Summary

China reported "phenomenal" credit growth in January. Five sets of data hit record high. The strong credit expansion in January despite PBoC's window guidance to slow down the growth signals only one thing that the loan demand is organic. As such, we are quite positive on growth outlook in the first half. We expect China's GDP in 1Q to accelerate.

Interesting to note, China's funding structure has shifted recently following the turmoil in the bond market. Despite the spike of issuance yields in the onshore bond market, average loan costs remained unchanged in 2016 according to the latest 4Q PBoC monetary policy report. As such, corporates have shifted their funding channel to on-balance sheet and off-balance sheet lending from the bond market. Nevertheless, the development of China's onshore bond market is unlikely to be deterred by the recent bond market volatility. In fact, total outstanding of bond has increased by 30.8% yoy in 2016 to CNY63.8 trillion, suggesting that China may bypass Japan as the world's second largest bond market in the next 1-2 years. PBoC said in its monetary policy report that it will continue to gradually open its bond market to foreign investors.

On monetary policy, PBoC admitted in the latest monetary policy report that in order to support growth, prudent monetary policy may lean towards easing at certain period. However, PBoC hinted that monetary policy is likely to be kept tight in 2017 for two reasons including higher inflationary expectation and asset bubbles in property market.

In Hong Kong, Hang Seng Index continued to outperform on a strong banking sector. HSI could face some strong resistance at 24364, the highest level since last September. Hong Kong's property market has benefited from China's outward direct investment. The rental of office buildings in Central (Hong Kong) increased 12.1% yoy over 2016 according to Savills. However, the increase in demand could be constrained by China's tighter grip on outward direct investment this year. Noted that China's outward direct investment fell by 35.7% yoy in January to US$7.73 billion due to tighter control on foreign currency purchase and remittance.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ China's central bank published its 4Q 2016 monetary policy report last Friday to summarize the polices in 2016 and set the policy tone for 2017.	▪ There are four highlights from the monetary policy report. ▪ First, the weighted average loan interest rate for non-financial corporate was at 5.27% as of end of 2016, unchanged from one-year ago. In contrast, bond yields have climbed up across the yield curve. For example, the issuance yield for 10-year government bond increased by 29bps from the similar issuance one-year ago to 2.7% in December 2016. This suggested that loan market was less affected by the rising volatility in both money and bond markets. The higher interbank funding costs and stable lending cost also suggests that banks' net interest margin may be squeezed last year. ▪ The development of onshore bond market will continue to be the highlight for this year. Total outstanding of bond in China rose to CNY63.8 trillion as of end of 2016, up by 30.8% yoy. China is likely to bypass Japan as the world's second largest bond market in the next 1-2 years based on the current projected pace. However, foreign ownership remains low. As such, PBoC said it will continue to gradually open its bond market to offshore players. ▪ On monetary policy, PBoC said that multiple mandates have increased the difficulties for monetary policy implementation. Meanwhile, it also admitted that in order to support growth, prudent monetary policy may lean towards easing at certain period. However, PBoC hinted that monetary policy is likely to be kept tight in 2017 for two reasons. First, inflationary expectation has increased. As such, PBoC will closely monitor the inflation pressure. Second, housing market remains the concern for central bank. Containing asset bubble is more important precautious way to lean against the financial risk. ▪ On currency, PBoC praised the new fixing mechanism and

	reiterated to allow market to play a bigger role in currency value.
▪ China resumed its reverse repo operation last week and injected CNY393.5 billion liquidity via medium term lending facility (MLF) but refrained from rolling over Temporary liquidity facility (TLF) maturing on Thursday and Friday.	▪ PBoC continued to follow its tight bias monetary policy closely. PBoC will continue to try to strike the balance between maintaining overall liquidity stable in the banking system and containing financial risk.
▪ Macau's Health Bureau announced a proposal to retain smoking lounges in casinos and increase the technical requirements for the lounges, instead of imposing full smoking ban.	▪ This means that some policy risks on the VIP segment are likely to be eased.

