**Highlights:**

We have overwhelming economic data and comments from various policy makers last week. On data, the most eye-catching part is probably the weaker than expected CPI despite PPI continued to edge higher. The reason why the entire market missed the CPI forecast was mainly attributable to two factors including stronger than expected decline of food prices post Chinese New Year and weaker than expected non-food prices. This at least tells us one story that the pass-through effect from higher PPI to CPI is not so smooth. This is in line with our call for contained inflationary pressure in 2017 despite higher PPI as we believe the recent spike of PPI was mainly driven by supply side factors rather than demand side factors. Should CPI stay low in the coming months, we think the room for further monetary tightening is probably limited. On credit data, China's new Yuan loan continued to grow at a faster than expected pace. However, as a result of window guidance to slow down the credit expansion, financial institutions may have to rebalance their lending structure. As a result, off balance sheet lending as well as bill financing have been contained. This explains why aggregate social financing fell short of new Yuan loan.

In addition, the unexpected trade deficit and rebound of China's FX reserve back to US$3 trillion in Feb gave us another interesting picture. We think the rebound of FX reserve despite negative valuation effect was due to unwind of long dollar position by exporters as exporters are more rational on RMB outlook. As such, the trade deficit in Feb did not necessarily lead to lower FX reserve. This was also echoed by the returning demand for foreign currency loan, which has recorded positive growth for three consecutive months, thanks to improving Yuan outlook.

For PBoC press conference last Friday, we have six takeaways to share as below. Apparently Governor Zhou Xiaochuan has been more positive on RMB outlook this year due to improving economic fundamental. Although interest rate differential may have short term impact on capital flows, he believes the long term outlook will eventually depend on economic fundamental. For details, please refer to the paragraphs below. On currency, the renewed weakness of RMB against dollar was merely the function of stronger broad dollar. RMB index has remained stable last week. For this week, market will pay attention to Jan and Feb growth data due tomorrow as well as Premier Li Keqiang's press conference.

| Key Events and Market Talk | |
|---|---|
| **Facts** | **OCBC Opinions** |
| ▪ The PBoC held its press conference last Friday. | ▪ **Highlights as below:**<br>▪ First, on currency, PBoC Governor Zhou Xiaochuan said there will not be any significant change in currency policy in 2017. RMB is likely to be more stable this year due to improving economic fundamentals. Meanwhile, he also said interest rate differential may have impact on the short term impact on capital flows, however, in the medium term, economic fundamental is more important. This implied that China is unlikely to passively hike interest rate to stabilize currency during the US interest rate hike cycle.<br>▪ Second, on opening of onshore bond market, Zhou said China will continue to promote bond market to attract more foreign investors. However, PBoC deputy governor Pan Gongsheng said China is not in rush to open and a more gradual opening is more suitable.<br>▪ Third, on monetary policy, Governor Zhou reiterated that China has lots of tools in its toolbox and there is no need to over read certain operations in reaction to the question about possible rate hike in China. However, Zhou also said excessive easing monetary policy is not good to press companies to go through supply side reforms.<br>▪ Fourth, on deleverage, PBoC deputy Governor Yi Gang said the development of direct financing will help lower China's leverage ratio. In addition, Zhou said de-capacity and destock will also help deleverage. On household leverage, it seems Zhou reckons that the recent leverage in household sector is beneficial, which will help lower housing inventory in lower tier cities though it may lead to asset bubbles in tier-1 cities. He thought housing loan will continue to grow at a relatively |

| | |
|---|---|
| | faster pace though it is necessary to balance the growth pace.<br>▪ Fifth, on FX reserve. It seems PBoC is not concerned about the recent decline of FX reserve. Yi Gang said the benefit is higher than cost using FX reserve to stabilize the currency.<br>▪ Last but not least, on restrictions on cross border flows. Zhou said the repatriation of profit from foreign companies and repayment of interest of foreign debt are under current account. Since 1996, China has already removed all the restrictions for cross border flows under current account. |
| ▪ Citibank announced that it will include China's onshore bond in its three government bond index though it did not give the specified details on the date. | ▪ The announcement came one day after Bloomberg included China's bond index in its bond indexes. The focus of China's opening this year will be on the onshore bond market. |
| ▪ China's Foreign Ministry Spokeperson confirmed that China is considering attending the meeting of the TPP this week in Chile. | ▪ China is exploring the option to strengthen the dialogue with Asia-Pacific countries. However it is still too early to jump to any conclusion that China will join TPP. |
| ▪ The CSRC chief Liu Shiyu stated that out of all the proposed schemes to connect the capital markets across the border, he would firstly consider launching the Bond Connect Scheme between Mainland China and Hong Kong. | ▪ This is in line with Chinese top levels' plan to open up the onshore bond market further this year. Combined with a wide range of new hedging tools to be introduced by the HKEX this year, northbound capital inflows via the Bond Connect could be expected. |
| ▪ The H-shares of Meitu Inc and Zhou Hei Ya International Holdngs Co Ltd, two famous names in Mainland China, rose to their record highs last week due to the strong investment demand from Mainland China via the Shenzhen-Hong Kong stock connect. | ▪ The two companies' H-shares have been given access to Mainland investors following the regular adjustment to the components of Hang Seng LargeCap Index, Hang Seng Mid-Cap Index and Hang Seng SmallCap Index on 6 March. Apart from the needs to diversify the portfolio and hedge against RMB risks, the inclusion of Chinese famous names to stock lists of the stock links also appeared to have bolstered onshore investors' demand for H shares. However, in 2H, the expected slowdown in China's growth may sideline some Mainland investors from HK stock market. We continue to expect that Hang Seng Index will find strong resistance at 24364 (the highest level since last September) this year. |
| ▪ According to Arcadis International Construction Costs 2017, Hong Kong ranked first in Asia and second in the world regarding construction costs. Shortage of labor in the construction industry has been driving up construction costs and delaying project completions. Labor productivity and the number of working days are declining. Out of 432,712 registered construction workers as at the end of February, 40% are older than 50 years old, according to data by Hong Kong's Construction Industry Alliance. | ▪ The aging problem, the reluctance of local population to work in the construction industry and the low acceptance towards migrant workers together may continue to push up construction costs. This will remain to be one of the major forces driving up housing prices in HK. |

