of January this year, exporters may have front loaded in the beginning of the January. ▪ In addition, the impact of political uncertainty on the global economy seems limited for now. Both UK and US economies remain resilient despite black swan political events. This may also continue to provide support to China's export. The rebound of China's export growth in January was also in line with improvement of new export orders under PMI to 50.3 in January from 50.1 in December. ▪ Overall speaking, the single month data during the Chinese New Year holiday may not give complete picture. As such, we try not to jump into conclusion too early without having February data on hand. ▪ The strong rebound of imports was mainly driven by the surging demand for commodity. Import of crude oil and iron ore by volume rose by 27.5% and 11.9% respectively in January while both imports by value surged by 72.3% and 85.5% respectively due to the sharp increase of commodity prices.

RMB	
Facts	**OCBC Opinions**
▪ The USDCNY ended the week above 6.88 and the USDCNH traded back to 6.87. ▪ RMB index, however, gained and recovered to 94.03 riding on the rebound of broad dollar.	▪ RMB's gain against the dollar paused after China released the weaker than expected January FX reserve data. Meanwhile, the rise of USDCNY was further underpinned by Trump's comments about "phenomenal" tax reform, which totally turned around the dollar weakness. ▪ The Japanese Yen weakened significantly following Trump's comments about tax reform, adding pressure on RMB depreciation. However, the stable Euro despite rising political premium helped cap the downside risk of RMB. ▪ Market focus is likely to shift towards Trump's economic and tax policy. The risk for RMB weaken against the dollar is likely to be higher should Trump roll out its border tax adjustment,

	which is believed to be dollar positive event.

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