Key Economic News	
Facts	**OCBC Opinions**
▪ Both China's CPI and PPI accelerated further in January to 2.5% yoy and 6.9% yoy respectively from 2.1% and 5.5% in December 2016.	▪ The rise of CPI in January was mainly the result of low base and seasonal Chinese New Year factors. The CPI rose by 1% mom mainly driven by food prices, which rose by 2.3% mom due to festival demand. ▪ CPI excluding food rose by 0.7% mom, strongest monthly growth since China launched month-on-month reading since 2011. The stronger than expected non-food inflation may be the result of pass-through effect from rising producer prices. ▪ Nevertheless, CPI is expected to fall in February as a result of falling food prices after Chinese New Year holiday as well as base effect. We expect the CPI to decline to around 1%. ▪ The rapid acceleration of PPI to 6.9% was partially due to low base effect as commodity prices collapsed last January. The PPI is likely to go up higher further to peak around 8% in February due to base effect.
▪ China's aggregate social financing spiked to a record high of CNY3.74 trillion in January despite PBoC's efforts to contain financial risk. ▪ New Yuan loan increased by CNY2.03 trillion. ▪ Broad money supply grew by 11.3% in January unchanged from the pace in December 2016. However, M1 decelerated to 14.5% from 21.3%.	▪ There are three takeaways from the latest aggregate social financing. ▪ First, off-balance sheet lending spiked to CNY1.24 trillion, highest in record. In particular, trust loan increased by CNY317.5 billion, highest since March 2013. The rebound of shadow banking activity was probably due to tightening property measures as well as window guidance on bank lending, which diverted the funding demand from on-balance sheet lending to off-balance sheet lending. ▪ Second, bond issuance continued to shrink for the second month, down by CNY53.9 billion, probably due to rising volatility in the bond market. However, equity financing in January hit a record high of CNY159.9 billion thanks to stable equity market. Nevertheless, percentage of direct financing, which include both bond and equity financing, shrank to only 2.8% lowest since May 2007, due to ballooning off balance sheet lending. ▪ Third, foreign currency loan increased by CNY12.6 billion, first positive growth in five months, highest since June 2015. The returning demand for foreign currency liability shows that the concern about RMB depreciation has normalized and market has increasingly accepted the expectation on two-way volatility. ▪ Zooming into new Yuan loan, housing loan remained strong in January despite tightening measures with medium to long term loan to household increased by a record high of CNY629.3 billion.

	▪ On positive note, medium to long term loan to corporate also surged to a record high of CNY1.52 trillion. This is probably the result of booming infrastructure projects on the back of proactie fiscal policy. ▪ Overall speaking, the credit expansion in January has been above policy maker's comfortable zone. This also justified PBoC's move to shift the money market funding curve higher to contain leverage. In addition, PBoC is likely to continue its window guidance to control credit expansion pace in the first quarter.
▪ China's outward direct investment fell by 35.7% yoy in January to US$7.73 billion due to tighter control on foreign currency purchase and remittance.	▪ Since late November, China's regulator has tightened FX purchase and outward remittance. All capital item transaction with FX purchase and outward remittance more than US$5 million needs to report to SAFE. Any overseas direct investment above US$50 million needs to get approval from the relevant government department. Onshore banks cannot provide SBLC to offshore loan without getting ODI permission. ▪ Those measures are likely to curb those irrational investments but it may also postpone the payment to future.
▪ China's forex purchase fell by CNY208.7 billion in January. The decline narrowed from CNY317.8 billion in December.	▪ The decline of forex purchase in January confirmed that capital outflows continued due to seasonal demand for foreign currency. However, the magnitude of decline was much smaller than that in January 2016, which fell by CNY644 billion. This shows that pressure for capital outflows has eased thanks to tightening measures. We expect capital outflows to slow down this year.
▪ According to the report of Savills, the rents of office buildings in Central (Hong Kong) increased 12.1% yoy over 2016.	▪ The demand was likely mainly from Mainland companies which eager to expand their foreign business. However, the increase in demand could be constrained by China's tighter grip on outward direct investment.
▪ HK's average rent of large private homes marked its largest annual growth since Global Financial Crisis in January. On monthly basis, the average rental rose for the 10th consecutive month and was up 1.5%.	▪ However, as the housing cooling measures are likely to propel home owners to lease their property rather than sell it, increasing supply may trim some upward pressure on the average rent of private homes.
▪ Macau: Low rates and the launching of new property projects have lured potential homebuyers, driving housing transactions up substantially by 130.6% yoy to 1257 units.	▪ The improvement in the gaming sector combined with a stable labor market has also underpinned investor sentiment. Higher demand and tighter supply pushed housing prices up significantly by 32.2% yoy to MOP103,805/square meter. Given a recovering economy, the housing market appears to have bottomed out. However, further improvement in the housing market may be prevented should the Fed raise rates at a faster pace. Any deceleration of growth in housing transactions would also translate into benign demand for new residential mortgage loans, which fell by 16.6% yoy to MOP4.15 billion in last December. Moreover, the increase in home supply ahead is likely to weigh on housing prices. We expect a -5% to 5% annual growth in housing prices over 2017.

RMB	
Facts	**OCBC Opinions**
▪ RMB gained against both dollar and currency basket last week.	▪ The stronger than expected credit expansion failed to suppress RMB and RMB quietly gained last week. RMB index rose to 94.21. However, the USDCNY fixing may go higher this morning due to weak closing last Friday.

	▪ It seems market has been increasingly paying attention to US's rhetoric on labelling China as currency manipulator. This may create some pressure for RMB to stay strong.

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