## Key Economic News

| **Facts** | **OCBC Opinions** |
|---|---|
| ▪ China's FX reserve rebounded to above US$3 trillion in February, up by US$6.9 billion to US$3.005 trillion, despite unfavourable valuation effect. | ▪ The appreciation of dollar in Feb suggested a negative valuation effect due to fall of the value of non-dollar reserve assets, however, according to the SAFE, the appreciation of asset prices more or less offset the impact of stronger dollar.<br>▪ In addition, FX reserve denominated in SDR also rebounded. This signalled the reduced pressure for capital outflows as a result of stabilized RMB exchange rate and tighter surveillance on capital outflows. |

| | |
|---|---|
| ▪ China's export fell unexpectedly by 1.3% yoy in dollar term in Feb while import surged by 38.1% yoy.<br>▪ As a result of strong import, China reported the first trade deficit in three years at US$9.15 billion. | ▪ The volatile export and import growth in Feb was partly distorted by seasonal pattern as companies tend to front load export ahead of Chinese New Year while import tend to be higher after Chinese New Year. As such, the trade balance in Feb is usually not a good indicator. In the past six years, China has recorded three negative trade balance in 2012, 2014 and 2017.<br>▪ Crude oil and iron ore imports by value grew by 69.4% and 107.9% respectively due to increase in commodity prices, however, stripping out the price factor, crude oil import by volume fell by 0.1% while iron ore import by volume grew by 13.4%. Given China's iron ore inventory has reached a high level, the import demand in future may start to fall. We expect China's trade balance to return to surplus again in March. |
| ▪ China's CPI decelerated at more than expected pace to 0.8% yoy in Feb, down from 2.5% yoy in Jan. PPI, on the other hand, was largely in line with market expectation growing by 7.8% yoy. | ▪ The deceleration of CPI growth in Feb was mainly due to seasonal effect and base effect. For example, food prices fell by 0.6% mom after Chinese New Year.<br>▪ However, the unexpectedly weak CPI was mainly the result of weaker than expected non-food prices in Feb after non-food prices posted the record high reading of 0.7% mom in Jan since China's statistics department released the mom reading in 2011. Non-food prices felly by 0.1% mom in Feb. This suggested the pass-through effect from higher PPI to CPI is not so smooth. This is in line with our call for contained inflationary pressure in 2017 despite higher PPI as we believe the recent spike of PPI was mainly driven by supply side factors rather than demand side factors.<br>▪ On producer prices, PPI grew by 7.8% yoy, slightly below our forecast of 8.1%. The strong PPI reading was mainly due to higher commodity prices as well as base effect. However, we think PPI may have peaked in Feb and is expected to fall gradually as the impact of base effect on PPI will slowly phase out. Meanwhile, the recent correction in commodity prices may also help ease pressures on producer prices. |
| ▪ China's new Yuan loan increased by more than expected CNY1.17 trillion in Feb. However, aggregate social financing only increased by CNY1.15 trillion, slightly weaker than expectation.<br>▪ Broad money supply M2 decelerated to 11.1% yoy while M1 re-accelerated to 21.4% yoy. | ▪ Although credit expansion slowed in Feb, the new Yuan loan is still considered as very strong after taking seasonal effect into account. For breakdown, both medium to long term loan remains sizable at CNY380.4 billion and CNY601.8 billion respectively. This is probably due to strong property demand in lower tier cities and demand from infrastructure investments. This is likely to support a stronger growth in the first quarter.<br>▪ Given tighter widow guidance by PBoC on credit expansion, financial institutions may have to rebalance their lending structure. As a result, off balance sheet lending as well as bill financing have been contained. This explains why aggregate social financing fell short of new Yuan loan.<br>▪ Bond financing continued to shrink for the third consecutive months, down by 107.3 billion. This was mainly due to recent volatility in the onshore bond market since 4Q 2016.<br>▪ On the positive note, demand for foreign currency loan continued to improve for the second consecutive month, up by US$19.9 billion, benefiting from the improving Yuan outlook. |

| RMB | |
|---|---|
| **Facts** | **OCBC Opinions** |
| ▪ RMB weakened against the dollar last week with the USDCNY broke 6.90 as a result of stronger broad dollar. However, RMB index remained stable trading around 94. | ▪ Recent RMB weakness was merely the function of dollar strength in the global market. CNH recouped some losses in the last part of trading hours last Friday after dollar retreated. This shows that investors have been rational. |

**OCBC Greater China research**

**Tommy Xie**
Xied@ocbc.com

**Carie Li**
Carierli@ocbcwh.com



Co.Reg.no.:193200032W